KPMG Meijburg & Co Tax & Legal

CJEU does not allow VAT recovery for contribution in kind

On September 8, 2022, the Court of Justice of the European Union (hereinafter: CJEU) rendered judgment in the W-GmbH case (C-98/21). The case focused on the VAT recovery right of a holding company that performs VAT-taxed services and also purchases services which it subsequently contributes to its two subsidiaries. The CJEU ruled that in this specific situation there is no right to recover the VAT on costs directly attributable to the contribution. The CJEU seems to have taken the VAT position of the subsidiaries, which have virtually no VAT recovery right, into account. Although the judgment was what was expected, we nevertheless have several reservations about the way in which the CJEU arrived at its ruling.

1. Background and facts

W is a property developer established in Germany with a majority shareholding in two German participations (X and Y). The entities do not form a VAT group. Because the facts for both participations are similar, we will only deal with the participation in X.

W holds 94% of the shares in X. The remaining 6% is held by Z. Participation X performs activities that are largely exempt from VAT. An agreement stipulates that the two shareholders W and Z will make a contribution in kind (hereinafter: contribution) in their subsidiary X. Z's contribution is in cash (EUR 600,000). W's contribution consists of the free provision of services to X.

The services – worth EUR 9.4 million in proportion to the shareholding – comprise architectural services, static calculations, drawing up plans for heat and sound systems, energy supply and network connections, and general contracting activities for two buildings to be constructed by X, as well as putting them up for sale on the market. To perform these services, W uses some of its own personnel or equipment as well as purchasing goods and services from other businesses.

Under another agreement, W also performs accounting and management services for X for a consideration. These services include the recruitment and dismissal of personnel and the purchase of materials. The services that W should perform for the contribution are expressly excluded from the second agreement.

2. Grounds of the CJEU judgment

The CJEU ruled that a contribution is comparable with the holding of shares and thus is not an economic activity. Moreover, there is a direct and immediate connection between the costs incurred for this contribution and the activities of X, and therefore the costs cannot be regarded as general overhead of W. According to the CJEU, there is no direct and immediate connection between the purchased services and the management services performed by W, not even if W could not provide these management services without the other services contributed in X.

3. Analysis of CJEU Judgment

It was to be expected that the CJEU would refuse the VAT recovery at W in this proceeding. By allowing W to recover VAT – which X would not have been able to do if it had purchased the services contributed by W directly – the CJEU would have put the VAT system under pressure. Moreover, the CJEU would thus have opened the door to

VAT savings structures. In recent case law, the CJEU has ruled against taxpayers several times in cases that dealt with VAT savings structures, for example in the judgment in the Paul Newey case (C-653/11).

Nevertheless, we still have a number of reservations about the reasons given by the CJEU for excluding VAT recovery at W. Because the CJEU did not use the doctrine of abuse in this judgment, there is a risk that the chosen approach will be interpreted broadly, which is not desirable. The CJEU noted unequivocally that the contribution is an independent non-economic activity. This is because the CJEU equated the contribution with the holding of shares. However, in certain circumstances the holding of shares is indeed an economic activity. We believe that this should also apply to the contribution, because the contribution does not always have to be an end in itself but is often also a means to carry on or strengthen a business. If we look at what the CJEU has steadfastly ruled in its judgments on the holding of shares – in the context of a contribution – we see the following potential situations:

1. The holding company performs taxable activities for its participation (in which it performs a contribution).
2. The activity (contribution) is a direct, permanent and necessary extension of the taxable activity (of management services performed for a consideration and/or of the contributor's business).
3. The contribution relates to (an independent part of) a business.

Given the context of the present case, we will only deal with option 1. In holding shares and providing management services for a consideration, W is solely performing activities that give rise to a full VAT recovery right. We believe W is thus holding the shares in X entirely as an economic activity. This qualification as economic activity – consisting of the performance of taxable activities for the participation – should in principle be in line with the CJEU judgment in Larentia + Minerva (C-108/14 and C-109/14). In our view, the contribution is then in essence inextricably connected to the taxable activities of the holding company.

However, in the present case the CJEU ruled that the contribution must be regarded as an – apparently – separate non-economic activity. In doing so, we wonder whether the CJEU has thus artificially split the holding of shares in two. We believe it could be argued that if the holding of shares is an economic activity for VAT purposes – due to the fact that the holding company performs taxable activities for its participation – any contribution that may be performed does not then mean that a new 'non-economic activity' arises. The CJEU seems to have taken that step. Under that approach, the VAT charged on purchases that is attributable to the contribution, is then not eligible for recovery. The CJEU thus seems to be pursuing a twofold approach in order to exclude the VAT recovery. Firstly, the VAT charged on purchases is not directly attributable to the activities of W, but to those of X. Moreover, the CJEU ruled that the contribution is a non-economic activity for W and that the associated attributable VAT charged on purchases is not eligible for recovery. It is therefore not clear to us which approach was decisive for the CJEU.

4. Impact on Dutch practice

We believe that case law as developed by the CJEU with regard to the problem of the holding company and VAT recovery has not changed. Furthermore, the facts dealt with in this judgment are quite specific. However, what the case does show is that activities concerning shares always seem to have their own special implications for VAT, which require customized solutions.

5. What can you do now?

The VAT recovery position of holding companies is continually in flux and frequently leads to disputes. It is extremely important to consider the VAT implications of the different options. The tax advisors of KPMG Meijburg & Co's Indirect Tax Group would be happy to see what opportunities are available for your specific situation. Please feel free to contact one of them or your regular advisor.

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