KPMG Meijburg & Co Tax Lawyers

Is VAT on services deductible in the case of the proposed sale of a participation if the sale ultimately does not proceed?

We recently informed you about the request for a preliminary ruling in the Ryanair case (C-249-17). That case, pending before the Court of Justice of the European Union (hereinafter: CJEU), concerns the question whether VAT on professional services is deductible if the proposed takeover of a participation is ultimately unsuccessful. An almost mirror image situation occurs in the C&D Foods Acquisition ApS case (C-502/17), in which the Danish court recently requested a preliminary ruling from the CJEU. This case concerns the deductibility of VAT on due diligence that is performed for a proposed, but ultimately unrealized, sale of shares in a subsidiary. The outcome of this case – just like the Ryanair case – could have a major impact on, for example, private equity firms and the M&A practice within groups, if the CJEU renders a judgment that differs from the current Dutch practice.

Current Dutch practice and impact

In the Netherlands, the VAT on preliminary services is generally deductible if the intended sale of a participation ultimately does not proceed, provided the holding company performs services for that participation which are fully subject to VAT, or the participation, together with the holding company, is a member of a VAT group that only performs VAT-taxed services. The relevant participation in both situations is then:

1) held in the 'business context' of the holding company, and
2) a VAT-exempt sale ultimately does not eventuate.

In that case, the preliminary expenses do not relate to a VAT-exempt sale of a participation, but are related to the entire business activity of the holding company. As a result, the preliminary expenses are deemed to be part of the general overhead. This means that for the purposes of the VAT deduction entitlement on these expenses all the business activities of the holding company are, in principle, taken into account, thus both the VAT-exempt services (such as the provision of interest-bearing loans) and the VAT-taxed services (such as management services). Only if the holding company actually uses services for a VAT-exempt sale of the participation, can the VAT deduction be limited, but even then not in all cases.

For example, in the case of the sale of a participation – that falls within the economic scope of the selling holding company – to a purchaser that is resident outside the European Union there is an entitlement to a VAT deduction. It is also possible to recharge the preliminary expenses (or some of them) with VAT to an affiliated party, and this recharging must be treated as a taxed service for VAT purposes. Other situations are also conceivable in which there is an entitlement to deduct the VAT on preliminary expenses in the case of a VAT-exempt transfer.

However, if the holding company holds its participations passively or its normal VAT deduction entitlement is limited as a result of VAT-exempt or non-economic activities, then account should be taken of the fact that the VAT on preliminary expenses for a proposed sale may be non-deductible. Moreover, in practice a dispute could arise with the Dutch tax authorities about who the purchaser of the preliminary services is.

How will the CJEU rule?
It is possible that the CJEU may approach the request for a preliminary ruling, in principle, along the lines of the deemed general overhead and arrive at a VAT deduction entitlement for C&D Foods in accordance with its normal business activities. In that case, the judgment rendered by the CJEU would correspond to current Dutch practice. Nevertheless, we do not entirely preclude the possibility that the CJEU will take a slightly different course, looking for example beyond the earlier judgments and asking to what extent the preliminary expenses should actually be included in the price that the holding company charges its participation for its VAT-taxed services. It is also possible – although this does not appear to be at issue as such – that the CJEU will focus on the question of who within the group is actually the purchaser of the preliminary services. In short, it does not appear possible to entirely predict the outcome in this case.

What can you do now?
The outcome of the C&D Foods Acquisition ApS case could be particularly significant to, for example, private equity firms and the M&A practice within groups. If you are intending to sell participations, then we advise reviewing your VAT position on time. It is then sensible to already investigate at an early stage:

1) whether the preliminary expenses are received at the right level within the group, and
2) whether the holding company acts within the economic sphere when selling participation(s) and whether there are VAT-taxed services in respect of the participation(s), or whether there is a VAT group.

Depending upon the actual situation, you can take further steps to optimize the recovery of VAT as much as possible, even if the sale does not proceed.

If you are currently consulting with the Dutch tax authorities about the possibility of deducting the VAT on preliminary expenses, 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 C&D Foods Acquisition ApS case. It may in some cases be advisable to await the CJEU judgment in this case. The advisors of Meijburg & Co's Indirect Tax Group 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.

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