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Holding companies' sale of shares: the underlying purpose test in the context of a direct and immediate link

by

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Summary

In the ever evolving and ambiguous environment of VAT treatment of sales of shares, the underlying purpose test has arisen as a new form of controversy. While it seems to be a viable method for establishing in specific circumstances a strong enough direct and immediate link to guarantee deduction also for costs incurred in relation to an exempt or out-of-scope share disposal, the test's nature and even its very meaning alone are far from self-explanatory.

Using relevant EU legislation, the case law of the CJEU and building upon the academic works of especially Ad van Doesum, Dennis Ramsdahl Jensen and Henrik Stensgaard, this thesis establishes the environment of the underlying purpose test. Against the background it is able to establish what the author of this thesis argues are the current meaning and significance of the underlying purpose test.

The test is essentially an objective determination of the direct and exclusive reason for the sale of shares based on the allocation of its proceeds. Its significance however is even more unclear. The author of this thesis argues that by its nature and operation the test is an unpractical, even impossible solution to the problem it was meant to solve and as such it has merely limited, if any, effect. Furthermore, taking into account the test's questionable relationship with the concept of the common system of VAT, should the current review process of the Commission result in amendments to the VAT treatment of financial services in the EU, the underlying purpose test as it stands at the moment is unlikely to survive much longer.

Preface

This thesis is performed during the Master studies of the author in European and International Tax Law at the School of Economics and Management, Department of Business Law of Lund University.

I would like express my deep gratitude to my supervisor, visiting Professor Sigrid Hemels, without whose expert guidance, constructive criticism and kind support this thesis would not be the way it is.

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Finally, I would like to give many thanks to especially my classmates, but also my friends and family for all their support and for making this an educational but also a fun year full of experiences that have enriched both my professional and personal life.

Abbreviation list

AG	Advocate General
CJEU, Court	Court of Justice of the European Union
Commission	European Commission
EU	European Union
MS	Member State
VAT Directive	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax
VAT	value added tax

1 Introduction

1.1 Background

Input value added tax (VAT) recovery is an inherent part of the common system of VAT, the European Union's (EU) general tax on consumption established in Council Directive 2006/112/EC[1] (VAT Directive).[2] By allowing persons qualifying as taxable persons the principal right of deduction regarding VAT incurred on their input supplies, EU VAT directs the actual burden of the tax onto the consumers. This neutralises the effects that for practicality reasons, EU VAT is levied on all stages of production and distribution of goods and services. Accordingly, the deduction system is intended to relieve taxable persons entirely of their burden of VAT incurred for their economic activities. However, as a notable exception to this rule, the deduction right does not extend to inputs which taxable persons use for the purposes of their exempt or non-taxable transactions.[3]

These quite clear lines become somewhat blurred, however, when the transaction at issue is a sale of shares. According to the case law of the Court of Justice of the European Union (the CJEU, the Court), a sale of shares is either outside the scope of VAT as non-economic activity,[4] or exempt in accordance with Article 135(1)(f) of the VAT Directive.[5] Regardless, where a direct and immediate link between the input costs and the taxable person's overall economic activity can be established, the deduction right is retained.[6] This raises an all-important question, fundamental for all businesses engaged

[1] Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

[2] Dennis Ramsdahl Jensen and Henrik Stensgaard, 'The Direct and Immediate Link Test regarding Deduction of Input VAT: A Consumption-Based Test versus an Economic-Based Test' (2014) 3 World Journal of VAT/GST Law 71, 71.

[3] Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, recital 5, Articles 1, 168; Ad van Doesum and Gert-Jan van Norden, 'European Union - The Right To Deduct under EU VAT' (2011) 22(5) International VAT Monitor 323, 323.

[4] *Inter alia* CJEU Judgement of 20 June 1996, *Wellcome Trust*, C-155/94, ECLI:EU:C:1996:243, para 33; CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 28; CJEU Judgement of 30 May 2013, *X BV*, C-651/11, ECLI:EU:C:2013:346, para 36. See also Ad van Doesum, 'The EU VAT Treatment of Shares and Other Securities' (2020) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3561536, 2.

[5] *Inter alia* CJEU Judgement of 20 June 1991, *Polysar*, C-60/90, ECLI:EU:C:1991:268, para 14; CJEU Judgement of 20 June 1996, *Wellcome Trust*, C-155/94, ECLI:EU:C:1996:243, para 35; CJEU Judgement of 6 February 1997, *Harnas & Helm*, C-80/95, ECLI:EU:C:1997:56, para 16; CJEU Judgement of 14 November 2000, *Floridienne & Berginvest*, C-142/99, ECLI:EU:C:2000:623, para 27; CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 51. See also Ad van Doesum, Herman van Kesteren and Gert-Jan van Norden, 'Share Disposals and the Right of Deduction of Input VAT' (2010) 19 EC Tax Review 62, 62-63.

[6] Regarding outside the scope activities, see CJEU Judgement of 26 May 2005, *Kretztechnik*, C-465/03, ECLI:EU:C:2005:320, para 36. Regarding exempt transactions, see *inter alia* CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, paras 58, 64.

in such activities in the EU: how is such a direct and immediate link established?

The case law of the Court contains crucial ambiguities regarding VAT consequences of share disposals, especially as it regards the deduction right, and accordingly, the direct and immediate link. This has managed to produce notable uncertainty among businesses.[7] Among this confusion, there is one option for building the link that the Court seemingly cannot make its mind about. This apparent, yet controversial and altogether questionable option for producing such a link, and indeed the very focus of this thesis, is building the direct and immediate link on the basis of the underlying, ultimate purpose for incurring the costs based on an objective economic analysis, or as referred to in this thesis, the underlying purpose test.[8]

The general uncertainty surrounding the VAT treatment of share deals makes the analysis of any part of it arguably quite topical at any time. Moreover, on 8 February 2021 the European Commission (the Commission) announced that it has lounged another consultation regarding a review of the VAT rules for financial services to inform possible future amendments to the rules.[9] This makes the topicality of the issue discussed in this thesis even greater.

1.2 Research question and aim

The research question of this thesis is: What is the meaning and significance of the underlying purpose test in the context of a direct and immediate link relating to holding companies' sale of shares?

The aim of this thesis is to ascertain the meaning of the underlying purpose test in case a share disposal by a holding company – how such purposes can be determined and on what basis should these purposes be considered. Additionally, the significance or the effect of the test in relation to the VAT treatment of the sale is analysed also taking into account the test's relationship with the common system of VAT.

1.3 Method and material

This thesis applies the legal dogmatic method.[10] The research question is analysed on the basis of law and principles stemming from EU legislation as well as relevant case law of the CJEU. This case law is collected by Ad van Doesum in his paper 'The EU VAT Treatment of Shares and Other Securities'.[11] Other case law of the Court is used only to support those discussions.

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[7] Ad van Doesum (2020), 4.

[8] Richard Woolich, 'VAT strategies for holding companies' (2019) Tax Journal https://www.taxjournal.com/articles/vat-strategies-for-holding-companies.

[9] Ulrika Lomas, 'EU Kick-Starts Review Of Financial Services VAT Rules' *Tax-News.com* (Brussels, 15 February 2021) <https://www.tax-news.com/news/EU_Kickstarts_Review_Of_Financial_Services_VAT_Rules____97915.html> accessed 9 May 2021. The review includes insurance services as well, but for the purposes of this thesis, it is discussed only as it relates to financial services.

[10] Sjoerd Douma, *Legal Research in International and EU Tax Law* (Enschede, Wolters Kluwer, 2014), 17-20.

[11] Ad van Doesum (2020), 3-4.

The analysis of primary sources is supported by consulting legal doctrine in relevant textbooks, commentaries and articles. This thesis builds upon especially the works of van Doesum[12] as well as those of Dennis Ramsdahl Jensen and Henrik Stensgaard [13]. It uses their papers to determine and analyse the broader context and environment on which the underlying purpose test operates, thus being able to provide a more focused analysis of the test that developed on the areas discussed in those papers.

