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HOLDING COMPANIES PUT TO THE VAT TEST

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In considering the VAT treatment of holding companies, it is necessary to keep in mind the fundamental concepts on which the EU VAT regime is based. Article 2 of the First VAT Directive[2] provides that the principle of the common system of VAT involves 'the application to goods and services of *a general tax on consumption exactly proportional to the price of the goods and services,* whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged.[3]

VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, is chargeable on each transaction after deduction of the amount of VAT borne directly by the various cost components. The mechanism of input VAT deduction is governed by Article 17(2) of the Sixth Directive – taxable persons are authorised to deduct the VAT incurred on costs from the output VAT for which they are liable.[4]

VAT is a tax on turnover. This fundamental principle implies that only economic activity carried out in a regular fashion by a taxable person falls within the scope of VAT.[5]

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2 First Council Directive of 11th April 1967 (67/227/EEC) - italics supplied.

3 Cf. Joined Cases C-93/88 and C-94/88 *Wisselink en Co. BV and Others* [1989] ECR I-2671.

4 For the scope of Article 17.2 of the Sixth Directive, see Case C-291/92 *Finanzamt Uelzen v Dieter Armbrecht* [1995] ECR I-2775 at paragraph 27 et seq.

5 For the VAT characteristics, see Case C-252/86 *Gabriel Bergandi v Directeur Général des Impôts* [1988] ECR I-1343; Joined Cases C-93/88 and C-94/88 *Wisselink en Co. BV and Others* [1989] ECR I-2671; Case C-109/90 *NV Giant* v *Gemeente Overijse* [1991] ECR I-1385; Case C-200/90 *Dansk Denkavit ApS and P Poulsen Trading ApS v Skatteministeriet* [1992] ECR I-2217, Case C-347/90 *Bozzi* v *Cassa Nazionale di Previdenza ed Assistenza a favore degli Avvocati e dei Procuratori Legali* [1992] ECR I-2947; Case C-208/91

A company carries out three types of activity (in chronological order):

(1) Preparatory activities, such as the acquisition of operating assets;[6]

(2) Economic activity in the operational stage – generation of turnover;

(3) Attribution of profit/loss (ascertainment of the company's year-end results).[7]

1 What is A Holding Company?

According to the European Court, a holding company is a company that 'holds' other companies.[8] The European Court also ruled that a holding company's business consists 'wholly or mainly in the holding of shares in subsidiaries'.[9]

2 What is the Vat Status of A Holding Company?

2.1. Passive Holding Company

A passive holding company, for this purpose, is a company which does no more than acquire shares in subsidiaries and receives dividends from those investments. The European Court has decided that 'Article 4 of the Sixth Directive must be interpreted that a holding company whose sole purpose is to acquire holdings in other undertakings, does not have the status of taxable person for the purpose of VAT and

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Beaulande v *Directeur des Services Fiscaux, Nantes* [1992] ECR I-6709; Case C-130/96 *Fazenda Pública v Solisnor-Estaleiros Navais SA* [1997] ECR I-5053; Case C-28/96 *Fazenda Pública v Fricarnes SA* [1997] ECR I-4939; Case C-347/95 *Fazenda Pública v União das Cooperativas Abastecedoras de Leite de Lisbao, UCRL (UCAL)* [1997] ECR I-4911; Case C-318/96 *SPAR Österreichische Warenhandels AG v Finanzlandesdirektion für Salzburg* [1998] ECR I-785.

6 See, inter alia, Case C-97/90 *Lennartz v Finanzamt München III* [1991] ECR I-3795, paragraph 13 (at end).

7 Case C-142/99 *Floridienne SA and another v Belgian State* 14th November 2000 at paragraph 22.

8 See, to that effect, Case C-28/95 *Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2* [1997] ECR I-4161, paragraph 42.

9 Case C-264/96 *Imperial Chemical Industries plc v Colmer* [1998] ECR I-4695, paragraph 30 regarding Article 52 of the Treaty.

therefore has no right to deduct tax under Article 17 of the Sixth Directive'.[10]

The mere acquisition of holdings in other undertakings does not amount to the exploitation of property for the purpose of obtaining income therefrom on a continuing basis because any dividend yielded by that holding is merely the result of ownership of the property.[11] The holding of such an acquisition cannot be regarded as constituting an economic activity in the sense required by Article 4(2) of the Sixth Directive. This implies that a passive holding company which acquires shares with the purpose of retaining them and obtaining dividend income, does not carry out an economic activity in the sense of Article 4(2).[12]

When a holding company has sources of income, other than dividends received from companies in which it has a shareholding, and carries out only a passive management function, does this lead one to conclude that such a holding company loses its remarkable and exceptional status of a non-taxable person?

2.2. Mixed Holding Company

A 'mixed' holding company is a company that is actively involved in the management of the companies in which it holds its participations.

Such a holding company is a taxable person since it carries out an economic activity.[13] This was explained for the first time in paragraph 19 of the *Floridienne*

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10 Case C-60/90 *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen, Arnhem* [1991] ECR I-3111 at paragraph 17. See, to that effect, Paul Farmer, EC Tax Journal [1997] 2/1 p. 41-48.

See also Case C-142/99 *Floridienne SA and another v Belgian State* 14th November 2000 at paragraph 17, Case C-16/00 *Cibo Participations SA v Directeur régional des impôts du Nord-Pas-de-Calais* 27th September 2001 at paragraph 18.

