

CJEU on deducting input VAT in share purchase (2/44/18)

On 17 October 2018 the Court of Justice of the European Union (CJEU) ruled on a taxable person's right to deduct input tax on consulting services for a share purchase that was not completed because of circumstances beyond the taxable person's control. This article explores the CJEU's findings and their practical implications.

The main proceedings and preliminary questions

An Irish airline incurred expenses on consulting and other services for a proposed acquisition of shares in another company. However, the airline was permitted to acquire only part of the target company's shares for reasons of compliance with competition law. Since the airline intended to provide taxable governance services to the acquired company, the airline deducted input tax on the services it had acquired for the share purchase. The Irish tax authority denied the right to deduct that input tax, and the airline went to court.

The High Court of Ireland asked the CJEU to answer the following preliminary questions:

- Is the intention of providing governance services to a target company after its successful takeover a sufficient basis for considering that an economic activity is carried out and that the input tax on goods and services purchased for the proposed taxable activity is deductible?
- Can there be a "direct and immediate link" between professional services received during the share purchase and governance services to be supplied in the event of a successful takeover for deducting the input tax on those professional services?

The CJEU's findings

In evaluating the airline's right to deduct input tax, the CJEU sought to determine whether a company intending to acquire shares in another company and to provide taxable governance services to the acquired company may be considered a taxable person, and whether it is considered a taxable person also in acquiring services for the share purchase, and whether the input tax paid on those services is deductible and to what extent.

The CJEU said that companies acquiring shares only for holding purposes are neither considered taxable persons under VAT law nor permitted to deduct input tax because holding shares does not mean that property is used with the intention of gaining steady income from it. Any dividend received from such shares is simply the result of ownership.

However, where holding shares results in a supply of governance services such as administrative, financial, commercial or technical services attracting VAT, the activity is considered an economic activity, and the cycle of economic activity includes preparations. Persons that intend to start an economic activity and invest capital for that purpose are considered taxable persons. Since the airline intended to provide taxable services to the acquired company, the airline is considered a taxable person, according to the CJEU.

The CJEU says the right to deduct input tax arises where a taxable person acquires goods and services for making taxable supplies. The system of deduction aims to exempt traders from VAT they have paid in connection with their economic activity. The system also ensures neutrality for the VAT treatment of all economic activities regardless of their purpose or result if they attract VAT. The right to deduct input tax is retained even if the proposed activity was not carried out and taxable supplies did not take place, and if circumstances beyond the taxable person's control made him unable to use the goods and services on which he had deducted input tax for making taxable supplies. It is crucial for those transactions to be objectively linked to the person's taxable business, i.e. to have occurred only as part of the proposed economic activity.

Since the airline intended to provide taxable services to the acquired company, the CJEU found the airline acted as a taxable person in acquiring services for the share purchase. As a result, the airline was permitted to deduct the input tax on the consulting services received for the share purchase even if the proposed taxable activity related to the acquired company did not take place.

Applying the CJEU's findings in practice

The findings of the ruling lead to the conclusion that in assessing grounds for deducting input tax in a similar situation the taxable person should answer the following questions:

- Did the taxable person intend to make taxable supplies at the time of acquiring goods and services?
- Are those expenses objectively linked to the taxable person's economic activity and necessary for making taxable supplies (if any)?

The taxable person's failure to carry out a taxable activity because of circumstances beyond his control cannot deny him the right to deduct input tax.