In interpretations of the relevant case law of the CJEU, literal interpretation is subject to a more objective interpretation that takes into account the context of the Court's wording as well. Thus, *inter alia*, words such as 'purpose', 'aim', 'reason', 'intention' and 'objective' in a similar context are interpreted as effectively having the same meaning.[14]

1.4 Delimitation

For the purposes of answering its research question, this thesis refers only to the VAT system of the EU. Additionally, while the conclusions of this thesis could to a certain extent be applicable also in relation to the general idea of the direct and immediate link, in this thesis the link is analysed merely in relation to the sale of shares by holding companies and as it regards the underlying purpose test. Any analysis of material relating to the link in a more general manner is used merely to answer the research question of this thesis.

Moreover, this thesis uses the concept 'holding company' in relation to all companies holding shares (and selling or purchasing them) within the EU and not only those with no other activities.

1.5 Outline

The second chapter of this thesis explains the fundamental aspects related to the underlying purpose test. To answer the research question, the test is examined with these aspects in mind and analysed from their perspective. Thus, the general rules of VAT that the test should abide by are defined. The third chapter focuses on direct and immediate link. The link and in which cases it is of relevance are analysed both in a more general manner as well as more specifically in relation to the sales of shares by holding companies. Based on the discussions in the previous two chapters, the fourth one analyses the underlying purpose test as established by the CJEU and interpreted by scholars. These discussions aim to ascertain the test's position as part of the direct and immediate link test. The fifth chapter analyses the underlying purpose test by determining its compliance with the fundamental principles of the common European VAT system. It is followed by the concluding remarks of the author on this thesis.

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[12] See Ad van Doesum (2020). See also Ad van Doesum, Herman van Kesteren and Gert-Jan van Norden (2010); Ad van Doesum and Gert-Jan van Norden (2011).

[13] See Dennis Ramsdahl Jensen and Henrik Stensgaard, 'The Distinction between Direct and General Costs with Regard to the Deduction of Input VAT – The Case of Acquisition, Holding and Sale of Shares' (2012) 4 World Tax Journal 3; Dennis Ramsdahl Jensen and Henrik Stensgaard (2014).

[14] Lexico, 'Synonyms of purpose in English' (Synonyms) <https://www.lexico.com/synonyms/purpose> accessed 12 April 2021.

2 VAT as a general tax on consumption

VAT is a turnover tax, and as such, it is general in nature, taxing all commercial activities involved in the supplies of goods or services, though only in regards to private expenditure, thus directing the ultimate cost of the consumption to consumers, albeit indirectly.[15] This very essence of VAT as a tax, although seemingly self-explanatory, possesses a fundamental role in setting the scene for any discussion relating to a more specific aspect of it. Therefore, prior to diving into the particular nature of the underlying purpose test, the directing outer layers of it derived from the above stated general concept of VAT demand some attention. Or as the CJEU put it in *Sofitam*[16], '[i]n order to answer the … question, it is necessary to consider the relevant characteristics and aims of the VAT system with particular reference to the deduction scheme and the concept of taxable person'.[17]

The definitions of taxable person, economic activity, the right to deduct and exemptions all play a key role in defining the underlying purpose test. Together with the guidance of the principle of fiscal neutrality (especially regarding the deduction right) and principle of legal certainty they constitute the most important fundamental aspects of VAT on which this specific test to be analysed rely and ought to lean on. Thus, this section provides some analysis on all of those concepts and principles separately, while also emphasizing their connections with one another, employing particularly the case law of the CJEU to exact their perhaps more specific definitions in relation to share transactions.

Although a discussion relating to each of the above-mentioned concepts and principles could stretch on for pages, as excellent research has already been conducted in relation to them also on the very complex and detail-oriented field of share dealings' VAT treatment, this section limits its discussions to only the fundamental aspects of each concept directly affecting the analysis of the research question – the meaning and significance of the underlying purpose test.

The main importance of principles of fiscal neutrality and of legal certainty in the context of this thesis is the guidance they provide to both the definitions of the concepts discussed in this chapter and the CJEU's judgements regarding share disposals. Thus, to keep the focus of this chapter on the research question of this thesis, the principles are interpreted mainly on the basis of their application rather than on more theoretical discussions.

[15] CJEU Judgement of 4 December 1990, *van Tiem*, C-186/89, ECLI:EU:C:1990:429, para 17; CJEU Judgement of 29 April 2004, *EDM*, C-77/01, ECLI:EU:C:2004:243, para 47; European Commission, 'What is VAT?' (Taxation and Customs Union) <https://ec.europa.eu/taxation_customs/business/vat/what-is-vat_en> accessed 2 April 2021; Ben Terra and Julie Kajus, *Introduction to European VAT* (IBFD, 2021) ch Introduction to VAT as Fiscal Phenomenon, 139-143.

[16] CJEU Judgement of 22 June 1993, *Sofitam*, C-333/91, ECLI:EU:C:1993:261.

[17] Ibid, para 9.

2.1 Taxable person

The definition of a taxable person for VAT purposes is laid out in Article 9(1) of the VAT Directive: '"[t]axable person" shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity'.[18] Thus, where there is a taxable person, there is also economic activity, or as the CJEU phrased it in *University of Cambridge*[19], '[i]n order to be considered to be a taxable person, a person must carry out economic activities, that is to say activities for consideration'.[20] As the VAT Directive aims to build a common system of VAT upon a uniform definition for a taxable person, the status of such a person must solely be determined based on that criterion defined in Article 9.[21] Therefore, it is indeed the performance (and accordingly also the definition) of economic activities that confers on a person the status of a taxable person.[22] Correspondingly, as preparatory acts are included in the scope of economic activities, according to the CJEU, also 'any person with the intention, as confirmed by objective elements, of independently starting an economic activity, and who incurs the initial investment expenditure for those purposes must be regarded as a taxable person'.[23]

What is more, it is appropriate to mention here, as the CJEU also emphasizes, that in accordance with Article 2 of the VAT Directive, the status of a taxable person alone is not enough, but a taxable person is also required to act 'as such' for a transaction to be subject to VAT.[24] This is a requirement once again rooted deeply in the definition of economic activity: 'the condition that a taxable person acts as such in the context of the proposed transaction, it must be noted that a taxable person, within the meaning of the second subparagraph of Article 9(1) of the VAT Directive, acts as such, in principle, *only if he does so as part of his economic activity*'.[25]

In the specific case of holding companies, the CJEU principally settled the issue already in 1991 with *Polysar*[26]: a pure holding company is not considered a taxable person within the meaning of VAT. In other words, a holding company that has as its sole object merely acquiring and holding shares of other companies does not carry out any economic activity.[27]

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[18] Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Article 9(1). See also CJEU Judgement of 29 April 2004, *EDM*, C-77/01, ECLI:EU:C:2004:243, para 48.

[19] CJEU Judgement of 3 July 2019, *University of Cambridge*, C-316/18, ECLI:EU:C:2019:559.

[20] Ibid, para 29.

[21] CJEU Judgement of 21 October 2004, *BBL*, C-8/03, ECLI:EU:C:2004:650, para 37.

[22] CJEU Judgement of 6 February 1997, *Harnas & Helm*, C-80/95, ECLI:EU:C:1997:56, para 20.

[23] CJEU Judgement of 12 November 2020, *Sonaecom*, C-42/19, ECLI:EU:C:2020:913, para 33.

[24] CJEU Judgement of 29 April 2004, *EDM*, C-77/01, ECLI:EU:C:2004:243, para 50; CJEU Judgement of 12 January 2017, *MVM*, C-28/16, ECLI:EU:C:2017:7, para 24.

[25] CJEU Judgement of 13 June 2018, *Polfarmex*, C-421/17, ECLI:EU:C:2018:432, para 37 [emphasis added].

[26] CJEU Judgement of 20 June 1991, *Polysar*, C-60/90, ECLI:EU:C:1991:268.

