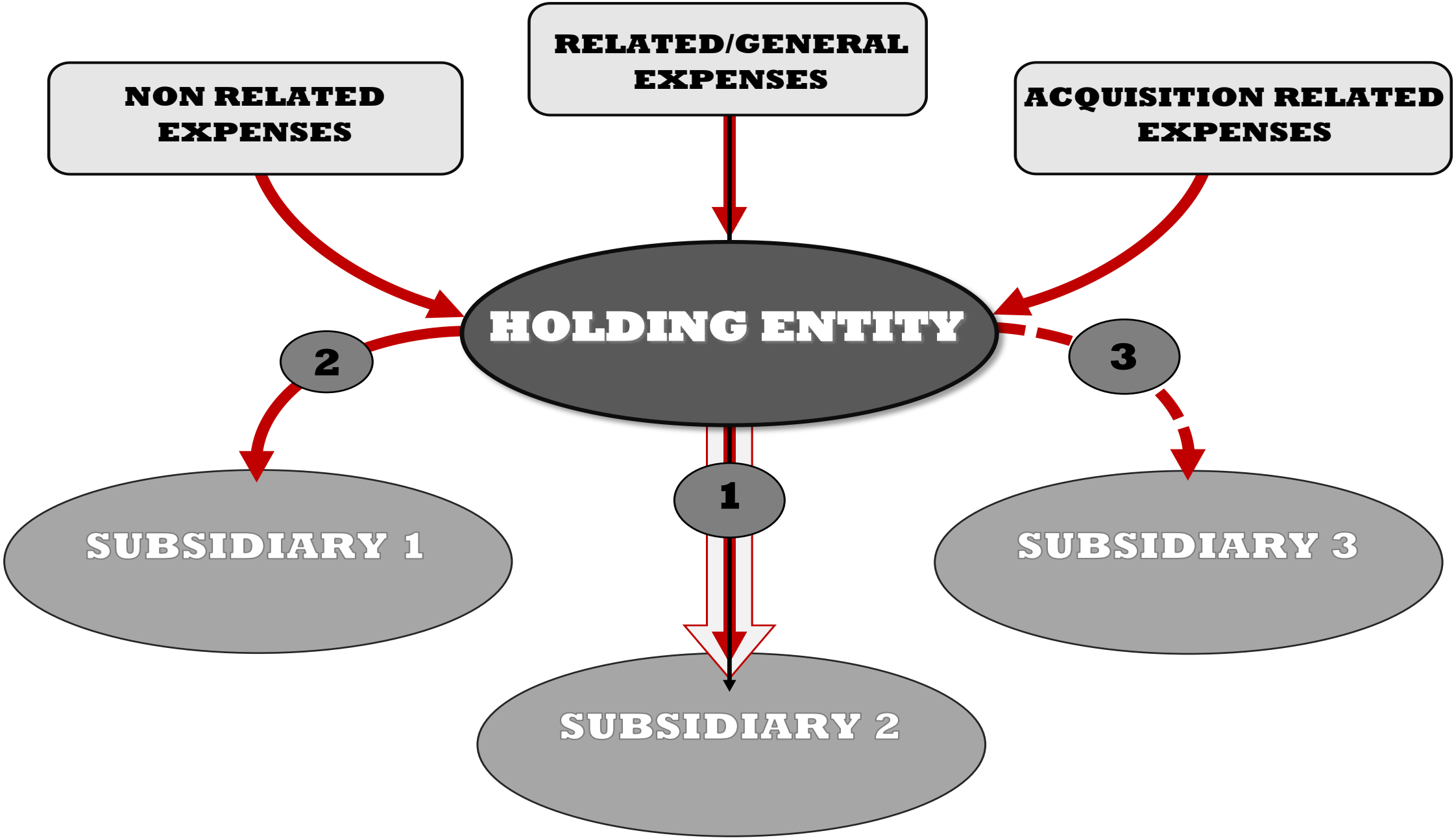
HODING ENTITIES AND VAT



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THE FACTS

- W was engaged in the **acquisition, administration and operation of real estate**, as well as the design, sanitation and execution of construction projects.
- As **holding entity**, W owned majority stakes in X and Y, engaged as well in real estate construction and home sales, mostly VAT-exempt.
- Through an agreement with the minority shareholders, it was settled to make monetary by the latter and **in kind contributions** by W. The latter consisted of the provision, in a proportion equivalent to their participation, and free of charge, of several services with respect to various immovable properties to be built by subsidiaries X and Y. W carried out these services, in part, with its own resources and, in part, by acquiring goods and services from other companies.
- Additionally, it was agreed that W would provide its subsidiaries, in this case for consideration, some **administrative support services** in relation to the construction of the two aforementioned assets. The supplies that W had to make as a social contribution were expressly excluded.
- W deducted all input VAT in relation to these supplies. The German tax authorities considered that W's social contributions in favour of X and Y should be classified as activities out of the scope of VAT, since they had not served to generate income for VAT purposes and, therefore, were not attributable to the economic activity of W. Consequently, they understood that the **input VAT** in relation to these activities was **not eligible for deduction**.

