

News Flash

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ECJ Judgement: The ECJ examined the right of the holding company to deduct input VAT

The ECJ examined the right of the holding company to deduct input VAT

In this edition of our News Flash, we present a case recently decided by the European Court of Justice (ECJ), which concerns the application of **the right to deduct VAT** from services that were the subject of a **non-monetary contribution by a partner to subsidiaries**.

In judgment C-98/21 from 8 September 2022, the ECJ deals with the question, whether a managing holding company that provides taxable output services in the form of management and accounting services to its subsidiaries has the right to deduct tax from the services which are received from third parties. These services are contributed to subsidiaries for a share in the general profit.

The German tax authority refused to recognize the right to deduct input VAT

The judgment concerns the German company W, which through VAT returns deducted the entire VAT amount paid on the input from transactions. These transactions were subsequently put as a non-monetary contribution by the partner to subsidiaries, as well as transactions related to the **provision of accounting and management services for consideration**.

The German tax authority refused to recognize the right to deduct input VAT, arguing that the amounts paid as input VAT in connection with the partner's non-monetary contribution to the subsidiaries due to their gratuitous nature, do not constitute **the subject of a commercial exchange** and should qualify as non-taxable activities, from which **do not have the right to claim VAT deduction**.

The case reached the Federal Court of Germany, which decided to suspend the proceedings and ask the ECJ preliminary questions related to the holding company's right to deduct input VAT from transactions, which the holding puts in subsidiaries for a general profit share. However, these fulfilments are not directly related to taxable transactions provided to subsidiaries and do not belong to the general cost elements of the holding company's own economic activity.

The right to deduct VAT in holding companies – rules according to the ECJ

According to the ECJ, what conditions need to be considered when applying VAT deduction in the case of holding company activities?

- According to the VAT Directive, a company is entitled to apply VAT deduction if it has the status of a taxable person and uses goods and services from which input VAT is deducted **for the purposes of its own taxable output**.
- If the holding company carries out taxable output transactions to its subsidiaries, it may be entitled to deduct the input VAT paid. However, this right exists only if the input transactions are directly related to the holding company's own transactions and if these transactions are **reflected in the price** of the output transactions or if they are **part of its general costs**.
- A holding company whose sole purpose is the acquisition of shares in other companies does not have the right to deduct VAT.
- In assessing whether there is a direct and immediate connection between the input transactions and the output transactions, **all the circumstances and the actual use** of the acquired services must be assessed.
- If the acquired services **are not directly related to the output taxable transactions** of the holding company, but with the transactions of the subsidiaries, this holding company is not entitled to deduct VAT paid on the input.

Summary of ECJ judgment on input VAT deduction

In the given case, the ECJ states that the holding company, which carries out output transactions in favour of its subsidiaries (management and accounting services) **does not have the right to deduct input VAT** from fulfillment procured from third parties, which are then put into subsidiaries for a share in total profit. This applies if:

- the input transactions are not in a direct and immediate connection with the holding company's own transactions, but with the transactions of subsidiaries,
- these input transactions are not reflected in the price of taxable transactions provided to subsidiaries
- and the transactions do not belong to the general costs of the holding company's own economic activity.

In the judgment, the ECJ again emphasized the **necessity of a connection between input transactions** with output transactions. The argument of insufficient proof of this connection with output transactions is increasingly becoming a reason for additional tax collection in the case of tax controls. You can read about practical problems related to tax controls in our previous news.

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