KPMG Meijburg & Co Tax Lawyers

Is VAT on professional services deductible if a share deal is unsuccessful?

On May 12, 2017 the Supreme Court of Ireland requested the Court of Justice of the European Union (CJEU) to render a preliminary ruling in the Ryanair case (C-249/17). The two questions posed to the CJEU 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. The outcome in this case could be particularly significant to, for example, private equity firms and the M&A practice within groups.

How will the CJEU rule?

The CJEU could suffice with a reference to its previous conclusions in the Cibo Participations judgment (C-16/00). The Irish court wonders to what extent the VAT on the professional services would be deductible if the takeover had been successful. The CJEU could conclude that it had already ruled on that question before. Although we do not consider it very likely, the CJEU could also reformulate the questions referred for a preliminary ruling so that it can address the situation where a takeover is unsuccessful. In that case, the CJEU could very well leave it up to the national court to examine whether Ryanair holds its (existing) participations as an economic or a non-economic activity within the group.

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. The Dutch tax authorities can thereby require that the intention to perform activities subject to VAT be substantiated with objective data (e.g. draft contracts, minutes of board meetings, remarks made in the financial statements, etc.). If the business can prove this is the case, then our experience is that this position can be maintained in respect of new participations that are to be acquired, even if the transaction does not go ahead. In such cases the deduction is applied in line with the normal deduction entitlement that applies to the taxpayer's entire business activity. If the acquirer does not yet have a track record for its existing participations, or always holds it participations passively, then the VAT on professional services may appear non-deductible.

What are your options?

The outcome of the Ryanair case (C-249/17) could be particularly significant to, for example, private equity firms and the M&A practice within groups. If you are intending to make acquisitions, then we advise reviewing your VAT position on time. It may be wise in the early stages of an acquisition to objectively substantiate that you intend to perform activities subject to VAT for 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 (C-249/17). 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.

Background information

The case

Ryanair is an airline providing low-budget flights in Europe. The plane tickets are not subject to VAT due to the application of the 0% VAT rate. Ryanair is nevertheless entitled to recover input VAT, given that these services fall within the scope of VAT (hereinafter also referred to as 'taxable activities'). Ryanair already held a 16% shareholding – later increased to 29% – in its competitor Aer Lingus and in October 2006 made a bid for the remaining issued shares in Aer Lingus. The takeover was intended to enable Ryanair to use its experience and expertise to improve Aer Lingus' result and to control costs. This would happen by providing management services. The takeover of Aer Lingus was ultimately unsuccessful. Ryanair incurred considerable costs for various professional services with regard to the intended takeover and deducted the input VAT on these services. The Irish tax authorities, however, take the position that Ryanair wrongfully deducted this VAT and base this, in short, on the following grounds:

1. There is no direct link between the professional services purchased and the management services provided, given that the takeover was unsuccessful.
2. Ryanair also cannot prove that there is a direct and immediate link between the professional services purchased and the taxable activities of Ryanair (providing flights). Moreover, Ryanair cannot prove that the costs are part of its general overhead.

According to Ryanair, it follows from CJEU case law that the VAT on costs incurred with a share purchase can be deducted if the involvement in the management of the participation concerned is accompanied by taxed activities. Furthermore, Ryanair takes the position that the intention to provide activities subject to VAT in the future is, in itself, sufficient reason to deduct the VAT on costs that were incurred at an earlier stage. The High Court of Ireland ruled against Ryanair and Ryanair filed an appeal with the Supreme Court of Ireland. The Supreme Court decided to ask the CJEU for a preliminary ruling on – in brief – the following questions.

Questions for which a preliminary ruling is sought

1. Is an intention to provide management services to a target company in the future, should the takeover be successful, sufficient to conclude that the potential acquirer performs economic activities, so that the input VAT paid on the professional services by the potential acquirer can be regarded as VAT on

supplies received for the intended economic activity of providing such management services?
2. Is there a sufficient 'direct and immediate link', in the sense of the requirement formulated by the CJEU in the Cibo judgment, between the professional services and any potential management services to be provided to the target company at a later stage, should the takeover be successful, so that the relevant input VAT is eligible for deduction?

Our analysis

To better understand this case and its potential impact, it is useful to distinguish a number of steps. According to European case law, a business that incurs investment expenditure, for example, to purchase a showroom or plant and equipment, in order to use this to perform activities subject to VAT, is, in principle, entitled to deduct the input VAT paid on this, provided the intention can be substantiated with objection information. The VAT deduction entitlement is retained, even in the unlikely event that the economic activity fails to eventuate. The identified investments consist of the purchase of assets that, by their very nature, lend themselves to carrying out services subject to VAT.

However, the purchase (and the holding) of shares does not, by itself, (automatically) imply that services subject to VAT will be performed in respect of the (intended) participation. After all, it is entirely possible that the participation is held as a passive investment merely for the purposes of receiving dividends. The key question is thus when the purchase (and holding) of a participation comprises an economic activity for VAT purposes. According to the CJEU, that is roughly the case if one of the following three circumstances arises:

1. the holding of the shares involves the performance of activities that are subject to VAT;
2. the holding of the shares takes place as part of a commercial activity, such as professional share trader;
3. the holding of the shares is the direct, necessary and sustainable extension of the taxable activity of the taxpayer.

If applied to Ryanair, these three criteria give rise to the following:

Re 1

As stated above, Ryanair does not get round to providing services subject to VAT to Aer Lingus, because the takeover attempt was *not successful*. The CJEU case concerning Cibo Participations SA (C-16/00) involved a successful purchase of shares, which was actually followed by the performance of activities subject to VAT. It follows from this case that there is an entitlement to deduct input VAT in respect of expenses incurred at an earlier stage, if services subject to VAT are provided to this participation at a later stage. The deduction is then based on the pro-rata recovery entitlement applying to the entire business activity. Crucial to the Ryanair case is however that the takeover was not successful and that therefore (in principle) also the direct link with the future services subject to VAT is broken.

Re 2
Ryanair is not a professional securities trader.

Re 3
What is precisely meant by the 'extension criterion' has not yet been elaborated on in European case law. If the holding of participations within the Ryanair group is part of the overall organizational structure within which the business as a whole is carried on ('group rationale'), then in our view it can be argued that the acquisition of or searching for new participations to expand or boost the group can be regarded as a direct extension of the existing economic activity. Ryanair is endeavoring to achieve sustainable returns through the intended acquisition of its competitor Aer Lingus, which – it can be argued – obviously go beyond merely receiving dividends. After all, Ryanair was aiming to use the potential takeover to boost the taxable activity of its entire group and to make the group more profitable. Takeovers may be necessary in certain markets to sustain and continue the taxable activity. Searching for and acquiring new participations then takes place as a continuation of its existing business. In that case, we believe that Ryanair must receive a VAT deduction in accordance with the VAT deduction entitlement that applies to its entire business activity, even if the share deal falls through. It can then be argued that the costs relate to its total business activity and thus are also part of its general overhead (and are included in the price of its plane tickets).

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