Changing ECJ case law on input VAT deductions for holding companies

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For many years, tax authorities have rejected holding companies' right to deduct input value added tax (VAT); however, the European Court of Justice (ECJ) has issued several decisions that have enabled a slow but unequivocal paradigm shift towards so-called 'active' or 'mixed' holdings (ie, holding companies which are directly or indirectly involved in the management of subsidiaries and provide them with taxable services). This article examines the most important decisions in this regard.

Input VAT deduction for active and mixed holding companies

The point of departure for ECJ case law on holding companies is that the acquisition and holding of shares in companies do not qualify as economic activities for VAT purposes. Thus, bearing in mind that the right to deduct input VAT relies on the principle that the goods and services in question are used in the context of taxable transactions carried out by a taxable person (or entity), the ECJ's stance prevents pure holding companies from being considered taxable persons for VAT purposes and consequently prevents them from deducting input VAT.

Notwithstanding the above, the ECJ has adopted a different position for active and mixed holding companies where there is an immediate and direct link between the input VAT and the company's economic activity.

The ECJ has recognised that when a holding company interferes directly or indirectly in the management of its subsidiaries (*Polysar*, C-60/90) and this interference implies the execution of taxable transactions (ie, the supply of services for consideration (*Floridienne*, C142/99)), there is an underlying economic activity that qualifies such holdings as taxable persons for VAT purposes.

Further, the ECJ has acknowledged that companies can deduct input VAT deriving from general expenses that are a component of the cost of the taxable operations ultimately performed by the holding company itself (*BLP*, C-4/94). The ECJ has also found that the right to deduct input VAT prevails even when the projected economic activity does not result in taxable operations or when the taxable person cannot use the input goods or services in taxable operations for reasons beyond their control (*Midland Bank*, C-98/98).

In another ECJ case, it was decided that even when a taxable person carries out simultaneous operations which give rise to the right to deduct input VAT and operations that do not, the VAT borne through general expenditure may be entirely deducted if the expenditure is linked to a part of a company's economic activity comprising the operations that give rise to the right to deduct input VAT (*Abbey National*, C-408/98). As per the ECJ's understanding, the receipt of dividends does not fall within the scope of VAT and therefore does not affect *pro rata* VAT deduction (*Sofitam/Satam*, C-333/91).

In *Cibo* (C-16/00), the ECJ ruled that, notwithstanding the fact that there was no direct and immediate link between the various services purchased by a company in connection with the acquisition of a shareholding in a subsidiary and the output transactions for which VAT was deductible, the costs of those services were deemed part of the general expenditure and, as such, had a direct link to the company's economic activity. Therefore, VAT on those services was deductible in proportion to the operations that gave rise to the right to deduct input VAT.

For interest that derives from loans granted by a holding company to its subsidiaries, the ECJ has ruled that loan operations may be deemed to be ancillary if they imply a minor use of resources or consumption burdened with VAT, thus preventing the interest from negatively influencing the right to deduct input tax (*EDM*, C-77/01).

The ECJ's defence of the right to deduct input VAT is reflected in the fact that while certain expenses burdened with VAT may be linked to an operation which is not subject to VAT or which is simply outside the scope of VAT, it is still possible to conclude that such expenses have an immediate and direct link to the taxpayer's economic activity. Thus, the corresponding VAT is deducted in proportion to the company's economic activity that corresponds to the operations which grant a right to deduct VAT (*Kretztechnik*, C-465/03 and *AB SKF*, C-29/08).

In *Portugal Telecom SGPS* (C-496/11), the ECJ, in an implicit application of the effective VAT allocation method (as opposed to the *pro rata* method), sustained that the holding was allowed to fully deduct input VAT for consulting services used for operations with a right to deduct VAT (eg, technical management and administration services for subsidiaries). This full deduction right had been previously denied by the Portuguese tax authorities based on their understanding that the *pro rata* method applied. The ECJ also ruled that the right to deduct input VAT cannot be restricted by the fact that the operations burdened with such input tax are merely ancillary.

Once again, the ECJ ruled against restricting the right to deduct VAT and emphasised that the only relevant aspect is the existence of a direct and immediate link between the input and output transactions.

New approach

More recent ECJ case law on VAT deductions for holding companies has used a similar approach to the Portuguese Arbitral Court's landmark decision in Case 77/2012-T, which combined the relevant reasoning behind the abovementioned ECJ decisions to provide a comprehensive legal overview (for further details please see "Landmark decision on holding companies' VAT deductions"). For example, in *Larentia+Minerva* (C-108/14) and *Marenave* (C-109/14), the ECJ concluded that active holdings are entitled to a full deduction of input VAT (including VAT on costs linked to the acquisition of subsidiaries for which the holding performs an economic activity), unless and to the extent that the holding company performs other VAT-exempt economic operations in addition to the services rendered to its subsidiaries which do not grant the right to deduct VAT. More recent ECJ decisions have confirmed this reasoning. In

MVM Magyar (C-28/16) the no right of deduction was upheld only because the services rendered to the subsidiaries were free of charge. The *Larentia+Minerva* (C-108/14) and *Marenave* (C-109/14) reasoning was also confirmed in *Marle Participations* (C-320/17) and *Ryanair Ltd* (C-249/17).

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