Flash News

VAT deduction for holding companies: Happy ending or another milestone in a never-ending story?

The Court of Justice of the European Union has released its decision in the joined cases Larentia + Minerva (C-108/14) and Marenave Schiffahrts AG (C-109/14). The Court answered the questions raised by Germany on VAT deduction of holding companies and VAT grouping rules.

As Luxembourg has not implemented the concept of VAT group in its legislation, this Flash News doesn’t touch upon the Court’s decision on German VAT grouping rules.

The analysis below concerns the ability of holding companies to recover VAT on costs incurred for the acquisition of shares in subsidiaries they will subsequently manage.

Question referred and decision of the Court

The German companies Larentia+Minerva and Marenave engaged costs to raise capital aimed at acquiring shares in undertakings, to which they would subsequently provide administrative, consultancy and business management services.

The German VAT authorities have assigned the costs incurred for the acquisition of shares to a non-economic activity (holding of shares), which means that the related VAT could not be recovered. Therefore, they refused the deduction of VAT incurred by Marenave. On the same grounds, Larentia+Minerva was only allowed to deduct a small part of VAT.

The question referred to the Court was: “Which calculation method is to be used to calculate a holding company’s (pro rata) input tax deduction in respect of input supplies connected with the procurement of capital for the purchase of shares in subsidiary companies, if the holding company subsequently (as intended from the outset) provides various taxable services to those subsidiaries?”

As indicated in our previous Flash News, dated 8 April 2015, the arguments of the Advocate General (handed down on 26 March 2015) provided a favourable view for active holding companies. The reasoning of the Court goes along the same lines, supportive of a VAT deduction in the context summarized below.

Before answering the question, the Court reminds some of the principles laid down in previous decisions:

(i) A holding company whose sole purpose is to acquire and hold shares in undertakings, without being involved in their management is not to be considered as a taxable person and does not have the right to deduct VAT incurred on costs (“passive holding company”);
(ii) It is otherwise where the holding is accompanied by involvement in the management of the subsidiaries. This means that the holding company carries out transactions within the scope of VAT, such as the supply of administrative, financial, commercial and technical services to the newly acquired subsidiaries (“active holding company”);

(iii) Even when transaction costs don’t have a direct and immediate link with a specific operation allowing VAT recovery, input VAT on such costs could still be recovered if they are part of an active holding company’s overhead costs and are, as such, components of the price of operations performed.

In a nutshell, the Court works with two scenarios to decide upon the deduction of input VAT on costs incurred for the acquisition of shares by an active holding company.

**Holding company involved in the management of all the subsidiaries acquired**

Following the reasoning of the Court, acquisition costs incurred by a fully active holding company must be seen as belonging to its general expenditure, and can be assigned to its economic activity. The Court confirmed that VAT incurred on these costs is in principle fully deductible.

By exception, if a part of the economic activities (in the scope of VAT) of the holding company consists of VAT exempt operations (without VAT credit), the deduction is limited based on one of the partial deduction methods provided by the VAT Directive (e.g. turnover-based pro rata computation).

**Holding company involved in the management of some of the subsidiaries acquired**

If the holding company involves itself in the management of some of the subsidiaries acquired, the acquisition costs are assigned partly to the holding company’s economic activity (active management of subsidiaries) and partly to its non-economic activity (passive holding of shares).

For partially active holding companies, VAT incurred on such acquisition costs cannot be fully deducted. The VAT Directive doesn’t provide a method to apportion costs between economic and non-economic activities. The Court reminds that it’s up to national authorities to find an appropriate formula.

Although the Court does not specifically address the case of acquisition costs incurred for the sole purchase of subsidiaries that will not be managed by the holding company, it seems clear that the VAT on those costs is not recoverable.

**Implications**

The judgment of the Court not only recalls principles of its previous case law on the deduction of holding companies; it goes further and clarifies the borderline between economic and non-economic activities.

This decision is most welcome in the current context of many tax administrations across the European Union questioning the holding companies’ VAT deduction. This decision will undoubtedly help clarify many situations.

Holding companies in Luxembourg also face challenges when deducting VAT. The VAT authorities regularly take the view that holding companies perform non-economic activities and can’t recover VAT on related expenses. The decision of the Court has the merit of confirming that a holding company performs non-economic activities only if, and to the extent that, it passively holds shares in subsidiaries. Active holding companies have now gained additional support from the European case law to deduct (part of) input VAT when they actively manage subsidiaries.
In some jurisdictions, the VAT authorities accept the deduction of input VAT incurred on acquisition costs only if, and to the extent that, the active holding can prove that it gets back the costs through the price of the taxable services it provides to its subsidiaries. The Court seems to undermine this approach in its final conclusion, as it doesn’t believe that recovering the cost would be a condition precedent for fully active holding companies to recover VAT on these costs. It will be worth seeing if the local VAT administrations will change their practice in this regard, as a result of the Court’s judgement.

Also, the Court doesn’t provide any guidance on what method of allocation should taxable persons use to apportion their costs between economic and non-economic activities, although this was the purpose of the question initially raised by Germany. In Luxembourg, there are currently no written guidelines in this respect and we don’t expect any guidance to be issued at this stage.

Although the decision of the Court is helpful, it doesn’t rule out all the questions that could rise in holding companies’ practice. The deduction of input VAT on running costs is one of the particular topics that haven’t been addressed by the Court. The deduction of these costs will have to be analysed on a case by case basis.

It’s time for active holding companies to (re)assess the methodology used to recover VAT. For some holding companies, this might be also an opportunity to find out if they can get back VAT paid in previous years, whether that VAT cost was due to decisions of the VAT authorities (which could now be seen as too restrictive) or due to prudent filing positions taken in the VAT returns.

PwC Luxembourg will help you review and adapt your holding company’s input VAT recovery methods to these new developments. We will set up with you a tailored-made method based on your holding company’s profile and on the details of the transactional and running costs it incurs (and approach the tax authorities, if needed), taking into account the recent updates of European case law.