Deduction of VAT by holding companies – The Larentia and Minerva case

Indirect Tax

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The CIOT has provided comments to HMRC on the input tax deduction implications of *Larentia and Minerva*

Key Points

- The case is not just about holding companies – it is also about acquiring interests in partnerships and similar entities
- We have suggested that the matter is quite complex and requires careful attention
- We have previously commented on the VAT grouping issues arising from this case

Background

We have provided input to HMRC on how to apply the ECJ judgment in *Beteiligungsgesellschaft Larentia and Minerva mbH & Co. KG v Finanzamt Nordenham C-108/14 and another*.

The case concerned two issues:

- eligibility of an entity to form part of a VAT group; and
- the deduction of VAT on costs incurred in acquiring an interest in such an entity.

In our response, we pointed out that the entities involved in the case were in fact limited partnerships, not holding companies and their subsidiaries. This, we argued, was significant because it meant that the principles applied not only to companies but also other entities that may not in fact be legal persons.

The deduction principles

We provided HMRC with some diagrams of a number of situations in which the principles emerging from *Larentia and Minerva* should be applied.

The first key principle was that, when an entity of any description that already undertakes an economic activity or as a result of the acquisition of an entity becomes economically active, the VAT on costs associated with the acquisition are intrinsically input tax and is therefore deductible (subject to any partial exemption limitations). There is no need to restrict the deduction for any non-economic activity because there is no direct link between the input tax and the non-business element – say, dividend income.

The second principle was that, when an entity (such as a holding company) acquires a target which becomes a single taxable entity (or VAT group) that undertakes an economic activity, it is necessary to bear in mind that there is then only one entity. The individual entities must then be ignored and the deductibility of VAT incurred must be based on the situation of the single taxable person.

Some detailed comments

Incurred by the taxable person

We commented on the view held by HMRC that an apportionment of VAT incurred may be necessary if it was incurred to acquire more than one entity, one or more of which were not active. We noted that there could be no blanket rule because several situations were possible. We also distinguished between apportioning VAT on acquisition costs and apportioning VAT on general overheads. In the case of acquisitions an apportionment may be needed but it should be borne in mind that the deduction principle allows a deduction for VAT and has a direct and immediate link to an economic activity.

We also addressed the issue of who should be the person regarded as the recipient of a supply on which VAT was incurred, bearing in mind that VAT is deductible only if it is incurred by a taxable person in the course or furtherance of a business (economic activity).

We then pointed out that, in the case of *Belgische Staat v Ghent Coal Terminal* (C-37/95), the ECJ held that preliminary costs on investment activity were deductible regardless of whether the planned investment took place, so there is no need for the VAT to be incurred after the decision to acquire. In this connection, we noted that a deduction might also be possible by an intending investor before the formation of a new entity (*Kopalnia Odkrywkowa Polski Trawertyn P Granatowicz, M Wąsiewicz spółka jawna v Dyrektor Izby Skarbowej w Poznaniu* (C-280/10).

Is the ‘acquirer’ undertaking an economic activity?

There have been arguments that a ‘holding company’ must make supplies to the target for VAT to be deductible. We pointed out that this should not be the case. For instance, the holding company may acquire a property or other business in order to obtain access to the property of the acquirer. Further, the act of acquiring a target can result in the acquirer becoming active.

The impact of VAT grouping

Here we noted that the impact of forming a VAT group is that the entities lose their identity in so far as the economic activity undertaken by the group is concerned. That means that, when considering deductibility, one need only to look at the group rather than how it is formed.

Conclusion

We await guidance from HMRC but we believe that the issues above need to be considered in determining the impact of the decision on VAT deductions. It is perhaps also worth noting that other VAT deduction issues may be indirectly impacted – for example, what adjustments need to be made when an entity ceases to be part of a single taxable person.