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Update: ECJ referral: Input tax deduction of a management holding company

The Supreme Tax Court has asked the European Court of Justice (ECJ) for a preliminary ruling on the input tax deduction of a functional (operating) holding company from certain input costs.

Background

The plaintiff, a limited company (GmbH), held an interest in two partnerships (KGs). Both KGs built certain housing properties and sold the respective residential units predominantly free of VAT. Third parties also held shares in both partnerships, albeit only as minority shareholders. The GmbH provided to both KGs certain services free of charge. It also provided accounting and management services: These included the handling of staff matters (e.g. recruitment and discharging of personnel), the purchase of material, the preparation of the annual financial statements and the preparation of tax returns and communication with the tax office. For these services a fee was charged by the GmbH. Explicitly excluded from the agreed management services were those services which the GmbH had to provide in its capacity as shareholder. GmbH provided these shareholder services partly with its own personnel and equipment and with the support of other companies against a fee which the latter charged to the GmbH. The tax office refused deduction of input VAT. The shareholder services were not attributable to the business activities of the GmbH and thus led to the exclusion of input tax deduction. The appeal was granted by the tax court of Lower Saxony and the case then went to the Supreme Tax Court.

ECJ case law: In principle, a holding company whose sole purpose is the acquisition of shareholdings in other companies without directly or indirectly intervening in the management of these companies is not a taxable person within the meaning of Art. 9 of the VAT Directive 2006/112/EC and therefore not entitled to deduct input VAT. However, a VAT deduction is possible if the expense was incurred in connection with an economic activity. An economic activity is assumed if the parent actively managed the subsidiary (and regularly supplied it with administrative, financial, commercial, or technical services). If the parent meets these criteria, its input VAT incurred on general business expenses will be fully deductible. The relevant portion of the VAT expense would be excluded from the deduction, however, if part of the subsidiaries' turnover itself was VAT-free. The ECJ's landmark decision in this respect was from 2015 (case references C-108/14 *Larentia + Minerva* and C-109/14 *Marenave* joint judgment of July 16, 2015 - see our **blog post**).

Supreme Tax Court decision

The GmbH provided taxable services by way of accounting and management services to its KG-subsidiaries and would therefore generally be entitled to a full input VAT deduction from its underlying input services. The Supreme Tax Court, however, has doubts whether the case at hand will stand up to current EU law and ECJ case law.

The services received could not have been obtained for the GmbH's own business but were rather directly and immediately attributable to the (largely) VAT-exempt activities of the subsidiaries. Given this, it therefore appears doubtful that the expenses incurred are attributable to the GmbH's "general costs" (the cost elements of its taxable output sales "accounting and management for the subsidiaries"). If the GmbH handled the procurement of services on its own account and subsequently passes the services through to its subsidiaries, it could no longer be maintained that the purchase of services is part of its (taxable) business.

The Supreme Tax Court therefore decided to stay the proceedings and referred the following two questions to the ECJ for a preliminary ruling.

First question: *Can a management holding company which makes taxable output sales to its subsidiaries also be entitled to deduct input VAT on services which it purchased from third parties and contributed to the subsidiaries in return for the grant of a share in the general profit, even though the input services purchased are not directly and immediately connected with the holding company's own business sales but rather with the (largely) tax-exempt activities of the subsidiaries and also do not form part of the general cost elements of the holding company's own economic activity?*

If the ECJ answers in the affirmative, the Supreme Tax Court further needs an answer to its **second question**: *Should the ECJ take the view that the input services in dispute should nevertheless entitle to an input tax deduction, the referring court has doubts as to whether the interposition of a parent company in the purchase of services of the subsidiary in order to obtain an input tax deduction to which is not entitled to per se is viewed as an abuse of law.* O*r can this interposition of the holding company be justified by non-tax reasons, although a full input tax deduction would then be in contrast to the VAT-system and would lead to a competitive advantage of holding constructions compared to single-tier companies?*

Update (18 August 2022):

The **final decision** by the European Court of Justice (ECJ) is scheduled for **8 September 2022.**

In his Opinion of 3 March 2022 the Advocate General (AG) suggests the ECJ to decide that **a managing holding company is not entitled to deduct input VAT** if the input services received are not directly and immediately related to the holding company's own turnover but to the (largely) tax-exempt activities of the subsidiaries, the input services received are not included in the price of the taxable turnover (provided to the subsidiaries) and do not form part of the general cost elements of the holding company's own economic activity.

The AG further points out that - in case the ECJ should decide otherwise - it is contrary to the objective pursued by the provisions of the VAT Directive on the deduction of input tax if a managing holding company is "interposed" in the purchase of services from subsidiaries in such a way that it itself purchases the services for which the subsidiaries themselves would not be entitled to deduct input tax if the services were purchased directly, transfers them to the subsidiaries in return for a participation in their profits (…). Such a structure would **constitute an abuse of rights**, even if it can be justified by non-tax reasons and provided that it is obvious from the outset that the main purpose is to obtain a tax benefit.

Source:

Supreme Tax Court decision of 23 September 2020 (XI R 22/18), published on 11 February 2021. - The

request for preliminary ruling is now pending before the ECJ under case reference C-98/21.

Keywords

economic activity, input VAT deduction, management holding