[27] Ibid, para 17; Ben Terra and Peter Wattel, *European Tax Law* (Kluwer, 5th edn 2008) 138; Rolf Eicke, *Tax Planning with Holding Companies: Repatriation of US Profits from Europe.*

2.2 Economic activity

As the definition of economic activity is such a fundamental part of the establishment of a taxable person, it is only right to follow a discussion on taxable persons with one outwardly simple, yet in its essence a complicated question: what constitutes economic activity?

In Article 9(1), the VAT Directive defines economic activities as encompassing '*any activity* of producers, traders or persons supplying services', in particular those relating to the '*exploitation* of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis' (exploitation in this context encompassing all those transactions, regardless of their legal form).[28] In accordance with the CJEU, principally this means that the VAT Directive accords VAT a very wide scope, although restricting it to only those activities of an economic nature.[29] Activities falling outside this scope of VAT are not subject to VAT at all.[30]

In applying that broad definition of economic activity, the CJEU considers that an analysis of it 'highlights the scope of that concept and its objective nature, in the sense that the activity is considered per se and without regard to its purpose or results. An activity is, as a general rule, categorised as 'economic' where it is permanent and is carried out in return for remuneration which is received by the person carrying out the activity'.[31] Thus, as economic activities may also consist of multiple consecutive transactions, preparatory acts themselves are included in the scope of economic activity as well.[32]

For the purposes of this thesis, it is important to note that the Court has consistently held that the mere acquisition of financial holdings in other companies is not enough for the requirement of 'exploitation' to be fulfilled. Instead, the receipt of dividends from such holdings is merely the result of ownership.[33] Furthermore, the holding company only exercising its rights as a shareholder is not sufficient to turn such passive status into economic activity.[34] Instead, as the Court ruled in *Wellcome Trust*, if such actions are not in themselves considered as economic activity, 'the same must be true of

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Concepts, Strategies, Structures (Kluwer, 2008) 61; Opinion of Advocate General van Gerven delivered on 20 January 1993, *Sofitam*, C-333/91, ECLI:EU:C:1993:21, para 11; Rita de la Feria, 'When do Dealings with Shares Fall Within the Scope of VAT?' (2008) 1 EC Tax Review 26 referenced in Nina Aguiar, 'Portugal Telecom: A New Door Open for Holding Companies to Deduct Input VAT' (2013) 2 World Journal of VAT/GST Law 73, 73.

[28] Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Article 9(1) [emphasis added]; CJEU Judgement of 29 April 2004, *EDM*, C-77/01, ECLI:EU:C:2004:243, para 48. See also CJEU Judgement of 13 June 2018, *Polfarmex*, C-421/17, ECLI:EU:C:2018:432, para 38.

[29] CJEU Judgement of 12 January 2017, *MVM*, C-28/16, ECLI:EU:C:2017:7, para 24; CJEU Judgement of 5 July 2018, *Marle Participations*, C-320/17, ECLI:EU:C:2018:537, para 19.

[30] Ad van Doesum and Gert-Jan van Norden (2011), 324.

[31] CJEU Judgement of 13 June 2018, *Polfarmex*, C-421/17, ECLI:EU:C:2018:432, para 38. See also CJEU Judgement of 12 January 2017, *MVM*, C-28/16, ECLI:EU:C:2017:7, para 25.

[32] CJEU Judgement of 12 November 2020, *Sonaecom*, C-42/19, ECLI:EU:C:2020:913, para 33.

[33] CJEU Judgement of 20 June 1991, *Polysar*, C-60/90, ECLI:EU:C:1991:268, para 13; Opinion of Advocate General van Gerven delivered on 20 January 1993, *Sofitam*, C-333/91, ECLI:EU:C:1993:21, para 11 referenced in Nina Aguiar (2013), 74.

[34] CJEU Judgement of 20 June 1991, *Polysar*, C-60/90, ECLI:EU:C:1991:268, para 13 referenced in Nina Aguiar (2013), 74.

activities consisting in the sale of such holdings'.[35] However, where 'direct or indirect involvement in the management of the companies' accompanies the holding, economic activity could be present.[36]

2.3 Right to deduct

Although VAT is charged on every level of production, ultimately, it is a tax meant only for private consumption. Accordingly, unless there are exemptions applicable, VAT is not to influence the pricing of goods or services within the chain of their production or distribution. This is where the all-important deduction right comes in.[37]

According to Article 168 of the VAT Directive, '[i]n so far as the goods and services are used for the purposes of the taxed transactions of a taxable person', the taxable person is entitled to the right to deduct.[38] Settled case law of the CJEU has tasked the deduction system of the VAT Directive with the purpose of relieving a trader of all VAT burden related to his economic activities in their entirety.[39] As such, the deduction system is '*an integral part of the VAT scheme* and in principle *may not be limited*', but instead the right to deduct must be exercised immediately as regards any and all taxes charged on input transactions.[40]

In *MVM*[41], the CJEU explained that to deduct the input VAT, the person in question must meet the conditions of a taxable person and act as such at the time of acquiring those goods or receiving those services from another taxable person. Additionally, he must use those supplies for the purposes of his own taxed output transactions.[42] Thus, the right to deduct also presupposes that the expenditure incurred in acquiring the supplies represents a cost component of the output transactions giving rise to it.[43] Here it is also appropriate to note that the deduction right arises when the tax becomes chargeable, so at the time of delivery of those goods or performance of those services.[44]

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[35] CJEU Judgement of 20 June 1996, *Wellcome Trust*, C-155/94, ECLI:EU:C:1996:243, para 33.

[36] CJEU Judgement of 20 June 1991, *Polysar*, C-60/90, ECLI:EU:C:1991:268, para 14 referenced in Nina Aguiar (2013), 74.

[37] Ben Terra and Julie Kajus (2021) ch Introduction to VAT as Fiscal Phenomenon, 158.

[38] Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Article 168.

[39] CJEU Judgement of 27 September 2001, *Cibo Participations*, C-16/00, ECLI:EU:C:2001:495, para 27; CJEU Judgement of 26 May 2005, *Kretztechnik*, C-465/03, ECLI:EU:C:2005:320, para 34.

[40] CJEU Judgement of 26 May 2005, *Kretztechnik*, C-465/03, ECLI:EU:C:2005:320, para 33 [emphasis added].

[41] CJEU Judgement of 12 January 2017, *MVM*, C-28/16, ECLI:EU:C:2017:7.

[42] Ibid, para 28. See also CJEU Judgement of 5 July 2018, *Marle Participations*, C-320/17, ECLI:EU:C:2018:537, para 26; CJEU Judgement of 12 November 2020, *Sonaecom*, C-42/19, ECLI:EU:C:2020:913, para 36.

[43] Dennis Ramsdahl Jensen and Henrik Stensgaard (2012), 5.

[44] This is the principal rule to chargeability. In that regard, see *inter alia* Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Articles 62, 63 and 167; CJEU Judgement of 17 October 2018, *Ryanair*, C-249/17, ECLI:EU:C:2018:834, para 21; CJEU Judgement of 12 November 2020, *Sonaecom*, C-42/19, ECLI:EU:C:2020:913, para 36.

