Putting in a bid

David Jacob and Tom Jarvis discuss recent CJEU cases that could improve the possibility of recovering VAT on corporate bid costs.

A taxable person (a person who carries out in any place any economic activity) receiving supplies of goods and services for the purposes of its taxable transactions can recover the VAT levied on those supplies 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.

> "The Advocate General moved away from the 'passive/active' holding company distinction as the gateway to VAT recovery,"

Buying shares can be preparatory to exploiting them as an economic activity. The Court of Justice of the European Union (CJEU) distinguishes between buying shares for passive investment purposes (simply to receive dividends, which is not an economic activity) and their purchase by a holding company that intends to provide management and similar services to its subsidiary (being an economic activity). This distinction is illustrated by the decisions in *Polysar Investments Netherlands BV* (C-60/90) and *Cibo Participations SA* (C-16/00)). The 'passive' acquirer cannot recover the VAT that it incurs in relation to its acquisition, but the 'active' holding company can. HMRC's guidance set out in the *VAT Input Tax Manual* at VIT40600 reflects this principle.

Key points

- Input VAT can be recovered if there is a direct and immediate link between supplies received and taxable supplies made.
- The Court of Justice of the European Union distinguishes between buying shares for investment and economic activities.
- The letting of a building by a holding company to a subsidiary could constitute management.
- In the *Ryanair* case, the Advocate General has suggested the importance of a 'functional link' between the share acquisition and business.
- To recover VAT on future bid costs, management services remain important, and should be documented.

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Two recent cases in this area may be helpful to taxpayers who have recently incurred, or will in the future incur, costs on successful or aborted share acquisitions.

First, in *Marle Participations Sarl* (C-320/17), the CJEU found that the taxable (as opposed to exempt) letting of property by a holding company to its subsidiary constituted involvement in the management of it, entitling the holding company to recover input VAT incurred on acquiring shares in the subsidiary.

Second, the Advocate General of the CJEU in *Ryanair Ltd* (C-249/17) appears to widen the scope for operating companies to recover VAT on the costs of strategic takeovers. The Advocate General moved away from the 'passive/active' holding company distinction as the gateway to VAT recovery in favour of analysing the 'functional link' between the share acquisition by an operating company and its main operating business.

The *Marle Participations* case

Marle Participations was the holding company of a manufacturing group. Its objects included managing shareholdings in several subsidiaries. Since 2009, Marle Participations had been undergoing a restructuring, involving the sale and purchase of securities. It deducted in full the VAT it had incurred on various restructuring expenses. The French tax authority denied the deduction, Marle appealed and, eventually, the French Administrative Supreme Court (Conseil d'Etat) referred the issue to the CJEU.

The only services that Marle Participations provided to its targets or sought to develop in relation to them was letting a building to an operating subsidiary, which used the property as a production site.

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The Conseil d'Etat asked the CJEU whether the letting of a building by a holding company to a subsidiary constituted direct or indirect involvement in the management of that subsidiary (so that acquiring and holding shares in that subsidiary constituted an economic activity). If so, under what conditions would that letting constitute involvement in the subsidiary's management?

The CJEU noted that the case law examples of VATable activities that constitute a holding company's 'involvement in the management of its subsidiaries' (such as supplying administrative, accounting, financial, commercial, information technology and technical services) were not exhaustive. In fact, that expression covered all transactions constituting an economic activity performed by the holding company for the benefit of its subsidiary.

Therefore, the CJEU concluded that the letting of a building by a holding company to its subsidiary amounted to involvement in managing it. In principle, this would entitle the holding company to recover input tax on the costs of acquiring the subsidiary. This was on condition that the letting was made on a continuing basis, carried out for consideration and taxable – in other words, the lessor had, as we put it, 'opted to tax' the property.

