VAT RECOVERY FOR BID COSTS

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The Advocate General ("AG") of the Court of Justice of the European Union ("CJEU") has opined [1] that Ryanair should be allowed to recover VAT on the considerable bid costs it incurred as part of its failed 2006 takeover of Aer Lingus. The AG considered the potential acquisition to have been a "strategic" one (intended to bring about a "direct, permanent and necessary extension" of Ryanair's taxable activity), such that it constituted an economic activity, and the bid costs to have had a direct and immediate link with Ryanair's taxable activity (entitling Ryanair to VAT recovery).

If the CJEU were to adopt the AG's opinion (which does not bind the CJEU), a fully taxable operating company acquiring a target company for strategic reasons should be able to recover VAT on bid costs (even if the acquisition were to fail) without having to carry on an economic activity in the form of providing (or intending to provide) management services to its new subsidiary (which is, essentially, a prerequisite for a holding company to recover VAT on acquisition costs).

BACKGROUND

To the extent that a taxable person (that is, a person who carries out in any place any economic activity) uses goods and services for the purposes of its taxable transactions, it can recover the VAT on supplies of goods and services it receives if there is a direct and immediate link between the costs of the supplies received and the taxable supplies made. The "direct and immediate" link can be to specific supplies made or to the taxable person's business as a whole.

Buying shares can be preparatory to the exploitation of those shares as an economic activity; however, the CJEU has hitherto distinguished between buying shares for passive investment purposes (simply to receive dividends, which is not an economic activity) and the purchase of shares by a holding company that intends to provide management and similar services to its subsidiary (being an economic activity). The "passive" acquirer cannot recover the VAT that it incurs in relation to its acquisition but the "active" holding company can. This principle is reflected in HMRC's published practice.

THE AG'S OPINION

In Ryanair's case, the AG moved away from the distinction between "passive" and "active" holding companies as the gateway to VAT recovery in cases where the acquirer is an operating company making a strategic acquisition. Instead, in those circumstances, she considered that the CJEU should have regard to the "functional link" between Ryanair's acquisition of the shares in Aer Lingus and Ryanair's main operating business.

In the AG's view, this functional analysis better addresses the facts of Ryanair's case while remaining consistent with the CJEU's case law. According to the AG's interpretation of that case law, direct involvement in managing a subsidiary by supplying management services to it was not the only way in which holding shares in that subsidiary could constitute an economic activity: rather, an economic activity could exist if acquiring or holding shares constituted a direct, permanent and necessary extension of a taxable activity.

The AG's view was that the strategic takeover of a business by which the acquiring company pursued the aim of extending or modifying its operating business was such a direct, permanent and necessary extension of a taxable activity. Ryanair's expenditure in connection with the acquisition undoubtedly constituted components of the cost of the (intended) supplies from the airline business following the takeover.

Further, in the AG's view, the fact that the intended takeover and the ongoing operation of Aer Lingus under Ryanair's full control never occurred had no bearing on her conclusion. In accordance with settled CJEU case law, Ryanair's intention to engage in an economic activity was enough and could not subsequently be called into question on the basis that there was, in fact, no takeover of Aer Lingus.

Therefore, in the AG's view, costs that an operating company incurred in connection with a takeover that was designed to bring about a direct, permanent and necessary extension of that operating company's taxable activity had a direct and immediate link with that taxable activity, entitling the operating company to recover VAT on those costs.

IMPLICATIONS

As mentioned above, if the CJEU were to adopt the AG's opinion, a fully taxable operating company acquiring a target company for "strategic" reasons should be able to recover VAT on bid costs (even if the acquisition were to fail) without having to provide (or having to intend to provide) management services to its new subsidiary.

Taxpayers who have failed to recover VAT on recent acquisitions in such circumstances may, therefore, want to re-examine that treatment, should the CJEU agree with the AG. And, looking forward, groups may (depending on non-VAT factors) consider structuring strategic acquisitions through operational companies.

However, in the meantime (and, perhaps, even until tax authorities update their published practice on this point), to stand the best chance of recovering VAT on bid costs, purchasers should still provide management services to the new subsidiary from completion of the acquisition (and document the intention to do so appropriately).

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1 Ryanair Ltd v The Revenue Commissioners (C-249/17)

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