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THE REASONING (I)

- The first **question raised** to the ECJ was to determine whether, under article 168(a), of the VAT Directive, in relation to 167, a **holding company** that carries out taxable operations for its subsidiaries for which VAT is charged, is entitled to deduct the borne VAT by the services that it acquires from third parties and that it contributes to the subsidiaries in exchange for a share in the general profits, when:
  - the services for which it pays VAT are not directly and immediately related to the holding company's own operations, but rather to the largely exempt activities of its subsidiaries;
  - these services have no effect on the price of the VAT taxed operations carried out in favour of the subsidiaries, and,
  - the aforementioned services are not part of the general expenses of the economic activity of the holding company.

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THE REASONING (II)

- Recalling, from the outset, the importance of the right to deduct VAT, something which is not exactly new, the ECJ also pointed out that, in order to deduct VAT, two **requirements** must be met:
  - The claimant must be a 'taxable person' within the meaning of the VAT Directive.
  - The goods or services invoked as the basis of this right must be used by the taxpayer for the needs of its own taxable operations, being the goods or services provided by another taxpayer (among others, judgment of 3-7-2019, The Chancellor, Masters and Scholars of the University of Cambridge, C-316/18).
- The first of these requirements was not controversial, since the participation in the subsidiaries was accompanied by an intervention in their management (judgments of 16-7-2015, Larentia + Minerva and Marenave Schiffahrt, C-108/14 and C-109/ 14, and of 5-7-2018, Marle Participations, C-320/17).

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THE REASONING (III)

- Regarding the second one, the ECJ has also started from its general criteria: from article 168 of the VAT Directive, it follows that the right to deduct input VAT requires that the **goods and services** acquired by the taxpayer are **used** for the needs of its own **VAT taxed transactions**.
- For the right to deduction to be recognised, it is, in principle, necessary a **direct and immediate relationship** between a specific transaction for which VAT is borne and one or more transactions for which VAT is charged and which rise the right to deduction. The right to deduct VAT presupposes that the expenses incurred form part of the constituent elements of the price of the operations for which VAT is passed on and that give the right to deduction.
- However, the deduction is also admissible when there is no direct and immediate relationship between a specific transaction for which VAT is borne and one or more transactions for which VAT is charged, provided that the costs form part of the **general expenses** of the taxpayer and, as such, are constitutive elements of the price of the goods or services provided. Indeed, such costs have a direct and immediate relationship with the economic activity of the taxpayer as a whole (judgments of 3-7-2019, The Chancellor, Masters and Scholars of the University of Cambridge, C-316/18, or 11-12-2020, Sonaecom, C-42/19, among others).

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THE REASONING (IV)

- **To assess** the existence of such a relationship, its **objective content** must be analysed, considering the total of the circumstances in which the operations have been carried out and taking into account only the operations that are objectively related to the taxable activity of the taxable person (judgment of 17 -10-2018, Ryanair, C-249/17), in view of the effective use of the goods and services acquired and the exclusive cause of the operation, which must be considered a criterion to determine its objective content (judgment of 11-8-2018, C&D Foods Acquisition, C-502/17).
- In the matter in question, the claimant purchased a number of services to meet its social contribution obligations to its subsidiaries.
- The admission of VAT deduction thus borne would require verification that said services have a direct and immediate relationship with operations of said company for which VAT is passed on or that they form part of the general expenses of the entity, so that are **constitutive elements of the price** of its goods or services.

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THE REASONING (V)

- From the above:
  - 1st. With regard to the direct and immediate relationship with W's operations for which VAT is charged, the ECJ has verified that the services for which VAT was borne **were not used to provide the services for which VAT is charged**, namely, their administrative services, from which it follows that they cannot be considered to form part of the constituent elements of the price of their services for which the tax giving right to deduction is passed on.
  - 2nd. Regarding the possible consideration as **general expenses**, the ECJ has indicated that the services acquired were the subject of social contributions to the subsidiaries. Therefore, it is not a question of necessary disbursements by W to acquire shares, but of disbursements that constitute, in themselves, the object of the social contribution to the subsidiaries. Such contribution of a holding company to its subsidiaries, whether in cash or in kind, forms part of the holding of company shares that does not constitute an economic activity for these purposes and, therefore, does not give the right to deduction. The exclusive cause of the operation in question is the realization by W of a social contribution.