As the right to deduct may generally not be limited, the CJEU had to specify those specific instances where the right may not in principle be relied on: 'where goods or services acquired by a taxable person are used for purposes of transactions that are *exempt or do not fall within the scope of VAT*'.[45] This conclusion derives from the fact that as there is no output tax to collect, no input tax should be deductible either.[46] Accordingly, where a taxable person uses the goods or services acquired to carry out both taxable and exempt or out of scope activities, only the amount of input VAT attributable to the taxed output transactions may be deducted.[47]

Even so, here it should be noted that where once arisen, the deduction right is retained even in cases where the intended economic activity was actually never carried out, thus giving rise to no taxed transactions. Same holds true, where the taxable person, due to circumstances beyond his control, was simply unable to utilize the goods or services giving rise to the deduction right for his taxable transactions.[48] Thus, as in the case of economic activity, and accordingly, the definition of taxable person, preparatory acts play an important role in properly assembling the definition of the right to deduct as well. Moreover, the CJEU has also held that taking into account the definition of taxable person including any person carrying out economic activity, whatever its purpose or result, the deduction right must also be guaranteed without it being subjected to a criterion as to for example the result of the taxable person's economic activities.[49]

2.4 Exemptions

A transaction can fall within the scope of VAT, yet by virtue of *inter alia* Article 135 of the VAT Directive, be exempt. Exempt transactions are those that come within the scope of VAT, but as a derogation to the main rule set in Article 1(2) of the VAT Directive, are not taxed.[50] For the purposes of this thesis, only the exemption on financial services established in paragraph (f) of Article 135 is of notable relevance: 'transactions, including negotiation but not management or safekeeping, in shares, interests in companies or associations, debentures and other securities, but excluding documents establishing title to goods, and the rights or securities' are exempt.[51]

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[45] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 59 [emphasis added]. See also CJEU Judgement of 17 October 2018, *Ryanair*, C-249/17, ECLI:EU:C:2018:834, para 29; CJEU Judgement of 3 July 2019, *University of Cambridge*, C-316/18, ECLI:EU:C:2019:559, para 24.

[46] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 59; CJEU Judgement of 17 October 2018, *Ryanair*, C-249/17, ECLI:EU:C:2018:834, para 29.

[47] CJEU Judgement of 6 September 2012, *Portugal Telecom*, C-496/11, ECLI:EU:C:2012:557, para 39.

[48] CJEU Judgment of 29 February 1996, *INZO*, C-110/94, EU:C:1996:67, paras 20, 22; CJEU Judgement of 17 October 2018, *Ryanair*, C-249/17, ECLI:EU:C:2018:834, para 25.

[49] CJEU Judgement of 5 July 2018, *Marle Participations*, C-320/17, ECLI:EU:C:2018:537, para 44.

[50] Ad van Doesum and Gert-Jan van Norden (2011), 324.

[51] Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Article 135(f).

According to the Court, the terms used to specify exemptions are to be interpreted strictly.[52]

2.5 Fiscal neutrality

As already stated, the definitions of taxable person, economic activity, right to deduct and exemptions are all subject to the principle of fiscal neutrality – 'a fundamental principle of the common system of VAT' according to the CJEU[53] – which is a specific expression of the equality principle, but only on the level of secondary EU law and its rules on taxation. Accordingly, it is not a principle against which it is possible to test the validity of secondary law, nor extend the laws' application beyond unambiguous provisions to that effect, but one which may be relied upon by a taxable person against national law provisions and their application.[54]

Where it comes to economic activities, the neutrality principle precludes treating objectively similar transactions differently for VAT purposes. As such transactions are in practice in competition with each other, a difference in their treatment could result in distortions of that competition. Likewise, economic operators carrying out the same activities cannot be treated differently in regards to levying VAT.[55] Accordingly, the CJEU has held that the 'exploitation' of Article 9(1) in connection with obtaining income from tangible and intangible property, refers to all transactions, regardless of their legal form, by which income is sought to obtain from such property on a continuing basis.[56]

Similarly, the implications of the neutrality principle also reach the right to deduct: the deduction system is meant to ensure the complete neutrality of taxation of economic activities, regardless of their purpose or result, so long as the activities are themselves principally subject to VAT.[57] Consequently, transactions taxed during the same tax period of all taxable persons enjoy the same deduction right, while, *a contrario*, none of similar transactions which are exempt from VAT are entitled to it.[58] Neutrality is also the basis for the retainment of the deduction right, even when the intended economic activity was not carried out. The Court remarks that another interpretation would be liable to create unjustifiable differences in tax treatment between businesses already carrying out taxable transactions and those still at the stage of seeking

[52] CJEU Judgement of 15 November 2012, *Zimmermann*, C-174/11, ECLI:EU:C:2012:716, para 22. See also CJEU Judgement of 2 July 2020, *BlackRock Investment Management*, C-231/19, ECLI:EU:C:2020:513, para 22.
[53] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 67 and the case law cited therein.
[54] Ben Terra and Julie Kajus (2021) ch Legal Principles, 51.
[55] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, paras 67, 76; CJEU Judgement of 12 November 2020, *Sonaecom*, C-42/19, ECLI:EU:C:2020:913, para 62 and the case law cited therein.
[56] CJEU Judgement of 26 June 2003, *KapHag*, C-442/01, ECLI:EU:C:2003:381, para 37 and the case law cited therein.
[57] CJEU Judgement of 27 September 2001, *Cibo Participations*, C-16/00, ECLI:EU:C:2001:495, para 27; CJEU Judgement of 26 May 2005, *Kretztechnik*, C-465/03, ECLI:EU:C:2005:320, para 34 and the case law cited therein.
[58] CJEU Judgement of 12 November 2020, *Sonaecom*, C-42/19, ECLI:EU:C:2020:913, para 63.

to commence them by the investment expenditure.[59] In the same way, arbitrary differences would arise between those latter businesses seeking to commence their transactions as well, as their right to deduction would thus ultimately be dependent upon the investments' resulting in taxable transactions.[60]

Furthermore, in *Ryanair*[61] the CJEU specified that as VAT should be neutral in relation to the tax burden of businesses, this necessitates that even the first investment expenditure incurred 'for the purposes of, and with the view to, commencing a business must be regarded as an economic activity; it would be contrary to that principle if such an activity commences only when taxable income arises'.[62] According to the Court, any other interpretation would direct the burden of VAT onto the traders, while leaving them with no right to deduct, thus creating 'arbitrary distinctions' on the basis of timing of the costs: investment expenditure incurred prior to the business' actual exploitation or during it.[63]

As it regards exemptions, in *Zimmermann*[64] the Court, referring to settled case law, stated that the principle of neutrality, while not a rule of primary law, must still be used to interpret exemptions alongside the principle of strict interpretation of exemptions. Thus, the interpretation of exemptions must be consistent with the objectives underlying them and comply with the requirements of fiscal neutrality. In this context, strict interpretation does not mean interpreting the exemptions in a manner that deprives them of their intended effects.[65]

2.6 Legal certainty

Another principle governing the interpretation of the VAT Directive is the principle of legal certainty, which is one of the VAT system's very objectives to ensure.[66] In essence, according to the Court's settled case law, the principle of legal certainty means that 'Community legislation must be certain and its application foreseeable by those subject to it'.[67] In *SKF*[68], the Court also specified that this requirement must be observed all the more strictly, where it regards rules which are liable to entail financial consequences, to ensure that those concerned may know precisely the extent of the rules' obligations imposed on them.[69]

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[59] CJEU Judgement of 17 October 2018, *Ryanair*, C-249/17, ECLI:EU:C:2018:834, para 25 and the case law cited therein.
[60] Ibid.
[61] CJEU Judgement of 17 October 2018, *Ryanair*, C-249/17, ECLI:EU:C:2018:834.
[62] Ibid, para 24 and the case law cited therein.
[63] Ibid.
[64] CJEU Judgement of 15 November 2012, *Zimmermann*, C-174/11, ECLI:EU:C:2012:716.
[65] Ibid, paras 22, 49-50.
[66] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 47; CJEU Judgement of 5 July 2012, *DTZ Zadelhoff*, C-259/11, ECLI:EU:C:2012:423, paras 25, 40 and the case law cited therein.
[67] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 77 and the case law cited therein.
[68] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665.
[69] Ibid, para 77 and the case law cited therein.

In accordance with legal certainty, save in exceptional situations, it is necessary to have regard to the objective character of the transactions.[70] Accordingly, treating transactions which are objectively similar differently would be contrary to legal certainty (as well as fiscal neutrality).[71] Moreover, transactions that are substantively identical cannot be treated differently for the purposes of levying VAT, merely based on whether they are part of the taxable person's normal and usual business or not.[72] Legal certainty also supports the principle of fiscal neutrality by, for example, ensuring that a strict interpretation of an exemption cannot restrict it in a manner not justified by the wording of the provision in question.[73]

2.7 Conclusion for chapter 2

This chapter introduces concepts and principles, the understanding of which is crucial for the determination of the underlying purpose test. In the common system of VAT, a taxable person is any person independently carrying out economic activity – principally any permanent activity carried out in return for remuneration. When a taxable person acts as such at the time of acquiring supplies that he uses for the purposes of his taxed transactions, he is entitled to the right to deduct, within the context of which he can deduct the input VAT costs he has incurred in acquiring those supplies. However, supplies a taxable person acquires to perform transactions that are outside the scope of VAT or as a derogation are considered exempt by virtue of *inter alia* Article 135 of the VAT Directive, create no such deduction right.

