KÜFFNER MAUNZ LANGER ZUGMAIER

KMLZ VAT NEWSLETTER

No VAT deduction for holding company for capital procurement

1. Background

VAT deduction for holding companies is a controversial topic. This applies especially for input transactions that are used for capital procurement. According to the case law of the ECJ, measures to procure capital in favor of the economic activity in general are directly connected to the economic activities of the company. The corresponding costs are part of its general costs and, according to the ECJ, are principally components of the costs of the output transactions. In practice, the view taken by the tax authorities is often more restrictive and does not always meet the requirements of the ECJ case law. Holding companies are often required to prove how the costs are taken into account in the price calculation.

Recently, the German Federal Fiscal Court intended to restrict VAT deduction for holding companies by assuming a non-economic activity and, to this end, referred the case Larentia + Minerva to the ECJ. However, on this occasion, the ECJ did not agree. With its judgment of 6 April 2016 (V R 6/14), the Federal Fiscal Court has, once again, raised this topic. In this judgment, there are further documentation requirements for VAT deduction for capital procurement.

Federal Fiscal Court again intends to restrict VAT deduction for holding companies

In the case Larentia + Minerva, the German Federal Fiscal Court intended to restrict VAT deduction for holding companies by assuming that holding companies always have a non-economic sector. On this occasion, the Federal Fiscal Court was thwarted by the ECJ, which did not agree with it. Now, the German Federal Fiscal Court is attempting to, once again, imply a non-economic activity in a holding company. It seems the court came to the right conclusion, considering the specific facts of the judgment. However, the court was only able to imply a non-economic activity due to the existing weak facts and the unfortunate argumentation of the plaintiff. Therefore, the findings of the court are to be taken with caution and cannot be generalized. Affected companies should prepare and provide sufficient documentation.

2. Facts

The plaintiff (“Holding”) is a limited partnership and shareholder of two subsidiaries in a third country, which pursued the afforestation, maintenance and management of a forest. The Holding supplied commercial services to its subsidiaries based on consultancy agreements. An annual fee of 10.000 USD was agreed for these services with each of the two subsidiaries. Therefore, the Holding was deemed to be a taxable person for VAT in accordance with sec. 15 para. 1 German VAT Act and therefore entitled to deduct VAT.

The Holding concluded a project development agreement with a GmbH. In this contract, the GmbH agreed to take on

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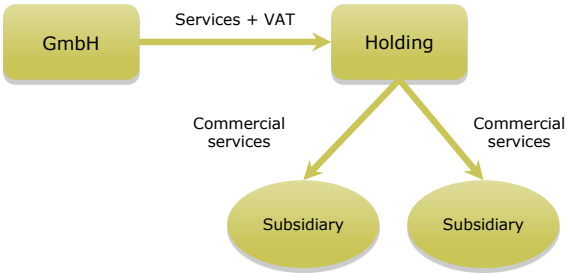
the examination of the economic viability of the concept and other related administrative activities as well as the consulting and support for the purchase of suitable property for the subsidiaries. Additionally, the Holding also concluded a sales agreement with the GmbH regarding the placement of limited partnership shares and marketing measures. Thus, the capital of the Holding was increased by taking on further shareholders from EUR 862.500 to EUR 7.800.000.



The Holding declared EUR 11.246 of taxable supplies but deducted EUR 90.798, thereof EUR 43.181 for the procurement of capital and EUR 27.972 for project development.

3. Federal Fiscal Court does not recognize a link to the economic activity

According to the German Federal Fiscal Court's view, the cost of capital procurement on this scale did not relate to the purchase of shares for the subsidiaries, as it was not necessary to procure capital in this amount. The German Federal Fiscal Court rejected the Holding's objection that "peculiarities" existed as regards the conditions in the founding year. The extent to which the consulting services, provided by the Holding to its subsidiaries would have changed in the following years was unclear. Furthermore, the Holding already held the shares of the subsidiaries, to which the Holding provided services.

The Federal Fiscal Court argued that the capital procured was obviously not required for the economic activity of the Holding and therefore was not deemed to be used for it. Consequently, in the view of the Federal Fiscal Court, the Holding performed non-economic activities, to which the capital procurement and the input transactions, were considered to be allocated. The court derived its argument from the fact that the Holding procured approx. EUR 7 million but did not put this sum at the disposal of the subsidiaries nor used it to acquire shares in the subsidiaries. Furthermore, the court held that the taxable supplies were way out of proportion to the 40 times higher costs.

4. Consequences for the practice

The Holding did not sufficiently convince the court that the input transactions, as a whole, or individually, related to its economic activity. Thus, the court came to the conclusion that the Holding must have used the input services for a non-economic activity. However, this does not mean that each holding company will, in the future, be regarded as having a non-economic sector. The principle remains that a holding company providing services to all of its subsidiaries for remuneration is a taxable person with 100% economic activity. The holding company only needs to demonstrate and prove that the input transactions and the procured capital is being used or will be used for the economic activity. Otherwise, according to the Federal Fiscal Court's view, the tax authorities may assume that a non-economic activity exists. Hence, it is recommended that holding companies safeguard their position by documenting the purpose of the capital procurement.