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TAX NEWSFLASH - 1

| 25/02/11 |



VAT deductibility of costs related to sales of shares: what is new for the active holding companies?

The State Council handed down two rulings inspired from the principles stated by the EUCJ (Pfizer Holding France ruling no. 307698 and Michel Thierry ruling no. 324181, December 23, 2010). These two decisions state new rules that companies shall anticipate with caution.

In short, the State Council laid down the principle that VAT paid on costs related to share sales was not recoverable if such costs were incorporated into the sale price of the shares held by an active holding company in a subsidiary. The State Council has applied this principle in a surprising way.

The State Council came over the EUCJ

In line with the EUCJ's position (AB SKF C-29/08 of October 29, 2009), the State Council pointed out that VAT paid on the purchase of goods or services is only deductible if there is a direct and immediate link between such input costs and an output economic transaction giving right to a deduction (also known as the attribution rule). If no such link can be established with a specific transaction giving right to a deduction, it is nevertheless possible to deduct such VAT when the costs in question are part of the taxable person's general costs, i.e., when they have a direct and immediate link more generally with the whole of the company's economic activities.

The SIVA ruling last summer had confirmed this position by ruling that VAT on brokerage expenses paid by a company in relation to a sale of investment securities outside the scope of VAT, where the yield was allocated to clearing the company's debts, was deductible, since it was possible to demonstrate that such expenses qualified as general costs in this specific case (CE ruling no. 292389 of June 10, 2010). This position, revised not long after by two decisions of the Court of Appeals¹, had made us optimistic on the regime improvement. In his conclusions on these cases, Laurent Olléon, rapporteur public, made a summary proposal regarding the structure of the reasoning. Either the costs are inherent in the sale -- in which case they are presumed to have a direct and immediate link with the transaction, and the related VAT is presumed to be non-deductible² -- or, on the contrary, if the costs are incurred in view of the transaction, they are deemed to form part of the taxable person's general costs and the VAT will be deductible³. Based on these two quite straightforward and coherent principles, the two presumptions are not, however, irrebuttable and taxpayers (or the administration, as the case may be) will be able to seek to refute this postulate by furnishing evidence to the contrary.

Beware of the distributions

The third recital of the Pfizer ruling states that "the transaction was of a non-economic nature insofar as the yield from this sale was distributed, irrespective of the terms of such distribution". The companies concerned will immediately see the pitfalls of this definition which shall be precised to avoid any abuse. Going by the decisions rendered in the past, we shall understand that, in practice, the transaction does not become non-economic simply because cash was made from it, but because of how such cash was allocated. Needless to say, it is not easy to make an assessment in practice. In the abovementioned SIVA ruling, the State Council admitted that VAT was deductible because the company was experiencing serious cash-flow difficulties forcing it to cash in some financial investments - the yield from which was allocated to clearing the debt. However, in the Pfizer case, the State Council refused deductibility in a context which, at first sight, seemed to be similar as the company was arguing that the sale had been planned in the context of the redeployment of its markets to make its business sustainable and to meet certain financial requirements.

The dialectical proof

The State Council states in the Pfizer case: "whereas the administration stated, and was not properly contradicted, that the company had furnished no evidence to the contrary showing that these costs were not incorporated into the sale price of the shares; whereas, consequently, the administration should be regarded as having proved that it had grounds to challenge the deductibility of the tax levied on its fees". Does this mean that, if the company is unable to demonstrate that the price did not incorporate the costs, then the administration is considered to have furnished sufficient proof? On the other hand, in the Michel Thierry case of the same day, the State Council dismissed the Minister's appeal on the grounds that "the investigation did not establish that these costs were borne by the buyers" but did not indicate in any further detail what elements brought about such conviction. Apart from listed companies, for which the administration will hardly be able to claim that the price includes the costs, vendors will have the difficult task of having to prove something which does not exist. Laurent Olléon did in fact point out that this is a delicate matter of "dialectical proof" insofar as the evidence to objectively demonstrate VAT deductibility is solely in the hands of the companies, which seems to imply that the burden of proof is systematically on the vendor. However, it is important not to forget that the administration had access, in both of the cases, to all of the evidence pertaining to adjustments made after tax audits. For the sake of



objectivity, one may also wonder what prevented the claimant from furnishing evidence to the contrary.

Strategic and financial stakes

What could we learn from these two rulings? Prudence and anticipation will be two attitudes to adopt in order to anticipate any future contestation, bearing in mind that special attention should be given to sale transactions which do not form part of an economic restructuring, and which are therefore considered to be non-economic. To this end, vendors will need to take care to gather, as from now, all evidence either to rebut the presumption of the non-deductibility of costs inherent in share sales or, on the contrary, to support the deductibility of costs incurred in relation to the sale. However, it remains likely that many past transactions will be the source of tax adjustments.

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