The application of taxable person, economic activity, right to deduct and exemptions follow the guidance of especially the principles of fiscal neutrality and legal certainty. Accordingly, objectively similar or same transactions or operators cannot be treated differently for VAT purposes, especially as it regards the right to deduct. This is to ensure foreseeability of the application of the VAT Directive and to avoid any arbitrary or unjustified differences in competition on the common market.

[70] CJEU Judgement of 5 July 2012, *DTZ Zadelhoff*, C-259/11, ECLI:EU:C:2012:423, para 25 and the case law cited therein.
[71] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 76.
[72] Ibid, para 47 and the case law cited therein.
[73] Ibid, paras 46-47; CJEU Judgement of 5 July 2012, *DTZ Zadelhoff*, C-259/11, ECLI:EU:C:2012:423, para 40.

3 Direct and immediate link

The underlying purpose test is a component of the direct and immediate link, as established by the CJEU,[74] and as such the link and its significance for the VAT treatment of share deals is important to perceive the test itself. Thus, it is appropriate to have a closer look at this link to understand the more specific context of the research question of this thesis.

Fundamentally, the idea of a direct and immediate link was created by the Court on the basis of Article 2 of the VAT Directive: whether it be a supply of goods or services or an intra-Community acquisition, for the transaction to be subject to VAT, it must be '*effected for consideration*'.[75] This wording thus creates the requirement for the establishment of a positive, direct and immediate link between a taxed activity and the consideration for it, as without it, the tax included in the consideration may not be deductible, unless the link can be established with the general costs of the business. Alternatively, the transaction is considered as exempt or outside the scope of VAT and as such resulting in no right of deduction.[76]

Within the more specific context of this thesis, a direct and immediate link is considered mostly as the necessary requirement to be found between a particular input transaction and a specific output transaction or transactions giving rise to the deduction right. Accordingly, such a link may also be established with the economic activities of a taxable person as a whole, where the input transactions' expenditure constitutes as part of the business' general costs and consequently represent cost components of all its output transactions.[77] Alternatively, the direct and immediate link could also be established with a clearly defined part of a taxable person's economic activity.[78] Consequently, to obtain the deduction right, the costs incurred must in some way be traced back to specific taxed cost objects and where they do not, or do so only partially, the right is respectively either denied completely or it results in but partial (proportional) deduction.[79]

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[74] See *inter alia* CJEU Judgement of 5 February 1981, *Coöperatieve Aardappelenbewaarplaats*, C-154/80, ECLI:EU:C:1981:38, para 12; CJEU Judgement of 8 June 2000, *Midland Bank*, C-98/98, ECLI:EU:C:2000:300, para 24.

[75] Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Article 2(1); Ben Terra and Julie Kajus (2021) ch Subject Matter and Scope, 180, 188.

[76] See *inter alia* CJEU Judgement of 22 October 2015, *Sveda*, C-126/14, ECLI:EU:C:2015:712, paras 28, 32-33 and the case law cited therein. See also Oskar Henkow, '*Sveda*—The increasing obscurity of the direct link test in EU VAT' (2016) 5(1) World Journal of VAT/GST Law 48, 48; Ben Terra and Julie Kajus (2021) ch Subject Matter and Scope, 180.

[77] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, paras 57-60 and the case law cited therein; Ben Terra and Julie Kajus (2021) ch Subject Matter and Scope, 188.

[78] Dennis Ramsdahl Jensen and Henrik Stensgaard (2012), 7.

[79] Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Articles 168, 174; Dennis Ramsdahl Jensen and Henrik Stensgaard (2012), 4, 6. For more information on pro rata deduction, see *inter alia* CJEU Judgement of 13 March 2008, *Securenta*, C-437/06, ECLI:EU:C:2008:166, paras 31-39;

This direct and immediate link is now elaborated further, first, with a discussion on the basis of the Court's case law in relation to the link as it affects the treatment of share disposals by holding companies, followed by a short analysis related to the fulfilment of the link in that scope.

3.1 Case law of the CJEU

As the Court observed in *Midland Bank*[80], there is no detailed definition of a direct and immediate link to be had '[i]n view of the diversity of commercial and professional transactions'.[81] Instead, in each situation the link must be applied by the national courts individually based on the particular circumstances of the case at hand.[82] Yet, to ensure a uniform application of the link, the CJEU has given guidance as to the link's nature.[83] Therefore, along with attempting to determine the applicability of the direct and immediate link in relation to share disposals, that guidance of the Court on the link's nature is the focus on this sub-chapter.

BLP represents the first ruling in which the deductibility of costs in relation to a sale of shares was brought before the Court.[84] This case is about a holding company BLP (that also provided management services to its subsidiaries) that after facing notable financial difficulties, decided to sell shares in one of its subsidiaries in order to raise money for paying off its debts. For the costs incurred in relation to the sale of shares, BLP claimed deduction of input VAT, but was denied by the authorities due to the costs perceived non-deductible nature, as they were principally incurred in connection with an exempt share disposal.[85]

The CJEU held that for input VAT to be deductible, the particular goods or services must have a direct and immediate link with taxed transactions. Accordingly, the Court rejected BLP's arguments in regards to the principle of fiscal neutrality allowing for the deduction right to extend to VAT paid or due on supplies with a direct or indirect link to a taxable person's taxable transactions, including those that are exempt, where they are used for carrying out taxable transactions.[86] Neither were arguments as to the dual purpose of the services in question accepted by the Court: BLP submitted that not only were the services used for the exempt sale of shares (an incidental transaction according to BLP), but also for taxable transactions falling within the company's objects.[87] Instead, according to the Court, the common system of VAT allows for deduction in relation to exempt output transactions only as an exception.[88] Furthermore, BLP's interpretation of fiscal neutrality was

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Mandy Gabriël and Herman van Kesteren, 'European Union - Calculation of the (Pre-) Pro Rata under EU VAT Law' (2011) 22(5) International VAT Monitor 332.

[80] CJEU Judgement of 8 June 2000, *Midland Bank*, C-98/98, ECLI:EU:C:2000:300.

[81] Ibid, para 25. See also Dennis Ramsdahl Jensen and Henrik Stensgaard (2012), 7.

[82] CJEU Judgement of 8 June 2000, *Midland Bank*, C-98/98, ECLI:EU:C:2000:300 referenced in Dennis Ramsdahl Jensen and Henrik Stensgaard (2012), 7.

[83] Dennis Ramsdahl Jensen and Henrik Stensgaard (2012), 7.

[84] Rita de la Feria, 'When do Dealings in Shares Fall Within the Scope of VAT?' (2008) 17(1) EC Tax Review 25, 28.

[85] CJEU Judgement of 6 April 1995, *BLP*, C-4/94, ECLI:EU:C:1995:107, paras 1-8.

[86] Ibid, paras 12-15, 19.

[87] Ibid, paras 16-17.