11 Case C-333/91 *Sofitam SA v Ministre chargé du Budget* [1993] ECR I-3513 at paragraph 12, Case C-80/95 *Harnas & Helm CV v Staatssecretaris van Financiën* [1997] ECR I-745 at paragraph 15, Case C-16/00 *Cibo Participations SA v Directeur régional des impôts du Nord-Pas-de-Calais* 27th September 2001 at paragraph 19.

12 Case C-142/99 *Floridienne SA and another v Belgian State* 14th November 2000 at paragraph 19, confirmed by Case C-102/00 *Welthgrove BV* v *Staatssecretaris van Financiën* 12th July 2001 at paragraph 17.

13 Case C-60/90 *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen, Arnhem* [1991] ECR I-3111 at paragraph 14, Case C-142/99 *Floridienne SA and another v Belgian State* 14th November 2000 at paragraph 18, Case C-16/00 *Cibo Participations* 27th September 2001 at paragraph 20.

case[14] where the European Court decided that involvement of that kind in the management of subsidiaries must be regarded as an economic activity within the meaning of Article 4(2) of the Sixth Directive, provided that it involves carrying out transactions which are subject to VAT by virtue of Article 2.[15]

The acquisition of the status of taxable person by a holding company results from the following three elements, each of which is discussed in more detail below:

1. The acquisition of shareholdings in other companies.

2. With the purpose of taking an active role vis-à-vis the activities of the subsidiary companies – this is what the European Court refers to as 'involvement'; and

3. Active involvement of the holding company in the activities of the subsidiary companies, resulting in turnover in the sense of Article 2 of the Sixth Directive.

A mixed holding company is normally a partially taxable person for VAT purposes. A partially taxable person for this purpose is a taxable person who carries out an activity which is within the scope of VAT as well as an activity which is outside the scope of VAT. An example of this would be a holding company that receives income from its investment portfolio (outside the scope) and also fees for supplies of services, for instance for legal and accounting services (taxable).

A partially taxable person must be distinguished from a 'mixed taxable person' which is a person who carries out both taxable and exempt transactions. All the transactions carried out by a mixed taxable person fall within the scope of VAT.

3 Holding Companies - Sources of Income Other Than Turnover

3.1 Dividends

A final dividend results from the distribution of the profits of a company as determined by decision of the general shareholders' meeting at the end of the accounting year. The right to declare a dividend is exclusively that of the shareholders. The amount of dividend received is determined by reference to the

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14 Case C-142/99 *Floridienne SA and another v Belgian State* 14th November 2000.

15 See also, to that effect, Case C-16/00 *Cibo Participations SA v Directeur régional des impôts du Nord-Pas-de-Calais* 27th September 2001 at paragraph 21.

number of shares held. The right to a dividend constitutes a fundamental right of the shareholder and economically is remuneration on capital.

Dividends are not the consideration for a taxable transaction.

In the *Satam Case* [16] the European Court decided that 'since the receipt of dividends is not the consideration for any economic activity within the meaning of the Sixth Directive it does not fall within the scope of VAT. Consequently, dividends resulting from holdings fall outside the deduction entitlement'.[17] 'Consequently, dividends must be excluded from the calculation of the deductible proportion referred to in Articles 17 and 19 of the Sixth Directive if the objective of wholly neutral taxation ensured by the common system of VAT is not to be jeopardised'.[18] This has been confirmed by the European Court in the *Régie Dauphinoise* case.[19]

As a result, the mere passive receipt of dividends does not constitute an economic activity for VAT purposes as it is purely the ownership of the share and nothing more that gives rise to the right to the dividend. Such an operation is outside the scope of VAT.

3.2. Interest

Three possibilities need to be distinguished:

1. The interest income results from the acquisition and holding of bonds.

   This constitutes a transaction outside the scope of VAT, as is the case for dividends. The interest received is linked with the mere ownership of securities.[20]

   This corresponds to the context of the *Polysar* and *Harnas & Helm* cases.

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16 Case C-333/91 *Satam SA v Ministre chargé du Budget* [1993] ECR I-3513, solution adopted in France by the Conseil d'Etat, 18th March 1994, No. 61 379.

17 Case C-333/91 *Satam SA v Ministre chargé du Budget* [1993] ECR I-3513 at paragraph 13.

18 Case C-333/91 *Satam SA v Ministre chargé du Budget* [1993] ECR I-3513 at paragraph 14.

19 Case C-306/94 *Régie Dauphinoise - Cabinet A Forest SARL v Ministre du Budget* [1996] ECR I-3695 at paragraph 17, solution adopted in France by the Conseil d'Etat, 27th December 1997 No. 140 829.

20 Case C-80/95 *Harnas & Helm CV v Staatssecretaris van Financiën* [1997] ECR I-745.

2. Interest income is received from loans made in the framework of a reinvestment, outside an economic activity.

   As is the case with dividends received, this receipt is also considered to arise from a transaction outside the scope of VAT.

   This was the case in *Floridienne*.[21]

3 Interest is received from placing capital at the disposal of a third party as part of a specific economic activity or as the direct and necessary prolongation of a taxable activity. In such case, the operation falls within the scope of VAT and influences the right of input VAT recovery.