Further, the CJEU decided that the referring court had to determine the extent to which Marle Participations could recover its input VAT on the acquisition costs in the light of *Beteiligungsgesellschaft Larentia + Minerva mbH & Co. KG* (C-108/14) and *Marenave Schiffahrts AG* (C-109/14). Under those decisions, a fully taxable holding company 'actively' managing its subsidiaries could obtain full input tax recovery as part of its general overheads. But if a holding company 'actively' managed only some of its subsidiaries, an input tax apportionment would be necessary. Therefore, the Conseil d'Etat had to determine whether the share acquisition for which Marle Participations sought to recover input tax concerned only subsidiaries to which it provided management services. If this were the case, it should obtain full input tax recovery. Alternatively, did that acquisition also concern other subsidiaries to which it did not provide management services? In that latter case it would be necessary to apportion the input VAT between its economic and non-economic activities.

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Ryanair

In October 2006, Ryanair made a formal takeover bid for Aer Lingus, but this was blocked on competition grounds. For that reason, Ryanair acquired slightly less than 29% of its target's shares. Ryanair incurred considerable costs for services in connection with the planned takeover and claimed deduction of the related input tax. The Irish tax authorities refused the claim. Ryanair appealed and, ultimately, the Irish Supreme Court referred the issue to the CJEU.

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The Advocate General suggested moving away from the distinction between 'passive' and 'active' holding companies as the gateway to VAT recovery if the acquirer is an operating entity 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 its main operating business.

A new analysis

In the Advocate General's view, this functional analysis better addressed the facts of Ryanair's case while remaining consistent with CJEU case law (including *Wellcome Trust* (C-155/94) and *Floridienne* and *Berginvest* (C-142/99)). According to her interpretation, 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.

She added that the strategic takeover of a business by which the acquiring company pursued the aim of extending or modifying its operating business was 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 after the takeover.

> "The two cases may prompt buyers that have failed to recover VAT on recent acquisitions in similar circumstances to re-examine that treatment."

Further, in the Advocate General's view, the fact that the intended takeover and the continuing operation of Aer Lingus under Ryanair's full control never occurred had no bearing on her conclusion. In accordance with settled CJEU case law (see *Rompelman* (C-268/83)), Ryanair's intention to engage in an economic activity was enough and could not be challenged later on the basis that there was, in fact, no takeover of Aer Lingus.

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

Planning point

If the CJEU adopts the Advocate General's opinion in *Ryanair*, 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.

Implications

In the context of the 'passive/active' holding company distinction, *Marle Participations* represents a welcome explanation of the width of the key concept of a holding company's 'involvement in the management of its subsidiaries'. Formalised management services agreements appear no longer to be the only route to achieving the 'active' holding company status that a BidCo requires to be able to recover VAT on acquisition costs. Now, it seems, merely letting an 'opted to tax' property to the target does the trick.

And, if the CJEU were to adopt the Advocate General's opinion in *Ryanair*, 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. This is without even having to provide (or having to intend to provide) management services to its new subsidiary. In the future, operating companies considering 'strategic' acquisitions may not (depending on non-VAT factors) need to establish new companies for that purpose, which would help to reduce the cost and compliance burden of the acquisition.

The question is, what is a 'strategic' acquisition? To put it another way, when does an acquisition constitute a 'direct, permanent and necessary extension of a taxable activity'? According to the Advocate General, Ryanair's (failed) purchase of a competitor was a 'strategic' acquisition. This will depend on the business in question but, at first blush, it appears to be a generous test. In the same way that *Marle Participations* has clarified what it means for a holding company to be involved in the management of its subsidiaries, perhaps the concept of a 'strategic' acquisition is one that the CJEU will develop over time. This is, after all, a perpetually evolving area of tax law.

Conclusion

These cases may prompt buyers that have failed to recover VAT on recent (successful or failed) acquisitions in similar circumstances to re-examine this, but the tax authorities have yet to update their guidance. Until then, to stand the best chance of recovering VAT on future bid costs, buyers should still provide management services (as *Marle Participations* defines them) to the new subsidiary from completion of the acquisition and document the intention to do so. ●

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