[88] Ibid, paras 18-23; Ben Terra and Julie Kajus (2021) ch Deductions, 678.

liable to mandate the authorities to carry out inquiries as to the intention of the taxable person, where no objective link to taxed transactions could be determined. This obligation would go against the objective of the common system of VAT to ensure legal certainty and principally applying the tax having regard to transactions' objective character.[89]

BLP's interpretation of the direct and immediate link represents the concept's introduction into the sphere of sale disposals.[90] As such, it forms the basis on which later case law regarding the link in this context builds upon its meaning. However, it is important to note here that the CJEU made its decision on the mere assumption that the sale of shares to which the costs were attributable to was an exempt supply.[91] Yet, according to Rita de la Feria, automatically reaching the conclusion that the Court, solely based on *BLP*, considers the sale of shares as an exempt activity might be an overly hasty one. This is especially the case in light of *Wellcome Trust*[92], a following judgement on precisely that matter, which deemed share disposals as principally non-economic activity instead.[93]

Yet, regardless of this ambiguity, the observations the CJEU made in *BLP* regarding the direct and immediate link in the scope of share transactions seem to hold. For instance, in *Cibo Participations*[94] (a judgement given after both *BLP* and *Wellcome Trust*) the Court re-emphasized its conclusions made in *BLP* that to gain the right of deduction, the purchased goods or services must have a direct and immediate link with their corresponding output transactions that are VAT deductible.[95] However, at the same time, *Cibo Participations* appears to represent at least a partial departure from the CJEU's approach in those two previous judgements, as here the Court acknowledged the difference between sales and purchases of shares: sale of shares is an output transaction while purchase of shares represents an input one.[96] Hence, there appeared also a possible option for the CJEU to adjust its opinion regarding the treatment of sale of shares for VAT purposes, including as it regards the direct and immediate link in this context. Yet, *EDM*[97] and (especially) *Investrand*[98] seem to have closed this door.[99]

In *EDM*, the Court made the key distinction between sales of shares constituting non-economic activity and those considered as exempt activities. This is an important development, as it has a great impact on the calculation

[89] CJEU Judgement of 6 April 1995, *BLP*, C-4/94, ECLI:EU:C:1995:107, para 24; Ben Terra and Julie Kajus (2021) ch Deductions, 678.
[90] Rita de la Feria (2008), 28.
[91] Ben Terra and Julie Kajus, *A guide to the European VAT Directives, Commentary on the Value Added Tax of the European* (Amsterdam: IBFD publications BV, loose-leaf), Chapter XI.5.5.12. referenced in Jeroen Bijl and Judit Kerékgyártó 'Recovery of Input VAT Incurred on Costs Relating to the Sale of Shares' (2003) 14(3) International VAT Monitor 209, 210.
[92] CJEU Judgement of 20 June 1996, *Wellcome Trust*, C-155/94, ECLI:EU:C:1996:243.
[93] Ibid, paras 32-33, 35; Rita de la Feria (2008), 28-29.
[94] CJEU Judgement of 27 September 2001, *Cibo Participations*, C-16/00, ECLI:EU:C:2001:495.
[95] Ibid, para 28. See also Rita de la Feria (2008), 30.
[96] Rita de la Feria (2008), 30-31, 36.
[97] CJEU Judgement of 29 April 2004, *EDM*, C-77/01, ECLI:EU:C:2004:243.
[98] CJEU Judgement of 8 February 2007, *Investrand*, C-435/05, ECLI:EU:C:2007:87.
[99] Rita de la Feria (2008), 31.

of the deduction right. According to the CJEU, the 'continuous' nature of the activities is the differentiating factor between the two, although, unfortunately, how to define the activity as being performed on a continuous basis or not was left quite unclarified.[100] Instead, the Court simply stated that 'neither the scale of a share sale, nor the employment in connection with such a sale of consultancy undertakings' constitute as criteria for making a distinction between activities of a private investor falling outside the scope of the VAT Directive and those of an investor performing activities constituting as economic activity.[101] Thus, apart from giving such clarifications to its previous judgments on the matter, *EDM* did not depart from those rulings, despite *Cibo Participations* offering the Court an ample opportunity to do so.[102]

As for *Investrand*, it provided another layer of complexity to the right to deduct in relation to a sale of shares. While still but a passive holding company, Investrand conducted a share disposal for a fixed sum as well as a further sum, the amount of which depended upon the profits of the sold company in the next few years. Subsequently, a dispute arose between the parties of the sale regarding that further sum that ultimately led to arbitration proceedings for which Investrand acquired legal services. As Investrand had begun supplying management services for consideration to the company it sold some of its shares from after the period for which the additional sum was calculated, but prior to the commencement of the arbitration proceedings, it wanted to deduct the input VAT regarding those legal services. However, the authorities disagreed and eventually the dispute was brought before the CJEU.[103]

The main issue under consideration before the Court was the establishment of a direct and immediate link between those legal services Investrand had obtained and its taxable activities (namely the management services for the company the shares of which were the subject of the sale). The Court began by stating that by then it was already settled case law that a sale of shares is not in itself economic activity and hence it falls outside the scope of VAT.[104] Accordingly, neither the steps Investrand took to recover a claim related to it are economic activity either, as they constitute no 'exploitation of property to produce income on a continuing basis', but gains of a holder of a claim instead. Consequently, no activity within the scope of the VAT Directive can be identified and so the costs of the legal services cannot be regarded as having a direct and immediate link with transactions giving rise to the deduction right.[105]

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[100] Ibid.

[101] CJEU Judgement of 29 April 2004, *EDM*, C-77/01, ECLI:EU:C:2004:243, para 61. See also Rita de la Feria (2008), 31.

[102] Rita de la Feria (2008), 32.

[103] CJEU Judgement of 8 February 2007, *Investrand*, C-435/05, ECLI:EU:C:2007:87, paras 7-21. See also Rita de la Feria (2008), 32; Ben Terra and Julie Kajus (2021) ch Deductions, 740.

[104] CJEU Judgement of 8 February 2007, *Investrand*, C-435/05, ECLI:EU:C:2007:87, para 25.

[105] Ibid, paras 26, 28.

Nevertheless, following *Cibo Participations* (and *Kretztechnik*[106]) the Court acknowledged that the direct and immediate link could also be established with the taxable person's economic activity as a whole, should the costs in question be regarded as general costs on the ground that the claim to which they are connected to forms a part of the assets of the business which it operates.[107] According to the CJEU, this was not the case here. Instead, it ruled that the 'exclusive reason' for the costs was not in the economic activities of Investrand, but mainly in 'safeguarding the financial consideration for the sale of shares' and even equated Investrand in these circumstances to a private shareholder.[108] Thus, in this particular situation, nor could a direct and immediate link be established to the taxable activity of Investrand as a whole.

This was a very restrictive interpretation from the Court. After all, the sale of shares here could be seen as a way for the company to boost its economic activities, as the Court, in essence, concluded in *Kretztechnik*. Instead, the differences pointed out be the Court between these two cases seem rather formalistic – Investrand showed no evidence that it would not have obtained the legal services had it not been carrying out taxable economic activities, whereas in *Kretztechnik* the company's economic activity was the 'exclusive reason' for its costs.[109] Regardless, this does not change the fact that Investrand still incurred the costs while already acting as a taxable person and those costs resulted from services obtained related to its assets.[110] Thus, in ruling that the costs for the legal services could not be linked to the general costs of Investrand, it would seem that the deciding factor was the timing of the costs incurred: the costs were connected with an activity that took place prior to Investrand attaining its taxable status. This seems a problematic conclusion, as it raises the question of compatibility between *Investrand* and the Court's previous case law on preparatory activities.[111] In the author's view, although *Investrand* is an interesting case in the sphere of direct and immediate link, it is perhaps better to simply view it as an example related quite heavily to its particular circumstances.

In *SKF*[112], questions were raised about the deductibility of input VAT on costs related to the sales of shares and the VAT treatment of the sale itself.[113] On the basis that the parent company was involved in its subsidiaries' management and decided to dispose of their shares for restructuring purposes, the Court, referring to *Kretztechnik*, stated that the disposal could be classified as a transaction consisting in obtaining income on a continuing basis from activities beyond the compass of a mere sale of shares. As a direct link with the group's activity could be discovered, the transaction indeed constituted a

[106] CJEU Judgement of 26 May 2005, *Kretztechnik*, C-465/03, ECLI:EU:C:2005:320.
[107] Ibid, para 29. See also Rita de la Feria (2008), 32.
[108] CJEU Judgement of 8 February 2007, *Investrand*, C-435/05, ECLI:EU:C:2007:87, paras 32-24.
[109] CJEU Judgement of 8 February 2007, *Investrand*, C-435/05, ECLI:EU:C:2007:87, paras 35-37; Terra B and Kajus J (2021), ch Deductions, 741.
[110] Terra B and Kajus J (2021), ch Deductions, 741.
[111] Rita de la Feria (2008), 33.
[112] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665.
[113] Nina Aguiar (2013), 78.