   This is derived from the *Régie Dauphinoise* and *Floridienne* cases.

According to the European Court, the subjection of loan operations to VAT presupposes that they consist of either an economic activity in the sense of Article 4(2) of the Sixth Directive, or are the direct, permanent and necessary extension of a taxable activity, and not incidental to this activity in the sense of Article 19(2) of the Sixth Directive.[22] In order to be such a specific economic activity from a VAT perspective, that activity needs to be carried out with a business or commercial purpose, characterised by, in particular, a concern to maximise returns on capital investment.[23]

'Commercial purpose' refers, for instance, to the activity of a bank, whose purpose generally is to realise a profit on the difference between interest paid on borrowed money and interest received on money lent. 'Business purpose' refers to the notion of a direct, permanent and necessary extension of a taxable activity.

Should the concern to maximise the return on capital investment be analysed from both a commercial perspective and a business perspective? In the writer's opinion, based on the decision in *Floridienne* that question should be answered in the affirmative - the interest received should relate to a business purpose or a commercial purpose in that it is linked with a concern to maximise return on capital investment.

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21 Case C-142/99 *Floridienne SA and another v Belgian State* 14th November 2000 .

22 Case C-306/94 *Régie Dauphinoise - Cabinet A Forest SARL v Ministre du Budget* [1996] ECR I-3695 at paragraph 22.

23 Case C-142/99 *Floridienne SA and another v Belgian State* 14th November 2000 at paragraph 28, in fine.

In *Harnas & Helm* the European Court insisted that a supply of services which consisted of the making available of funds to a third party could not be an economic activity. The placing of the funds at the disposal of a third party must meet certain other requirements in order to fall within the scope of VAT - there must be an activity by which a tangible or intangible good is exploited in order to obtain income on a continuing basis.

The Court has stated that the activity must be carried out with a business purpose. Moreover, it seems that a holding company cannot be assimilated with a professional lender which is guided by a commercial purpose when lending money.

The professional activity of negotiation of securities presupposes that the professional lender provides services to its clients and is not a mere consumer of services. This brings us to the key notion of a client or clientele for credit transactions. The reference to a client is clearly relevant to distinguish a loan in the framework of an economic activity from a loan by a holding company outside any economic activity.

It is essential in this context that the credit transactions are rendered to third parties (clients). The Opinion of Advocate General Fennelly in *Floridienne* gives a good illustration of this. After demonstrating that the loans granted by a holding company are not economic operations, he reminded the court that it was necessary that the taxable person render services to clients.[24]

A holding company does not lend money to clients – it does not have 'clients' – nor does a holding company act as an entrepreneur in the *Rompelman* [25] sense. The role of a holding company making loans to its subsidiaries reflects more that of a co-ordinator of the financial policies of the group, with the legitimate concern of ensuring the solvency of the companies in which it holds shares. This is clearly different from a company acting from a commercial or business perspective and

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24 The Advocate General underlined that:

> 'while financially the lending activity of a bank and that of the applicants vis-à-vis their subsidiaries would differ little, the economic nature of their underlying activities is different' (see paragraph 35 of his Opinion)... 'for such lending activity to be carried on an economic basis for VAT purposes, the supposed grantor of credit must engage in the activity in question not only on an ongoing basis, a condition satisfied here, but also for commercial purposes, which, to my mind, are absent where it is clear that the sums lent were lent to subsidiaries within the same corporate group for the purposes of permitting the latter to carry on their commercial activities vis-à-vis third parties' (see paragraph 36 of his Opinion).

25 Case C-268/83 *Rompelman* v *Minister van Financiën* [1985] ECR I-655.

concerned to maximise its return on investment.

A holding company could be compared in some senses to a private investor. Indeed, where a holding company makes capital available to its subsidiaries, that activity may be considered to be an economic activity provided that it is not confined to managing an investment portfolio in the same way as a private investor.[26]

In the unlawful state aid cases, the European Court has investigated whether a capital injection by a public body could be compared to the conduct of a private investor. The Court decided that the private investor with whom the public investor pursuing economic policy aims must be compared was not the ordinary investor laying out capital with a view to realizing profit in the relatively short term, but was a private holding company or a private group of undertakings pursuing a structural policy – whether general or sectoral – guided by the prospect of profitability in the longer term.[27]

This supports the idea that a holding company acts to some extent like the manager of the financial policy of the group, within the framework of services of governance, so that the holding company obtains, by the means of its subsidiaries, the hoped-for profits. In other words, the holding company only makes loans to its subsidiaries in order to secure their financial health and thus profits. A holding company's objective when making loans is different from a financial institution's objective. Pursuing the same train of thought, a holding company can choose to sustain the losses in its subsidiaries enabling it to close down business in the best circumstances. A holding company does this, not only to achieve some indirect profit, but also for reasons of the group's image or the refocusing of the group's activities.

3.3 Other income

Transactions in Shares

In what cases can transactions in shares (in the sense of Article 13(B)(d)5 of the Sixth Directive) be regarded as constituting an economic activity?

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26 See Case C-155/94 *Wellcome Trust Ltd v CCE* [1996] ECR I-3013, at paragraph 36; Case C-230/94 *Enkler v Finanzamt Homburg* [1996] ECR I-4517, paragraph 20 and Case C-142/99 *Floridienne SA and another v Belgian State* 14th November 2000 at paragraph 28.

