No VAT recovery for a holding company on the purchase of services that are contributed to its subsidiary

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This case is about the recovery of VAT on the purchase of services by a holding company that contributes these services to its subsidiaries. The holding company purchasing these services does not perform any VAT exempt activities and performs services for consideration for the subsidiaries to which it contributes the purchased services. The subsidiaries perform mainly VAT exempt activities, which means that if they would have purchased the services themselves, instead of the holding company, the VAT on those services would not be recoverable (or only a very small amount). The holding company deducted all VAT on the services it purchased and contributed to its subsidiaries. The CJEU ruled that the VAT on these services is not recoverable. In this Indirect Tax Alert we look into why the CJEU decided that the VAT was not deductible and what this could mean for other taxpayers.

The facts of the case and the CJEU's ruling

In this case, the holding company that purchased the services and contributed these to its subsidiaries, held that performing taxed activities for a subsidiary also means that it does not perform any non-economic activities vis-à-vis that subsidiary any more either. This would allow full VAT recovery for any activity related to this and other subsidiaries to which taxed services are performed.

The CJEU disagrees. To come to non-deduction, however, the CJEU applies a slightly different line of reasoning. First of all, the CJEU holds that the purchased services are not used by the holding company in order to be able to perform the agreed services for its subsidiaries. The expenditure incurred by the holding company for it to obtain those services cannot be regarded as being part of the components of the price of its taxed output services, which give rise to a right to deduct.

If costs cannot be directly allocated to taxed output, a business can still have a right to deduct VAT provided that the costs incurred qualify as 'general costs', constituting components of the price of the goods or services which the business supplies and that therefore have a direct and immediate link with its economic activity as a whole. In this respect, the CJEU holds that the purchased services are the object of the holding company's shareholder contributions to its subsidiaries, which are not, therefore, expenditure which the holding company needs to incur to acquire shares, but expenditure which itself constitutes the very object of the holding company's shareholder contribution to its subsidiaries. Such a contribution from a holding company in favour of its subsidiaries, whether in cash or in kind, comes under the holding of shares which does not amount to an economic activity within the meaning of the VAT Directive and does not therefore give rise to a right to deduct. The CJEU concludes by mentioning that the exclusive reason for the transaction in question is a shareholder contribution from the holding company.

In the operative part of its ruling, the CJEU does not explicitly mention that the contribution of the services qualifies as a non-economic activity. The CJEU rules that (the relevant provisions in the EU VAT Directive must be interpreted as meaning that) a

holding company which carries out taxable output transactions in favour of subsidiaries is not entitled to deduct the input tax incurred on the services that it obtains from third parties and supplies to the subsidiaries in return for the grant of a share in the general profit, where, first, the input services have direct and immediate links not with the holding company's own transactions, but with the largely tax-exempt activities of the subsidiaries, second, those services are not included in the price of the taxable transactions carried out in favour of the subsidiaries and, third, the said services are not part of the general costs of the holding company's own economic activity.

What this means for businesses (holding companies)

First of all, it is clear from this ruling that a holding company that performs VAT taxed activities for its subsidiary, can still perform activities in relation to that same subsidiary that do not allow the holding company to deduct the VAT on the costs of those latter activities. This is definitely the case where the costs incurred are not used by the holding company for its own economic activities but where a third party, in this case the subsidiary of the holding company, actually uses these services for its own activities.

It can be argued that this case only applies to the contribution in kind of purchased (goods or) services by a holding company, as these (goods and) services are not used by the holding company for its own economic activities, but by the subsidiary they are contributed to. It remains to be seen whether there are more activities that a holding company that performs taxed activities for a subsidiary, that qualify as non-economic activities.

In our view, the non-deductibility should rather be considered the result of the absence of a direct link between the services performed for the subsidiary as well as the economic activities performed by the holding company as a whole. This is, inter alia, the result of the fact that the purchased services are not used by the holding company itself but rather for performing the activities of its subsidiary. This had already been confirmed by the CJEU in earlier case law. Also, the fact that the CJEU does not mention any relation between the purchased services and any supposedly non-economic activity in the operative part of its ruling, could suggest that the reason for disallowing deduction is based on the described absence of the link between the purchased services and any taxed output, or economic activity as a whole, of that holding company. Therefore, in our view, the case hinges around who actually uses the services that were purchased for its own economic activities rather than that they were specifically used for non-economic activities.

We note that we cannot exclude the chance that tax authorities across the EU may try to argue that the range of non-economic activities as performed by holding companies incudes more than previously expected, and that they may look for reasons to exclude VAT recovery on costs that they may consider costs incurred as a shareholder rather than in the course of performing economic activities.

The above is based on our interpretation of current tax legislation and case law published to date. This Indirect Tax Alert provides general information with no pretence of completeness, and it is not a tax advice.

Information
For more detailed information about the matters discussed in this Alert, please contact one of EY's tax advisers listed below.

Indirect Tax

Jeroen Bijl
Tel.: +31 88 4071111 | e-mail: jeroen.bijl@nl.ey.com

Timo Bootsman
Tel.: +31 88 4074876 | e-mail: timo.bootsman@nl.ey.com

Bas Breimer
Tel.: +31 88 4078773 | e-mail: bas.breimer@nl.ey.com

Gijsbert Bulk
Tel.: +31 88 4071175 | e-mail: gijsbert.bulk@nl.ey.com

Folkert Gaarlandt
Tel.: +31 88 4070559 | e-mail: folkert.gaarlandt@nl.ey.com

Caspar Jansen
Tel.: +31 88 4071441 | e-mail: caspar.jansen@nl.ey.com

Daniel Kroesen
Tel.: +31 88 4078361 | e-mail: daniel.kroesen@nl.ey.com

Petra Pleunis
Tel.: +31 88 4073797 | e-mail: petra.pleunis@nl.ey.com

Annemarie Sanders
Tel.: +31 88 4071179 | e-mail: annemarie.sanders@nl.ey.com

Jeroen Scholten
Tel.: +31 88 4071009 | e-mail: jeroen.scholten@nl.ey.com

Walter de Wit
Tel.: +31 88 4071390 | e-mail: walter.de.wit@nl.ey.com

Remco van der Zwan
Tel.: +31 88 4078370 | e-mail: remco.van.der.zwan@nl.ey.com

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