'direct, permanent and necessary extension of the taxable activity of the taxable person' and as such fell within the scope of VAT.[114]

As for the sale itself, due to the parent company's involvement in the management of its subsidiaries, the Court held that the sale in this case was more than merely a simple securities sale. And as a direct link with the parent's taxable activity could also be discovered, the share sales were subject to VAT, yet, by virtue of Article 135(1)(f) of the VAT Directive, exempt:[115] share transactions are subject to VAT, when carried out to secure 'a direct or indirect involvement in the management of the companies in which the holding has been acquired'.[116] Thus, it should be noted, the CJEU seems to indicate that a holding company selling shares is by default not considered as economic activity. Instead, the disposal must have a direct link with the organization of the group's activity, thus constituting as 'direct, permanent and necessary extension' of the parent's taxable activities.[117]

With these conclusions, for the author of this thesis *SKF* seems to represent a good guideline regarding the current attitude of the Court on share disposals. Indeed, in *C&D Foods*, a case about the deduction of input VAT incurred in connection with consultancy services supplied to a company providing management services to its sub-subsidiary, the shares of which it intended (but did not) sell, the Court confirmed its position in *SKF*.[118] In *C&D Foods* it held that for a share disposal to come within the scope of VAT, 'the direct and exclusive reason' for that disposal must principally be the parent company's taxable economic activity or the 'the direct, permanent and necessary extension' of it. These require the disposal to be carried out with a view to allocating its proceeds directly to the parent company's taxable economic activity or the economic activity of that group.[119] However, as van Doesum rightly points out, with the apparent weight the Courts seems to have attached to the intention of the share disposal in *C&D Foods*, how well these particular conclusions align with the Court's earlier case law on the matter (especially *BLP*), is quite questionable. Similar concerns regarding the manner in which such intention is determined and *SKF* could also be raised.[120]

In summary, on the basis of the case law explained above, the following requirements for deduction of costs related to share disposals can be determined: (1) the holding company has the status of a taxable person; (2) it acts in that capacity when carrying out the share disposal; and (3) a direct and immediate link can be established with taxed transactions giving rise to the

[114] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, paras 31-33; Nina Aguiar (2013), 78-79.
[115] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 52 referenced in Nina Aguiar (2013), 79.
[116] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 31 referenced in Nina Aguiar (2013), 79.
[117] Ad van Doesum (2020), 17, 19.
[118] CJEU Judgement of 8 November 2018, *C&D Foods*, C-502/17, ECLI:EU:C:2018:888, paras 2, 17; Ad van Doesum (2020), 17, 19.
[119] CJEU Judgement of 8 November 2018, *C&D Foods*, C-502/17, ECLI:EU:C:2018:888, para 38. See also Ad van Doesum (2020), 19.
[120] Ad van Doesum (2020), 20-21.

deduction right.[121] On these bases, the general field on which the direct and immediate link operates has now been determined to the extent possible based on the currently available case law on the matter. Although sales of shares seem to have a tendency to either fall out of the scope of the VAT Directive or be considered as exempt activities in accordance with Article 135(1)(f) of said Directive, these types of transactions have also managed to fulfil the criteria for deduction, including the specific conditions for a direct and immediate link to be established with regard to the general costs of the taxable person's economic activity as a whole.[122]

3.2 Consumption-based test and economic-based test

In accordance with Article 168 of the VAT Directive, the right to deduct requires the input transactions to be '*used for the purposes*' of a taxable persons' taxed transactions.[123] On the basis of the CJEU's case law, two approaches to the application of the direct and immediate link test can be distinguished based on this wording. Firstly, the consumption-based test, according to which a cost is used for certain supplies where it is consumed as a direct and immediate consequence of those supplies. Alternatively, according to a more economic-based test, a cost is used for the supplies, if it is allocated to and calculated into their prices.[124]

As seems to be the theme where it regards the CJEU's case on share disposals, there is no definite answer as to which of these tests ought to be applied.[125] However, for the purposes of this thesis, it is important to understand that these two different approaches exist and what their difference is, as depending on which of them is used could affect the operation, if not the very existence of the underlying purpose test as a tool to establish a direct and immediate link.

3.3 Direct and immediate link in share disposals

The direct and immediate link is only relevant in relation to sales of shares, where the costs are not exclusively connected with such a sale, but instead with the taxable person's economic activity as a whole, as part of its general costs.[126] Thus, establishment of such general costs are the main focus of this sub-section.

Jensen and Stensgaard argue that due to the two different approaches regarding the meaning of 'used for' in Article 168 of the VAT Directive, there are also two alternative ways to establish general costs in this context. A recent example of the consumption-based approach is *Becker*,[127] in which the sole trader, majority shareholder and managing director of a VAT group,

[121] Ibid, 24.
[122] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 58; Dennis Ramsdahl Jensen and Henrik Stensgaard (2012), 13.
[123] Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Article 168 [emphasis added]; Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 72.
[124] Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 72-73.
[125] Ibid, 74.
[126] Dennis Ramsdahl Jensen and Henrik Stensgaard (2012), 13.
[127] CJEU Judgment of 21 February 2013, *Becker*, C-104/12, EU:C:2013:99.

Becker, under criminal investigation proceedings regarding his business activities incurred lawyer costs addressed to the company for which he deducted input VAT. The question thus arose as to the direct and immediate link between those lawyer costs and the taxable person's taxed output transactions.[128] The Court could not establish such a positive link that would have allowed this deduction.[129] Using the consumption-based approach it observed that to ensure legal certainty, only the *objective content* of the transaction can be taken into account. As the costs were incurred directly and immediately to protect private interests of the accused, in light of this objective content, the costs could not be considered as being incurred for the economic activities as a whole. The causal link between them was not enough for the Court. In delivering this reasoning, the Court relied heavily on *BLP*, another example of the consumption-based test in practice.[130]

Accordingly, in the context of this consumption-based interpretation of 'used for', for a cost to be defined as a general one, it needs to be consumed in the course of the overall economic activity of a taxable person.[131]

According to Jensen and Stensgaard, *X BV*[132] offers perhaps the clearest guidance to be followed where the economic-based test is applied.[133] X BV acquired services in conjunction with an exempt disposal of shares for which it fully deducted the input VAT. X BV's reasoning behind this deduction was that the disposal was to be considered a transfer of totality of assets and services and that those costs in connection with it were part of the general costs of its entire economic activity.[134] On the whole, the Court seemed to agree. Referring to *inter alia Cibo Participations* and *SKF*, it considered that the distinction between direct and general costs depends on the where the cost of the input services is incorporated into: 'in the cost of *particular output transactions* or in the cost of *goods or services supplied by the taxable person as part of his economic activities*'.[135] The Court even specified this rule somewhat more by stating that since the disposal in this case is an exempt transaction, the deduction right exists only where the costs of the services supplied to X BV in connection with it are part of X BV's general costs relating to its overall economic activity, '*without being incorporated in the sale price* of those shares'.[136]

Thus, based on the economic-based test, the key to this distinction seems to be the allocation of the costs: where the inputs are allocated to the price of the taxable person's output supplies as part of his overall economic activities,

[128] Ibid, paras 8-13.
[129] Ibid, para 33.
[130] Ibid, paras 20, 23-25, 30-31; CJEU Judgement of 6 April 1995, *BLP*, C-4/94, ECLI:EU:C:1995:107, para 24; Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 75.
[131] Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 72-73.
[132] CJEU Judgement of 30 May 2013, *X BV*, C-651/11, ECLI:EU:C:2013:346.
[133] Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 80.
[134] CJEU Judgement of 30 May 2013, *X BV*, C-651/11, ECLI:EU:C:2013:346, paras 11, 56 referenced in Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 80.
[135] CJEU Judgement of 30 May 2013, *X BV*, C-651/11, ECLI:EU:C:2013:346, para 55 [emphasis added]. See also Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 80.
[136] CJEU Judgement of 30 May 2013, *X BV*, C-651/11, ECLI:EU:C:2013:346, para 56 [emphasis added]. See also Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 80.

these costs are defined as general ones for the company.[137] This compartmentalization of the costs between those considered as direct ones and those part of the general costs of the economic activity as a whole is supported by other recent CJEU case law. In *SKF* the Court added (referring to *Securenta*[138]) that the input costs have a direct and immediate link to the economic activities of a taxable person where they can be '*solely* attributable to downstream economic activities' and are therefore 'among *only* the cost components of transactions within the scope of *those* activities'.[139]

The two explained tests being applied by the CJEU to make a distinction between direct costs and general costs are hardly beyond inconsistencies[140] and very reasonable critique,[141] not the least of which are the practical issues raised by having two greatly differing approaches to something as fundamental as the positive link needed to guarantee deduction. However, for the purposes of this thesis, this is as far as discussion on this controversy goes.