27 See Case C-305/89 *Commission v Italy 'Alfa Romeo'* [1991] ECR I-1603 at paragraph 20; Court of First Instance, Cases T-129/95, T-2/96 and T-97/96 *Neue Maxhütte Stahlwerke – Lech-Stahlwerke* [1999], ECR II-17 at paragraph 109 and Case T-296/97 *Alitalia spa v Commission* 12th December 2000 at paragraph 96.

The European Court consistently distinguishes between three situations in this area:[28]

(1) Transactions carried out as part of a commercial share-dealing activity;[29]

(2) Transactions carried out in order to secure a direct or indirect involvement in the management of the companies in which the shareholding has been acquired;[30]

(3) Transactions which constitute the direct, permanent and necessary extension of the taxable activity (three associated criteria).[31]

In the *Wellcome* case, the European Court decided that the purchase and sale of shares by a sole trustee in the framework of management of the assets of a charitable trust was outside the scope of VAT. The trust was forbidden to engage in transactions in shares, interests in companies or associations, debentures and other securities and was instead required to make all reasonable efforts to avoid engaging in trade when exercising its powers while being precluded from taking majority shareholdings in other companies.[32]

The European Court has also decided that the mere acquisition and holding of bonds, activities which are not subservient to any other business activity, and the receipt of income therefrom are not to be regarded as economic activities conferring on the person concerned the status of a taxable person.[33] The Court thus refuses to consider that the mere management of an investment portfolio can be assimilated with an economic activity.

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28 See Case C-80/95 *Harnas & Helm CV v Staatssecretaris van Financiën* [1997] ECR I-745 at paragraph 16.

29 See Case C-155/94 *Wellcome Trust Ltd v CCE* [1996] ECR I-3013, paragraph 35.

30 Case C-60/90 *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen, Arnhem* [1991] ECR I-3111 at paragraph 14 and Case C-155/94 *Wellcome Trust Ltd v CCE* [1996] ECR I-3013, at paragraph 35.

31 Case C-306/94 *Régie Dauphinoise - Cabinet A Forest SARL v Ministre du Budget* [1996] ECR I-3695 at paragraph 18 – as the ECJ does not set out a quantitative threshold for the last criterion ('necessary'), does that mean that the ECJ recommends a qualitative criterion?

32 See Case C-155/94 *Wellcome Trust Ltd v CCE* [1996] ECR I-3013 at paragraph 35 in fine.

33 See Case C-80/95 *Harnas & Helm CV v Staatssecretaris van Financiën* [1997] ECR I-745.

Share-Dealing

A trader in shares is different from a holding company. A share-dealing company holds shares in order to sell them in accordance with the company's objective or with a commercial purpose. This implies that a share-dealing company has concluded contracts with third parties (its clients); the share-dealer normally acquires and sells shares for the account of these clients. Consequently, it is necessary that the share-dealing company renders services to its clients without it being a mere consumer of services.[34] In other words, the sale of shares constitutes an economic activity when it is accompanied with the supply of related services. The transfer of titles in such situation constitutes an economic activity.

Placement of Shares and Securities in Treasury

This category contains the shares and securities that are merely held as a long term investment, to harvest the proceeds without the intention of being involved in the management of the company in which the shareholding is acquired. Such an acquisition is simply made in the interest of good management of a company's patrimony.

The acquisition by a holding company of securities in order to realize short-term gains would be considered to be speculation, which would not be regarded as an economic activity for VAT purposes since it is does not require active involvement evidenced by supplies of services.

4 Holding Companies - Turnover

In order to determine the notion of turnover, one has, in accordance with Advocate General van Gerven's Opinion in *Satam*,[35] to look at the normal meaning of the word 'turnover', that is, the amount of sales of goods and services to third parties resulting from a regular economic activity of a company, taking into account price reductions or rebates. In this respect, Advocate General van Gerven refers to Article 28 of Directive 78/660/EEC relating to the annual accounts of certain companies, which defines the notion of 'net turnover' in order to complete the profit and loss account:

> 'net turnover shall comprise the amounts derived from the sale of products and the provision of services falling within the company's ordinary

34 See Case C-80/95 *Harnas & Helm CV v Staatssecretaris van Financiën* [1997] ECR I-745.

35 Case C-333/91 *Satam SA v Ministre chargé du Budget* [1993] ECR I-3513.

activities, after deduction of sales rebates and of value added tax and other taxes directly linked to the turnover'.[36]

Involvement

This concept is especially difficult to understand and also difficult to elucidate. Involvement depends on the intention of the acquirer of the shares – the shareholder must acquire its shares with an 'active' intention.

Since *Polysar*, the European Court has seemed to grant an entity the status of taxable person by reason of 'inward' transactions (i.e. acquisitions of shareholdings) or, more accurately, in the light of the intention of the shareholder in acquiring the shares. This could give the impression that transactions in shares or securities are only exceptionally part of an economic activity. The European Court has, however, ruled that involvement in the management of subsidiaries must be regarded as an economic activity within the meaning of Article 4(2) of the Sixth Directive in so far as it entails carrying out transactions which are subject to VAT by virtue of Article 2 (such as the supply of administrative, financial, commercial and technical services by a holding company to its subsidiaries).[37]

One of the pre-requisites for involvement is that the shareholding should be acquired on a long-term basis (sufficient to make the involvement possible). Subsequently, the involvement should result in transactions falling within the scope of VAT; only then can a holding company be regarded as a VAT taxable person.

