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CJEU: the purpose of the sale of shares may limit VAT recovery right

On November 8, 2018, the Court of Justice of the European Union (hereinafter: CJEU) rendered judgment in the C&D Foods case (C-502/17). The case concerned the recovery of VAT on costs related to a proposed, but ultimately not realized, sale of shares. The CJEU deemed the purpose for which the shares were sold as being decisive for whether there is a VAT recovery right on professional advisor fees. C&D Foods intended to use the proceeds of the sale to repay a debt it had with its bank, which was also its shareholder. According to the CJEU, the share sale by C&D Foods was, in that case, an activity falling outside the scope of VAT. Consequently, the VAT charged on professional advisor fees was wholly non-deductible. This judgment may have a major impact on current Dutch practice concerning the sale of participations.

1. CJEU judgment

The Danish company C&D Foods is a member of the international Arovit group. It indirectly holds all the shares in Arovit Petfood and provides management and IT-related services to this participation. At a certain point in time, the shares of the Arovit group ended up in the hands of a bank, which had acquired these shares for EUR 1, because the then current owner could not meet its payment commitments to that bank. The bank intended to sell the shares in Arovit Petfood.

A law firm was engaged for the sale of the shares in Arovit Petfood, for which it drew up a draft agreement with an unnamed buyer. C&D Foods - the indirect shareholder of Arovit Petfood - ultimately abandoned the sale as no suitable buyer could be found. C&D Foods fully deducted the VAT on the professional advisor fees, but the Danish tax authorities refused to grant a VAT refund.

The CJEU confirmed that C&D Foods intended to use the proposed sale of the shares to repay outstanding debt at its bank, the new shareholder of the group. According to the CJEU, such a share sale is not directly related to the VAT-taxed services of C&D Foods, nor does it constitute an extension thereof. This means that the sale of the participation falls outside the scope of VAT and there is no VAT recovery right for the professional advisor fees.

2. Further analysis and impact on the Dutch practice

Noteworthy in this case is that the bank that had acquired the Arovit group had always intended to sell Arovit Petfood, as this would ensure that it no longer acted as a creditor of the Arovit group. It was also the bank that had arranged the professional advisor services for the account of C&D Foods. The only reason for selling the participation was thus to use the proceeds of the sale to repay existing debt to the bank, i.e. the new shareholder. The direct link with the VAT-taxed activities of C&D Foods is absent in this specific context. The CJEU seems to suggest a direct link between the professional advisor services and the shareholder interests of the Arovit group.

In our view, the CJEU judgment must be regarded in the specific context of the facts. The judgment expressly leaves room for a full or partial VAT recovery of professional advisor fees in the event of a share sale, if the sale takes place in the context of a restructuring or rationalization of a group on its own initiative. The purpose of this should be to use the proceeds of the share sale to strengthen the VAT-taxable activities

of the group. This was also confirmed in previous CJEU case law (the SKF case, C-29/08).

In the Dutch practice, professional advisor fees in respect of a proposed sale of shares are generally regarded as general overhead, if the participation is actively held by providing VAT-taxed services to that participation, or if the participation is included in a VAT group. The normal VAT recovery rules apply to these costs. If a holding company intends to sell a participation, then given the CJEU judgment in this case it is essential to substantiate the purpose of the sale. If it is purely to serve the business interests of the group, then we believe that there is a VAT recovery right in accordance with the normal VAT recovery right and the associated limitations on this right.

We would like to point out here that the repayment of debt may very well also serve the business interests of the group. After all, relieving the debt position of a group directly affects its credit rating, the possibility of concluding new contracts with suppliers, or the possibility of carrying on new business activities. In this respect, what is important for the group in a business sense, may also be important for its shareholders, and in this sense there is a common interest for all stakeholders in such cases. Further development of the law on this issue will have to show exactly where the line should be drawn.

3. What are your options?

In light of the CJEU judgment, it is essential to examine the purpose of selling a participation and how the proceeds from the sale are used. If your business is involved with the sale of participations (whether or not occasionally), then it is certainly advisable to consult your designated advisor to discuss the implications of this judgment.

The outcome of this judgment is of major importance for M&A practices, whether or not within groups, private equity enterprises, but also for operating businesses holding participations. Our specialists in the Indirect Tax Group and the M&A Group will be happy to be of assistance in this respect.

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