KPMG Meijburg & Co Tax Lawyers

Advocate General: VAT on strategic acquisitions deductible

On May 3, 2018, Advocate General Kokott (hereinafter: AG Kokott) at the Court of Justice of the European Union (hereinafter: CJEU) issued her Opinion in the Ryanair case (C-249/17). The case concerned the deductibility of VAT on professional services. Ryanair had purchased these services, because the company wished to acquire shares in its competitor, Aer Lingus. The High Court of Ireland had earlier ruled that the VAT on these professional services could not be deducted, because the takeover attempt had ultimately failed. AG Kokott took another view and concluded that Ryanair may deduct the VAT on professional services. The final judgment in this case, which is still pending, could be particularly significant to, for example, private equity firms and the M&A practice within groups.

AG Kokott's Opinion

AG Kokott characterizes Ryanair as an operating company – distinct from the classical financial holding company – that performs business activities in the aviation market with which it generates turnover. According to AG Kokott, the proposed takeover of competitor Aer Lingus through the acquisition of all its shares can be compared to the situation in which a business wishes to acquire the physical labor resources and plant and machinery of a competitor (and not only the shares in order to merely generate dividends). It makes sense that such a 'functional analysis' considers the envisaged turnover from the operating aviation activities for the VAT deduction on professional adviser fees. According to the AG, there is a direct and immediate link between the professional services purchased to acquire the shares in Aer Lingus and the price of the aviation activities. After all, Ryanair would, in any event, have to offset these costs in the price of air tickets if it wants to operate profitably. AG Kokott is thus implying that Ryanair is entitled to recover input VAT in accordance with the pro rata VAT recovery right that applies to its overall business activities, even if the takeover is ultimately unsuccessful.

How will the CJEU rule?

In her Opinion, AG Kokott elaborates further on the "extension theory" (*verlengstukgedachte*) and in such a way that, also outside the situation of a failed share acquisition, VAT recovery is possible in holding situations within a group. In doing so, the AG provides the practice with a very welcome interpretation of the extension theory. We can imagine that the CJEU will, in principle, consider the outcome of this Opinion desirable, but we do not rule out that it may use a different approach. Although the CJEU has referred to the extension theory in previous judgments, it has to date never been interpreted in a holding context. We are therefore curious to see whether the CJEU will go along with AG Kokott's Opinion, or that the CJEU will circumscribe the questions with due observance of the facts in this case and respond more specifically to them.

Current Dutch practice and impact

In the Netherlands, the VAT on professional services can generally also be deducted if a takeover is unsuccessful, provided that there is an objective intention to provide services subject to VAT in respect of that participation. In our view, this intention is present if investigation shows that the acquirer is involved in the management of the other participations already held, or if its policy makes clear that new participations are always added to the existing VAT group. In such cases, the deduction is applied in line with the

normal VAT deduction entitlement that applies to the taxpayer's overall business activity. If the acquiring company does not yet have a track record for its existing participations, or always holds it participations passively, then according to current practice the VAT on professional adviser fees should be treated as non-deductible. However, if the CJEU follows the AG's Opinion and fully adopts the interpretation of the extension theory, then a VAT deduction limitation may not apply in the case of a strategic acquisition of shares intended to expand or change the existing operating activities of the acquiring company.

What are your options?

The outcome of the Ryanair case could be particularly significant to, for example, private equity firms and the M&A practice within groups. If you are planning acquisitions, we recommend that you review your VAT position on time. Having consideration for this Opinion, it is still advisable to objectively substantiate at an early stage that it concerns a strategic acquisition and that you intend to perform VAT-taxed activities in respect of the intended participation. This will enable you to secure the recovery of input VAT as much as possible, even if the acquisition is unsuccessful.

If you are currently consulting with the Dutch tax authorities and supplementary assessments have been or will be imposed, then we recommend that you file a notice of objection in order to preserve your rights, thereby referring to the Ryanair case, in particular the Opinion of AG Kokott. It may in some cases be advisable to await the CJEU ruling in this case. The advisors of Meijburg & Co's Indirect Tax and M&A Group would be pleased to assist you further with this issue. Feel free to contact one of these tax advisors or your regular contact for more information.

Meijburg & Co
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