The main pointers in this respect are:[38]

– Having significant influence in the management of other companies is not, as such, sufficient to enable a holding company to be regarded as a taxable person;

– If a holding company does not carry out transactions subject to VAT in the sense of Article 2 of the Sixth Directive, the holding company will not be

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36 Fourth Council Directive 78/660/EEC of 25 thJuly 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies – O.J. L222, 14.08.1978, p. 11.

37 Case C-142/99 *Floridienne SA and another v Belgian State* 14th November 2000 at paragraph 19; Case C-16/00 *Cibo Participations SA v Directeur régional des impôts du Nord-Pas-de-Calais* 27th September 2001 at paragraph 21.

38 See Y. Bernaerts, 'Holding, limites particulières du champs d'application', pieces extracted from the presentation of 10th May 2001, at a seminar organized by Van Ham & Van Ham in Brussels under the presidency of Prof. Marc Dassesse.

a taxable person;

– A holding company which is a taxable person will have this status from the moment at which shareholdings are acquired with the intention of involvement in the management of the companies in which the shares are acquired. Indeed, 'it is the acquisition of goods or services by a taxable person acting as such that gives rise to the application of the VAT system and therefore of the deduction mechanism'[39].

Involvement cannot be merely theoretical although the holding of majority shareholdings could indicate the intention to be involved in the management leading to qualification as a taxable person. This intention should then materialise in the carrying out of taxable transactions, revealing unequivocally involvement in the acquired undertakings.

The concept of active involvement implies that one or more taxable output transactions are carried out with which the involvement is closely linked.[40] These transactions should be thus an objective and necessary consequence of the involvement. Management services carried out for a consideration give substance to the intention of involvement in the acquired undertaking.

Other services can also substantiate the necessary involvement, for instance advisory services, accounting services, marketing services, joint R&D projects.[41] The impact and size/scope of such services determine the degree of involvement by the holding company.

On the one hand, the concept of involvement is subjective depending on the intention of the holding company, while on the other hand, the transactions which substantiate the involvement are an objective and necessary consequence of the involvement.

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39 Case C-97/90 *Lennartz v Finanzamt München III* [1991] ECR I-3795 at paragraph 15 and Case C-400/98 *Finanzamt Goslar* v*Breitsohl* [2000] ECR I-4321 at paragraph 35.

40 Case C-142/99 *Floridienne SA and another v Belgian State* 14th November 2000 at paragraph 19; *Welthgrove BV* v *Staatssecretaris van Financiën* 12th July 2001 at paragraph 17, Opinion of Advocate General Stix-Hackl; Case C-16/00 *Cibo Participations SA v Directeur régional des impôts du Nord-Pas-de-Calais* 27th September 2001 at paragraph 22.

41 See, in France, Tribunal Administratif Poitiers, 25th February 1999 in Revue de Droit fiscal No. 25/1999 and TA Besançon, April 6, 2000, in Revue de droit fiscal No. 52/2000

N.B. In relation to input tax deduction, this domestic case law is strictly speaking void after the *Cibo Case* despite the same result (see the comment on the *Cibo Case* post).

Direct involvement is exercised directly by a holding company while indirect involvement is exercised through subsidiaries. The legal entity that plans to be involved in the management of other undertakings can make its involvement concrete only by carrying out transactions itself or through another person acting on its behalf. Where involvement is through the taxable activities of a third party, the subsidiary in the case we are considering here, the involvement is indirect and can only be subject to VAT on the basis of a supply for consideration between the holding company and its subsidiary.

5 Holding Companies - Management Fees

If a company is involved in the management of another company through the appointment of a director, or in accordance with a specific shareholder agreement whereby it has the power to enforce management policy, this activity falls within the scope of VAT (if carried out for consideration) and is deemed to take place at the business establishment of the supplier.[42] This viewpoint is based on the *von Hoffmann* case[43] and is applicable to management services in Belgium and in the Netherlands.[44]

Two issues need to be emphasised regarding management services.

The first issue concerns the profit shifting from a subsidiary to a parent company. For fiscal purposes, it may be decided to shift a profit earned by a subsidiary company to its parent. In order to do this, the parent can charge a management fee to its subsidiary, without there being an actual supply of services.[45]

Regarding the second issue, the Belgian viewpoint as evidenced by an administrative decision of 19th October 1999 is that no distinction is made for VAT purposes between the case where the management function is carried out as director or as the result of a specific contract. The fact that both situations have identical

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42 Article 9 (1) of the Sixth Directive, see to that effect the administrative decision of the Belgian VAT Authorities dated 19th October 1999, N° E.T. 95.797 in Revue TVA 145.

43 See Case C-145/96 *von Hoffmann v Finanzamt Trier* [1997] ECR I-4857.

44 See, to that effect, Hoge Raad der Nederlanden, 1st March 2000, N° 35.206. N.B. The same viewpoint exists in the UK but is not in Austria, France and Spain.

