

Advocate General at CJEU: VAT deduction limitation for 'setting aside' capital raised in expectation of new investment

On May 14, 2020, Advocate General Kokott (hereinafter: AG Kokott or AG) at the Court of Justice of the European Union (hereinafter: CJEU) issued her Opinion in the Sonaecom case (C-42/19). The case concerns the deduction of VAT on professional services and investment banking fees for an intended share acquisition that was ultimately not realized. Although the CJEU had recently ruled on this in the [Ryanair case \(C-249/17\)](#), the present case is distinguished by the changed use of the capital that was raised to acquire the participation. According to the AG, by 'setting aside' the capital in an interest-bearing loan within the group, Sonaecom is faced with a VAT deduction limitation. As a result of the corona crisis, setting an investment on hold and holding the capital raised for it may occur more frequently. If the capital is held in expectation of a new investment, we believe it is possible to avoid a VAT deduction limitation.

1. Background

Sonaecom is a Portuguese holding company involved with the acquisition, holding and management of participations. In 2015 it wanted to acquire shares in Cabovisão, which is involved with audiovisual entertainment, telephony and internet. Sonaecom had market research performed with a view to the acquisition. It also engaged an investment bank to effectuate a bond issue. Sonaecom wanted to use the raised capital to acquire the shares in Cabovisão in order to subsequently perform services for it in exchange for a fee. It fully deducted the VAT charged on the professional services and on the investment banking fee.

The shares in Cabovisão were ultimately not acquired. In the meantime, Sonaecom set the raised capital aside by providing an interest-bearing loan to its parent company. The Portuguese tax authorities argued that Sonaecom should not have deducted the VAT on the professional services and the investment banking fee. On the one hand, because the VAT is attributable to a non-economic activity (the acquisition and management of a participation) and, on the other, because the VAT is attributable to a VAT-exempt activity (a loan to the parent company). The Portuguese court decided to ask the CJEU for a preliminary ruling on the VAT treatment.

2. AG Kokott's Opinion

AG Kokott starts by noting that in her view Sonaecom is a mixed holding company. Besides the wish to acquire the shares in Cabovisão, Sonaecom also intended to provide services to the subsidiary in exchange for a fee. The AG then addresses the amount of the VAT deduction on the professional services. She believes that Sonaecom has a full right to recover input VAT, regardless of the fact that no shares in Cabovisão were ultimately acquired. According to the AG, the professional services can be allocated directly to the intended acquisition of the participation and the subsequent envisaged VAT-taxed services. The fact that the acquisition ultimately does not proceed, therefore does not lead to the obligation to adjust the VAT previously deducted.

Although it is not clear what fee Sonaecom would have charged Cabovisão for its services, it is possible that the fee would be significantly less than the costs incurred for the professional services purchased. According to the AG, although this mismatch creates a feeling of unease, she firmly believes that the right to deduct VAT should not be limited in such cases.

The AG then addresses the VAT deduction in respect of the investment banking fee for the issue of bonds. She examines whether the intended VAT-taxed use of the capital is decisive for the VAT recovery right or whether it is the actual VAT-exempt use that is decisive. Sonaecom initially intended to use the capital to acquire Cabovisão, but when this did not proceed it set the capital aside by providing a loan to its parent company.

The AG believes that the actual use of the services is decisive for the VAT recovery right. The VAT on the fee paid to the investment bank is thus non-deductible. According to the AG, Sonaecom unsuccessfully argues that the capital was purely set aside at the parent company and was used later on to acquire participations in other companies. The AG believes that in that case there is no room to adjust the non-deductible VAT, because the services provided by the bank when issuing a bond loan are not related to a capital item that can be adjusted. According to the AG, the non-deductibility of the VAT on the investment banking fee is thus final.

3. Dutch practice and possibilities for VAT deduction

3.1 Is the VAT charged on professional services for the acquisition of a participation deductible?

In the Dutch practice, it is customary to regard the professional services purchased to acquire a participation as general overhead, provided there is an intention to perform services to the participation in exchange for a fee. This approach is based on previous CJEU case law. In the present case, AG Kokott has chosen another approach based on the relatively recent judgment in the Ryanair case (C-249/17). In those proceedings, the CJEU ruled that Ryanair had a full VAT recovery right, because the VAT on professional services was directly related to the intention to acquire all the shares in another company and to provide VAT-taxed services to that company. Should the CJEU decide to follow this Opinion, there may be a definite break with older case law and thus more room to fully recover the VAT on the acquisition of participations if VAT-taxed services are provided to those participations.

3.2 Is VAT on the costs for issuing bonds deductible after the destination for the raised capital has changed?

Unlike in the Portuguese Sonaecom case, the fee charged by an investment bank for issuing bonds would be exempt from VAT in the Netherlands. This means that any non-deductible VAT would not be an issue for taxpayers in the Netherlands. If VAT is payable by taxpayers on other types of services related to the issue of bonds, but the capital was then temporarily used for purposes other than the intended taxed transactions, this does not automatically mean that there is a VAT deduction limitation.

In order to ensure that VAT recovery is possible when temporarily setting aside capital in anticipation of a new investment, we suggest considering the following three possibilities:

- 1) The company that raised the capital provides an interest-bearing loan to a group company with which it forms a VAT group.
- 2) The company that raised the capital provides an interest-bearing loan to a group company that is established outside the European Union and this is moreover business-motivated.
- 3) Holding the capital in order to realize the acquisition of a participation at a later date, to which VAT-taxed services will be provided. In that case it is crucial that you are able to sufficiently demonstrate that this intention did indeed exist.

Moreover, it is questionable whether without these possibilities the VAT on the professional services that was deducted in an earlier period – in accordance with the intention for VAT-taxed use – would have to be adjusted if the designation of the raised capital only changes in a later VAT return period. It could be argued that the professional services were already used in an earlier period and therefore no adjustment has to be made in the Netherlands.

4. What can you do now?

If, due to circumstances, for example, as a result of the corona crisis, the intended acquisition of a participation cannot be realized, we recommend that you examine the VAT implications of this in more detail. In light of AG Kokott's Opinion in the Sonaecom case, there are various possibilities available to ensure the VAT on professional services is fully deductible. However, we will have to wait and see whether the CJEU follows the AG on this. Regardless of the outcome, it remains crucial that you identify, in advance, the VAT implications of an intended investment and consider the steps that will need to be taken in the unlikely event that the investment is not realized.

If you would like to discuss this Opinion, feel free to contact the advisors of Meijburg & Co's Indirect Tax Services Group or your usual advisor.

Meijburg & Co
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