

Contribution in kind and VAT (1) 2/40/22



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Every now and then corporate groups decide to undertake a strategic restructuring of their assets, including a transfer of assets to one or more group companies for financing another activity. Using a contribution in kind to increase a company's share capital raises a number of important legal and tax issues. In this article we will explore whether a contribution in kind attracts VAT, as well as assessing the need to adjust the input VAT deducted on the contribution and the right to deduct the input VAT on services acquired for the contribution, such as expert valuation services and legal advice.

Is a contribution in kind within the scope of VAT?

Under the VAT Act, VAT is charged on supplies of goods and services for a consideration that a taxable person acting as such makes in the course of his economic activity. This means that not all transactions are within the scope of VAT as taxable or exempt under section 52 of the VAT Act.

The VAT Act makes it clear that transferring the ownership or use of a business to another economic operator does not qualify as a supply of goods for a consideration. This provision is included in the VAT Act by reference to article 19 of the VAT directive,¹ which permits a member state to take the view (an optional provision) that a supply of goods has not taken place if all or some of the person's assets are transferred for a consideration or free of charge, or as a contribution to a company, and the acquirer is considered to succeed to the transferor's rights.

According to the case law of the Court of Justice of the European Union (CJEU), the term "transfer of all or some of the assets" is interpreted as covering the transfer of a business, or of an autonomous part of business, that comprises tangible and intangible assets that together constitute a business or its part capable of conducting an autonomous economic activity but this excludes a simple transfer of assets such as a sale of inventory.²

The Supreme Court of Latvia has interpreted the term "transfer of business" for VAT purposes in the light of the VAT directive.³ To recognise a transfer of business and find that the transfer of a business or of its stand-alone part has taken place, it is essential to establish that the acquirer has received a set of business elements that are sufficient for conducting a stand-alone, independent economic activity. So the facts and circumstances in this context should be examined by considering whether the acquirer has received all that is necessary for a permanent continuation of the economic activity. What set of elements is sufficient depends on the particular type of economic activity.

Accordingly, if a contribution in kind allows us to find a transfer of business, the contribution is outside the scope of VAT.

It is quite difficult to answer the question of how we should treat a contribution in kind for VAT purposes if we cannot find a transfer of business. For example, a wholesaler contributes one of his several pieces of real estate (RE) – a warehouse he used for storing its goods, but he does not transfer any rights or liabilities, so there would be no reason to believe the RE amounts to a business. Should we treat this transfer as a supply of goods (taxable or exempt depending on the RE's status)? Could we treat the

contribution as a share-related transaction also for the contributor, or should we find that two transactions have taken place: a supply of shares and a supply of RE (a swap)?

The CJEU's case law on share dealings states that a simple acquisition, supply or holding of shares is not an economic activity for VAT purposes. A simple acquisition, supply or holding means that the purpose of the transaction is to hold shares with a view to receiving dividends. If shares are acquired, supplied or held in order to trade in securities, or to intervene, directly or indirectly, in the running of the acquired company, or if this is a direct, permanent and necessary continuation of a taxable business, the transaction is within the scope of VAT.

Could we use this principle in evaluating a share acquisition in exchange for a contribution in kind?

In a brochure titled "Questions and answers about VAT treatment" the State Revenue Service has answered the question of whether VAT is chargeable on contributions to a company's share capital in exchange for securities and share certificates: According to its economic substance this transaction does not qualify as a supply of goods or services for a consideration, so it is outside the scope of VAT. Unfortunately, the reasons for this opinion have been withheld.

Next week we will be writing about the obligation to make adjustments when performing a contribution in kind and about the right to deduct input VAT on acquired services.

¹Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

²CJEU ruling C-29/08 of 29 October 2009, paragraph 37 and the case law it refers to

³Ruling A420289415 of 21 May 2019, SKA-631/2019