45 See Bomer and Van Kesteren, 'Concernproblematiek: belastbaarheid van kostendoorberekeningen', Weekblad voor fiscaal recht, 2001/6442, 12th July 2001, page 967.

consequences may seem strange.[46] If the consideration for management activities consists of a share of annual profits, could it be regarded as the counterpart of a taxable supply of services?

In this respect, the following question also arises: when a holding company acts as director of another company, does the management fall within the scope of VAT or is such activity as a mere internal operation? In order to answer this question it is necessary to focus on the concept of the independence of a taxable person within the meaning of Article 4(4) of the Sixth Directive.

The Holding Company as Director

Concept of independence

Article 4(4) of the Sixth Directive determines what does not fall under the word 'independently'. In order to be independent, there should not be any legalities creating the relationship of employer and employee as regards:

(a) working conditions

(b) remuneration and

(c) employer's liability.

The European Court has confirmed that employed persons and other persons bound to an employer by a contract of employment or by any other legal ties creating the relationship of employer and employee are not within the scope of VAT.[47]

A French case, that might be challenged for other reasons, evaluates the status as taxable person on the basis of the legal status of the person concerned: only natural persons can be regarded as not acting independently within the meaning of Article 4(4) of the Sixth Directive[48] since it is impossible, with respect to legal persons, to identify a relationship of employer and employee.[49] According to that French case

46 See in this respect, Y. Bernaerts, 'La localisation des prestations de services – Etat des lieux - 2 ème partie' in Comptabilité et fiscalité pratique, Kluwer, March 2001, page 97.

47 See Case C-202/90 *Ayuntamiento de Sevilla v Recaudadores de las Zonas Primera y Segunda* [1991] ECR I- 4247.

48 Transposed as Article 256 A, second indent of the French CGI.

49 See CAA Nantes, 16th December, 1997, Tardieu Consultant, in Revue de Droit fiscal, No. 19/1998.

therefore, legal entities are always acting independently.

The 'organ theory'

Following the Opinion of Advocate General Fennelly in the *Floridienne* case, a holding company also carries on activities through its organs. These activities, in so far as they are conducted within the company (for example, in its relations with the shareholders and the company's own organs), cannot be regarded as economic activities within the meaning of the Sixth Directive. There is no 'question of economic activities independently carried on within the meaning of Article 4(1) of the Sixth Directive in the case of activities which the holding company, or persons acting in its name, carries out in its capacity as director or officer of a subsidiary company. A director or officer of the company does not act on his own behalf but only binds the (subsidiary) company whose instrument he is; in other words, where he acts in the exercise of his duties under the company instruments, there is no question of his acting independently. In that regard, his actions must be equated with those of an employee who, as Article 4(4) of the Sixth Directive expressly states, does not act independently'.[50]

Based on *Ayuntamiento de Sevilla*[51] it could be considered that the European Court, at least implicitly, had rejected the argument that the relationship between a company and its organs (shareholders, directors, etc.) could be assimilated to a relationship of employer – employee.[52]

6 Holding Companies – Deduction of Input Tax[53]

It is useful first to summarise the relevant cases which have come before the European Court in this area.

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50 See Opinion of Advocate General N. Fennelly delivered on 4th April 2000 in Case C-142/99 *Floridienne SA and another v Belgian State* 14th November 2000 at paragraph 25 in fine.

51 Case C-202/90 *Ayuntamiento de Sevilla v Recaudadores de las Zonas Primera y Segunda* [1991] ECR I- 4247.

52 Advocate General Tesauro was of the opinion in Case C-202/90 *Ayuntamiento de Sevilla v Recaudadores de las Zonas Primera y Segunda* [1991] ECR I- 4247 that the absence of organic integration in a company characterizes the performance of an independent economic activity (see Opinion of 4th June 1991 at paragraph 6 in fine - Who can claim that contrary is also true?

53 See, Peter Jenkins, 'The right to recover input tax and its enemies', VAT Monitor, 6, 1995.

BLP PLC v CCE[54]

Paragraph 2 of Article 17 of the Sixth Directive must be interpreted in the light of paragraph 5 of that Article. Paragraph 5 lays down the rules applicable to the right to deduct VAT which relates to goods or services used by the taxable person 'both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible'. The use in that provision of the words 'for transactions' shows that to give the right to deduct under Article 17(2) the goods or services in question must have a 'direct and immediate link' with taxable transactions – the ultimate aim pursued by the taxable person is irrelevant in this respect.[55]

What is meant by a direct and immediate link?[56]

In the writer's view 'direct' supposes a causal relation while 'immediate' implies a requirement for a brief temporal continuance between input and output. The deduction of input VAT must be analysed prima facie on a transaction by transaction basis. After *BLP*, the concept of a global right to deduct VAT was in effect outlawed.

Midland Group Newspapers Ltd v CCE [57]

Looking for a direct and immediate link between inputs and taxable outputs presupposes that the costs incurred form part of the price of those output transactions. If those transactions are transactions in respect of which input VAT can be deducted, VAT recovery is not limited. Costs incurred after the related output transaction is completed will be considered as attributable to the entire economic activity and treated as overhead costs.

Abbey National Plc v CCE[58]

Inputs for which no direct link can be made with one or more output transactions are characterised as overhead costs and are consequently subject to the input tax recovery rules that apply to the whole economic activity. Where a taxable person

54 Case C-4/94 [1995] ECR I-983.

55 Case C-4/94 *BLP Plc v. CCE* [1995] ECR I-983 at paragraphs 18 and 19.

56 For a further discussion of this concept see 'VAT: Deductibility of the costs of issuing new shares – the 'direct and immediate link' tests' – Christian Amand *ECTJ* 5/3 [2001] 203.