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THE REASONING (VI)

- To the foregoing, it has been added that the aforementioned services constituted a **social contribution** in kind to the subsidiaries, which should be made free of charge, with the subsidiaries being the ones that would use them in their operations. The fact that such services are intended to be used by W subsidiaries establishes a direct relationship with the operations of said subsidiaries and confirms the non-existence of a direct and immediate relationship with the economic activity of W. The finding that the aforementioned services have a direct relationship with the activities of these is not invalidated by the fact that W has transferred them to its subsidiaries, since the effective use of the services must be taken into account.
- The right to deduct is solely for the purpose of completely freeing the taxable person from the VAT corresponding to their economic activities. Disbursements that are not related to the **taxable operations** carried out by the taxable person, but to operations carried out by a **third party**, do not generate a right of deduction (judgment of 10-1-2020, Vos Aannemingen, C-405/19). The fact that this last assessment was made in the context of a case that did not concern a holding company has been considered as irrelevant, since it responds to a rule generally applicable to the right of deduction. Since the actual use of the services purchased by W shows that they are directly related to the operations of its subsidiaries,

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THE REASONING (VII)

- Therefore, the **objective content** of the operation reveals that there is **no direct and immediate relationship** between the costs of the services acquired by W and its economic activity. These costs are not part, as general expenses, of the constituent elements of the management and accounting services of W.
- This conclusion is not invalidated by the circumstance, alleged by W, that it is only thanks to their social contributions that the subsidiaries can maintain their own activities and therefore need their accounting and management services. Indeed, to the extent that these circumstances are proven, they do not demonstrate the existence of a direct and immediate relationship between the services covered by the contributions and the economic activity of W. The services for which VAT is paid were acquired with the objective to make a social contribution, which cannot be considered an operation that has its exclusive and direct cause in the economic activity of W, namely, the provision to its subsidiaries of accounting and management services subject to VAT.

THE CONCLUSION

- A holding company that carries out taxable operations for its subsidiaries for which VAT is charged is not entitled to deduct the tax borne on the services it acquires from third parties and that it contributes to the subsidiaries in exchange for a share in the general profits, when,
  - firstly, the services for which VAT is payable are not directly and immediately related to the holding company's own operations, but rather to the largely exempt activities of its subsidiaries;
  - secondly, these benefits have no effect on the price of the operations subject to the tax carried out in favour of the subsidiaries, and,
  - thirdly, the aforementioned benefits do not form part of the general expenses of the economic activity of the holding company .

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ADDITIONAL TOPICS (I)

- 1st. This decision is a **counterweight** to that of 5-7-2018, C-320/17, Marle Participations, in which the ECJ accepted the deduction of the input VAT connected with the acquisition of shareholdings in subsidiaries incurred by a holding company involved in the subsidiaries' management by letting them a building and which, on that basis, carries out an economic activity as belonging to its overheads.
- In my humble opinion, the criteria maintained by the ECJ on the matter was not consistent with the logic of VAT operation and with its own jurisprudence on VAT deduction, perfectly analysed in the judgment of 8-9-2022, case C-98/21, W:

ADDITIONAL TOPICS (II)

a) a) If there is **no relationship** between the services received and the services provided to the subsidiaries, nor is it possible to classify them as **general expenses** (**flow 1** of the graphic at the beginning), VAT is not deductible.

b) If the expenses form a constitutive **part of the price** of the services provided to the subsidiaries or of the general expenses of the entity (**flow 2**), the VAT will be deductible.

c) Finally, we are left with the expenses related to the **acquisition of the participation** (**flow 3**), which the ECJ classified as deductible. Assuming that to provide services to an entity it is not necessary to be a shareholder, and also taking into account the lack of relationship between the services received to carry out the acquisition and the provision of services to subsidiaries (flows 1 and 2), the criterion established in the case C-320/17 is somehow challenged (although the ECJ itself try to preserve it in its reasoning). Let us add that, in the event that services are not provided to subsidiaries (all or some of them), the holding entity returns to the world of partial or non-deduction (judgment of 5-7-2018, C-320/17, Marle Participations).

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ADDITIONAL TOPICS (III)

- 2nd. In the second question raised, the ECJ was asked whether, in a case in which, if the concerned services had been purchased directly by the subsidiaries, the input VAT would not be deductible, the interposition of a holding company that acquires and claims full deduction can be considered an **abusive practice**.
- Unfortunately, it has not been considered necessary to answer this question, given the content of the answer to the first one.

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