

Israel Desk E-mail Bulletin

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European Court rules on VAT deduction in the event of costs that are partly business and partly non-business

On 13 March 2008, the European Court of Justice ("the European Court") ruled in the *Securenta* case regarding the deduction of VAT on costs that are partly business and partly non-business. It was confirmed in this case that an entrepreneur that also performs non-business activities must take into account that VAT on costs that are partly business and partly private are only partially deductible. This can affect, among other things, deduction for holding companies.

The *Securenta* case

The business activities of *Securenta* consisted of, among other things, the exploitation of registered property. *Securenta* also performed activities that were non-business related, consisting of holding and selling participations and other investments. It had incurred costs for a share issue. The capital accumulated by the issue was not only used for business activities. The European Court held that the VAT on the costs was only deductible to the extent the costs could be attributed to business activities. The European Court leaves it to the Member States to determine a calculation method for the deduction.

Significance to practice

This case is important to all companies that perform both business and non-business related activities, including holding companies that perform business activities. As long as the so-called holding resolution from 1991 is not revoked by the state secretary for Finance, in many situations, a party can invoke the fact that the resolution states that non-business activities of holding companies do not affect the right of deduction.

A holding company that does not grant loans or perform other types of business activities, by the way, is not an entrepreneur at all, so that the ruling is not relevant to that category.

In situations in which the holding resolution is not or no longer applicable, the following must be taken into account in the convergence of business and non-business activities.

- To be able to deduct VAT, it must in any event be demonstrated that the costs were incurred for business activities.
- If capital is only used for business activities, the VAT incurred on

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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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the costs for attracting capital is deductible.

- It is not yet clear what calculation method the tax authorities will use to determine the percentage of deductible VAT on costs that can be attributed to both business and non-business activities.
- If the attracted capital is not used or only used in part for the business activities (such as for investing in registered property that is let), but rather used for investments and (minority) participations that are not related to the (main) activity, the VAT on the costs for the attracted capital cannot be deducted *pro rata*. Suppose that 20% of the attracted capital is not used for the business activity (investment in registered property), then it would be logical that 20% of the VAT incurred on costs for attracting capital is also not deductible.
- In the *Securenta* case, the investments were part of the non-business activities. Based on case law, investments can, indeed, be considered part of business activities under certain circumstances.
- With regard to an “actively involved holding company” that performs services subject to VAT for its subsidiaries, it may be argued that the costs for purchasing a participation are related to the business activities, meaning that the VAT is deductible.
- The VAT on costs that are attributable to exempted business activities (such as extending loans to EU parties) continues to be non-deductible.

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@lovensloeff.com> or any other member of the Israel Desk.