57 Case C-98/98 [2000] ECR I-4177.

58 Case C-408/98 [2001] STC 497.

carries out several different economic activities, input VAT incurred on overheads relating to a clearly defined part of these taxable activities is deductible to the extent that the part to which the inputs relate carries the right to input VAT recovery.

The decision in *Abbey National* presupposes that a taxable person can split its different activities in accordance with objective and controllable criteria.

Cibo Participations SA v Directeur régional des impôts du Nord-Pas-de-Calais [59]

As far as input VAT incurred on services relating to the acquisition of shareholdings is concerned, the European Court pointed out in the *Cibo* case that there is no direct and immediate link between the services purchased by a holding company in relation to a shareholding and one or more output transactions in respect of which VAT is deductible.[60]

Furthermore, as already mentioned, there is no causal relationship and no temporal continuance between the services incurred in relation to the acquisition of the shareholding and any future sales of that shareholding. Those related costs have a direct and immediate link with the whole economic activity carried on by the payer and should be regarded as overhead costs that could be subject to a proportional deduction when the payer is a mixed taxable person.

Direct Attribution of Input Tax

The direct attribution system operates in the following way:

– Input VAT incurred in connection with transactions falling outside the scope of VAT is not deductible;[61]

– The nature of the costs incurred is established and compared with the output transactions (analytic approach).

As to the input tax on overhead costs (i.e. costs which have a direct and immediate link with the whole economic activity), the following scheme applies.

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59 Case C-16/00 27th September 2001.

60 Case C-16/00 *Cibo Participations SA v Directeur régional des impôts du Nord-Pas-de-Calais* 27th September 2001 at paragraph 32.

61 See mutatis mutandis the Opinion of Advocate General van Gerven, in Case C-333/91 *Sofitam SA v Ministre chargé du Budget* [1993] ECR I-3513 at paragraph 16.

1. Overhead costs which relate to a business segment in respect of which VAT is deductible are deductible in full.[62]

2. Overhead costs which relate to a business segment in respect of which VAT is not deductible are not deductible.

3. Other overhead costs are deductible in proportion if the person to whom the supplies have been made is a mixed taxable person.

Direct Attribution – Example

A Luxembourg supplier carries out a share valuation exercise for a Belgian mixed holding company. This service is provided as part of a proposed acquisition of a shareholding in a subsidiary. In accordance with the implementing provisions in force in the recipient's Member State,[63] the supply of services is regulated by the third indent of Article 9(2)(e) of the Sixth Directive.

The European Court has on several occasions considered the interpretation of Article 9(2)(e) and concluded that it not only covers supplies by the professions listed in that Article, such as lawyers, consultants, accountants and engineers, but also supplies of the same nature. The list in Article 9(2)(e) is to be interpreted strictly. If the Community legislator had intended to cover all activities carried on in an independent manner, the article would have been in general terms.[64] Instead, the Community legislator has listed the professions mentioned as a means of defining the categories of service covered.[65]

The European Court has proposed a dual method of interpretation of the third indent of Article 9(2)(e).[66] In order to determine if the provision applies, two alternative tests are to be applied:

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62 Case C-408/98 *Abbey National plc v CCE* [2001] STC 497 at paragraph 40.

63 See in that respect the Belgian administrative decision N° E.T. 27.720 of 20th February 1979 in Revue TVA 40, 466.

64 Case C-167/95 *Maatschap MJM Linthorst, KGP Pouwels and J Scheres cs v Inspecteur der Belastingdienst/Ondernemingen Roermond* [1997] ECR I-1195, paragraph 14. See for substantial comment Terra/Kajus *A Guide to the European VAT Directives*, part 2 – 82,38.

65 See Case C-145/96 *von Hoffmann v Finanzamt Trier* [1997] ECR I-4857.

66 See Case C-145/96 *von Hoffmann v Finanzamt Trier* [1997] ECR I-4857.

(1) Services consisting of the general and principal activities carried out by consultants, engineers, consultancy bureaux, lawyers and accountants fall within the scope of the third indent of Article 9(2)(e). If the service concerned fulfils this criterion, the place of supply principle in Article 9(2)(c) is applicable, as long as all the other conditions are fulfilled.

(2) If the service concerned does not fall within (1) above, it has to be established whether this service can be regarded as a similar service (that is, with the same purpose) as the activities of the professions listed in the provision.

As already mentioned, a mixed holding company qualifies as a partially taxable person (performing economic activities and activities outside the scope of VAT). If the recipient of the services is acting as a taxable person, the service is deemed to be supplied in the country where he has established his business. Does a holding company act as a taxable person for this purpose?

As a matter of fact, a taxable person does not always act 'as such'.[67] It should be pointed out that, for example, this multiple status should be taken into account inter alia in the following situations:

- Private persons who are VAT taxable persons by reference to their activities performed inside the scope of VAT may also have activities outside the scope of VAT.[68]

- The situation of partially taxable persons, meaning persons that perform activities outside the scope of VAT in part (for example, mixed holding companies) the status of partially taxable person implies that a legal entity can act within or outside its economic activity.

