

Israel Desk E-mail Bulletin

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ECJ ruling regarding input VAT attributable to the sale of subsidiaries

On 29 October 2009 the European Court of Justice ('ECJ') delivered its judgement in the SKF case. The ECJ ruled that the input VAT on expenses which are directly linked to the sale of shares in subsidiaries to an EU-based purchaser cannot be deducted and, therefore, is an actual cost for the seller. However, this does not necessarily mean that all input VAT incurred in relation to a share sale is never deductible: some input VAT may, under certain circumstances, be recoverable. According to the ECJ a right to deduct may exist either if the sale of shares qualifies as a transfer of a going concern or if the costs are attributable to the general business activities of the (active) holding company. This decision will have impact on and may create opportunities for VAT-taxable persons who have sold or will sell shares in other companies.

The case

AB SKF is the parent company of an international industrial group. Besides holding shares in subsidiaries, AB SKF renders VAT taxed services to its subsidiaries and as such is considered an active holding company. As part of a group reorganisation, AB SKF intends to sell shares of both partially and wholly owned subsidiaries. In connection with these sales AB SKF received services from third parties. These included specific services in respect to the share transaction and services relating more to the general business reorganisation.

As the sale of shares is not VAT taxed, the question arises whether the input VAT on these services can be deducted. In principle, VAT-taxable persons can only deduct input VAT on expenses insofar as they are attributable to VAT taxed economic activities.

The decision of the ECJ

Previously the ECJ ruled that if a holding company is involved in the management of a subsidiary and renders services to that subsidiary, the relevant acquisition expenses must be considered as general expenses. The input VAT on general expenses can be deducted pro rata, (calculated on the basis of the overall ratio of VAT taxed economic activities performed by a VAT-taxable person). This implies that companies activities which are merely VAT taxed, are fully entitled to deduct input VAT.

In the SKF case the ECJ has ruled that under certain circumstances the sale of shares may constitute a transfer of a business as a going concern. In that case the input VAT remains deductible pro rata.

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Loyens & Loeff is an independent Benelux law firm with over 750 lawyers and has offices in the main financial centres around the world. Loyens & Loeff combines an integrated corporate law, regulatory and tax practice.

The members of the Israel Desk strongly focus on Israeli clients that invest or trade in Europe or other regions, as well as on international companies and financial institutions that want to expand their businesses to Israel. The team comprises members from various Loyens & Loeff practice groups.

The experience of the members as regards the Israeli market is combined with their extensive knowledge of international tax law, corporate structuring, banking and securities law, regulatory law, employment law. In addition to being part of the Israel Desk, the members also participate in Loyens & Loeff teams that focus on specific industries and sectors, such as energy, real estate, private equity, fund structuring, corporate finance, and financial products.

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If such a sale does not qualify as a transfer of a going concern, the sale of shares by an active holding company is exempt from VAT. As a result the input VAT on any expenses directly and immediately attributable to such a sale to EU-based purchasers cannot be deducted. However, the ECJ also ruled that expenses for the sale of shares that are not directly and immediately attributable to the sale of shares, but have been incurred in light of the general business activities, should be regarded as general expenses. As mentioned, the input VAT on such expenses is deductible on the pro rata basis of the holding company.

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Consequences for the Benelux practice

Although the decision of the ECJ limits the deductibility of input VAT on expenses that are directly attributable to the sale of shares within the EU, it also offers opportunities.

For some years, Belgium has allowed the deduction of VAT in the case of issuance and the acquisition of shares necessary for the management of group companies. As a result of the SKF case this will also be possible in relation to business reorganisation involving sale of shares.

Until now, the Luxembourg VAT administration has been quite reluctant regarding the deduction of the VAT incurred in connection with shares. This case could thus offer some opportunities for the taxpayers, especially active holdings, and this should be monitored taking into account the circumstances at hand.

In the Netherlands, an active holding company is under certain circumstances already allowed to deduct the input VAT on the sale of shares on its pro rata basis. This decision of the ECJ will limit the deduction insofar as the costs are directly attributed to the sale of the shares. On the other hand: the ECJ ruling also provides additional options to reclaim VAT if subsidiaries are sold.

Due to the fact that the SKF ruling leaves room for interpretation and the existence of current administrative guidelines in Belgium and the Netherlands careful diligence is required when these type of expenses are made.

If you would like to discuss the specific consequences of the SKF judgement, please do not hesitate to get in touch with your contact person at Loyens & Loeff.

Members of the Israel Desk visit Tel-Aviv on a regular basis. If you would like to make an appointment or would like to receive more information with respect to the above, please feel free to contact <mailto:jeroen.janssen@loyensloeff.com> or any other member of the Israel Desk.