Does this imply that the place of a service supplied to a partially taxable person should be split, for example, when a consultancy service cannot be specifically allocated to the recipient's activities performed within the scope of VAT or to its activities performed outside the scope of VAT?

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67 See, mutatis mutandis, Case C-97/90 *Lennartz v Finanzamt München III* [1991] ECR I-3795 at paragraph 17: a person can act in his capacity as a taxable person and allocates goods [or services] to his economic activity. There is thus an objective criterion and an option. See also, in that respect, the consequences of the *Lennartz* and *Polysar Cases* in France in the new trend of the jurisprudence of the Conseil d'Etat (CE, 29th December 1995 - *Sudfer* case).

68 See Case C-291/92 *Finanzamt Uelzen v Dieter Armbrecht* [1995] ECR I-2775.

The answer to this question should be found in an examination of the closely related concept of tax liability.

The VAT system is conceived in such a manner that the place of supply rules correspond with a specific system that designates the person liable for the VAT. If one would argue that a split of the service should be made in determining the place of supply, a similar split should be made regarding the person liable to pay/account for the VAT due. This would be in contravention of the European Court's jurisprudence, which clearly stipulates that the purpose of Article 9 of the Sixth Directive is to avoid conflicts of competence between the Member States.

This viewpoint is at the very least contrary to the intention of administrative simplification and to the concern of rational fiscal treatment for a transaction that is regarded as a single transaction.[69] To divide the payment of VAT between two Member States for cross-border transactions, in the context of the same contractual relationship, would simply not be coherent.[70]

Regarding a partially taxable person acting as the recipient of services, the VAT treatment for the services supplied by a VAT taxable person established in another Member State, regarding Article 9(2)(e) third indent of the Sixth Directive, has three elements:

- The supplied service can relate exclusively to the economic activity of the partially taxable person – in such a case, the place of business establishment of the recipient of the services normally applies.

- The supplied service relates exclusively to the non-economic activity of the partially taxable person – in such a case, the place of the business establishment of the supplier of the service applies and VAT is in principle not deductible.

- The service received relates to the whole of the recipient's activities – in such a case, taking into account the specific priority of the place of the recipient rule over the place of establishment of the supplier rule and bearing in mind the indivisibility of the quality of the person liable for the payment of tax, the supply should in principle be deemed to be made in the country

69 See the Opinion of Advocate General Fennelly delivered on 25th April 1996 in Case C-327/94 *Dudda v Finanzamt Bergisch Gladbach* at paragraphs 35 and 44 in fine regarding the 'administrative simplification'.

70 Concerning the coherence of the fiscal regime or fiscal consistency, see Case C-204/90 *Bachmann* [1992] ECR I-276.

of establishment of the recipient (Article 9(2)(e) of the Sixth Directive).

One could argue that this last point is debatable. Nevertheless, 'a deliberate policy of reading Article 9(2) in a restrictive fashion would be mistaken'.[71] The possibility should not be excluded that the European Court, if asked to express its viewpoint in this matter, would choose the subsidiary solution, being the place of the supplier in order to eliminate any uncertainty.[72]

If the place of the supply of the service is the Member State of the recipient, the deduction question needs to be considered.

Before the *Cibo* case,[73] if a VAT authority (for instance, France or Belgium)[74] refused to allow the deduction of input VAT charged on costs relating to the acquisition of shareholdings, it necessarily implied that it was assumed that the acquisition was directly linked with either:

(i) a transaction outside the scope of VAT (e.g. the distribution of future dividends) or

(ii) an exempt transaction (e.g. the sale of existing shareholdings) in the sense of the *BLP* case.[75]

Applying the place of supply rules to the first situation, the recipient of the services could then not claim to be acting as a taxable person in the framework of his economic activity.

After the *Cibo* case, such an argument in the first situation is untenable.

The Commission has confirmed the non-deductibility of input VAT in the second situation, referring to the opinion of the VAT Committee expressed in July 1990

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71 See in that respect Terra/Kajus *A Guide to the European VAT Directives*, part 2 -79 and their comments about lex generalis (Article 9(1)) and lex specialis (Article 9(2)).

72 See mutatis mutandis, Case C-429/97 *Commission v France* 25th January 2001

73 Case C-16/00 *Cibo Participations SA v Directeur régional des impôts du Nord-Pas-de-Calais* 27th September 2001 at paragraph 18.

74 Q R Parl, Chambre, n° 75, 14th May 2001, 8464 - Q. n° 525, Desimpel, 29th November 2000.

75 Case C-4/94 *BLP Plc v CCE* [1995] ECR I-983.

refusing the deduction of VAT on costs incurred for a sale of shares.[76]

Looking at the second situation after the decision in *Cibo*, the costs relating to the acquisition of shareholdings have to be regarded as overhead costs in the sense of the *Midland Bank* case. These costs have a direct and immediate link with the whole economic activity of the holding company. In principle, the VAT incurred on such costs is fully deductible. A proportional deduction on basis of Article 17(5)1 of the Sixth Directive should, however, be used for mixed taxable persons.

7 Conclusions

The author's aim has been to stimulate discussion in a global VAT context. Has he succeeded or has he merely drawn attention to a VAT conundrum?

76 OJEC, 19th June 2001, C 174 E/128, Question N° E3729/00.