3.4 Conclusion for chapter 3

This chapter introduces the direct and immediate link, a concept the CJEU has developed in its case law to represent the positive link Article 168 of the VAT Directive requires between a taxable person's input transactions and taxed output transactions for the establishment of a right to deduct. Traditionally, the Court's case law considers share disposals as output transactions that are either exempt or entirely out of scope of VAT. Accordingly, where a direct and immediate link is established directly with the share disposal itself, a taxable person cannot rely on the deduction right. However, where a direct and immediate link is instead formed with the general costs of a taxable person acting as such, the right to deduct is retained.

Based on the wording of Article 168 of the VAT Directive, the Court has adopted two different approaches for the application of the direct and immediate link test in the field of share disposals: the consumption-based test and the economic-based test. In accordance with the consumption-based approach, general costs are those consumed in the course of the overall economic activities of a taxable person, whereas the economic-based test bases the distinction on the input costs' allocation. Comparing the two approaches shows that they are liable to create notably different definitions for general costs that could have a significant impact on the deduction right in the field of share disposals. However, for the moment the Court uses both of these approaches and as such there is no one answer on which of them ought to be applied.

[137] Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 72-73, 81.
[138] CJEU Judgement of 13 March 2008, *Securenta*, C-437/06, ECLI:EU:C:2008:166.
[139] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, paras 60, 62 referenced in Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 81.
[140] See for example CJEU Judgement of 6 April 1995, *BLP*, C-4/94, ECLI:EU:C:1995:107.
[141] See for example Dennis Ramsdahl Jensen and Henrik Stensgaard (2012); Dennis Ramsdahl Jensen and Henrik Stensgaard (2014).

4 Underlying purpose test

As the context of the direct and immediate link and its consequences, along with its general building blocks have been deciphered (at least to the extent the current case law allows), this thesis focuses now on, as Woolich put it, one of the more uncertain arguments for establishing the link, and indeed the main research question of this thesis: what is the meaning and significance of the underlying purpose test?[142] One way to illustrate this legal problem is through the conflict the CJEU seems to have created with its contradicting judgements in *BLP* and *C&D Foods*: in *BLP* the Court explicitly stated that the ultimate aim for the taxpayer in incurring the costs is all but irrelevant, whereas in *C&D Foods* the direct and exclusive reason for the sale was instead a decisive criterion.[143] Thus, in the words of van Doesum, *C&D Foods* is quite difficult to reconcile with *BLP*,[144] and whether by intention of the Court or not, seems to represent a notable enough divergence from *BLP* to have commenced a discussion as to the possible existence of an underlying purpose test.

First, this chapter focuses on the meaning of the underlying purpose test, analysing what is needed for its establishment. These discussions are followed by considerations as to the significance of the test and its reliability as a method for establishing the direct and immediate link.

4.1 Meaning of the underlying purpose test

From the outset, the meaning of the underlying purpose test on the basis of the case law appears simple: whether the underlying purpose for a taxable person's share disposal, and accordingly its related costs, can establish a direct and immediate link to the taxable persons' taxable activities (i.e. general costs). This raises a main question however, of how to determine this underlying purpose?

In accordance with the principle of fiscal neutrality, the answer seems clear – objectivity is the key. The CJEU seems to agree with this assessment. In *BLP*, the subjective intention behind the sale was to raise funds to pay off the company's debts.[145] The Court considered that the ultimate aim pursued in the taxable person's motivation for making an exempt supply to be irrelevant for the deduction right.[146] *University of Cambridge*, although not as such about share disposals, also provides some interesting insight into this discussion. The university claimed deduction in relation to costs it had incurred in connection with its out-of-scope investment activities, the income from which it also subsidised its taxable activities. The Court was thus asked

[142] Richard Woolich (2019).
[143] CJEU Judgement of 6 April 1995, *BLP*, C-4/94, ECLI:EU:C:1995:107, para 19; CJEU Judgement of 8 November 2018, *C&D Foods*, C-502/17, ECLI:EU:C:2018:888, paras 37-38.
[144] Ad van Doesum (2020), 20.
[145] CJEU Judgement of 6 April 1995, *BLP*, C-4/94, ECLI:EU:C:1995:107, para 3; Richard Woolich (2019).
[146] CJEU Judgement of 6 April 1995, *BLP*, C-4/94, ECLI:EU:C:1995:107, para 19; Ad van Doesum and Gert-Jan van Norden (2011), 326.

to deliberate on whether a sufficient link could be established between the costs of managing the fund and other activities to justify the treatment of those costs as general ones.[147] In refusing the existence of such a link due to the lack of incorporation of the costs into the sales prices of the university's taxable transactions, the Court also rejected the concept of subjective intention behind the donations playing a role in input VAT recovery.[148]

In *Becker*, the Court observed that in obliging the tax authorities to consider all the circumstances surrounding the transactions, to take account only of the transactions' *objective content* is the most compatible approach to pursue the aims of the common system of VAT, namely ensuring legal certainty and facilitating the application of VAT.[149] In *C&D Foods* (referring to *Becker*), despite it using a more economic-based approach, the Court reaffirmed that it is indeed in light of the transactions' objective content that it is necessary to determine the existence of a direct and immediate link.[150] Accordingly, it seems quite clear that regardless if the Court is using either the consumption-based or the economic-based test, objectivity alone is directing these discussions.

This conclusion is however not complete as such, as interestingly in both *Becker* and *C&D Foods* the Court also makes it a point to clarify that the exclusive reason for the transaction at issue is a criterion for determining the objective content. Where it is clear that the exclusive reason for the transaction is not in the taxable activities of a taxable person, no direct and immediate link can be established, even if that transaction would, in light of its objective content, be subject to VAT.[151]

The above thus raises the question, what do 'objective' or 'exclusive reason' as concepts mean under these circumstances? Can an objective or exclusive reason for a sale of shares even be determined? According to van Doesum, a sale of shares is 'a disposal of shares which a shareholder / holding company holds in another person (subsidiary)'.[152] As such, at least the definition of the sale alone does not seem to imply an objective reason behind the decision to sale shares in the first place. Such a conclusion is in line with the general complexity of business-related decisions – there are countless circumstances, any of which alone or in connection with other ones could result in a decision to sell. Van Doesum thus rightly raises the practical issue of determining just one single, exclusive reason for the sales.[153] Therefore, the Court seems to have argued itself into a difficult situation, as to maintain neutrality of the

[147] CJEU Judgement of 3 July 2019, *University of Cambridge*, C-316/18, ECLI:EU:C:2019:559, paras 9-16, 19; Richard Woolich (2019).
[148] CJEU Judgement of 3 July 2019, *University of Cambridge*, C-316/18, ECLI:EU:C:2019:559, paras 28-33; Richard Woolich (2019).
[149] CJEU Judgment of 21 February 2013, *Becker*, C-104/12, ECLI:EU:C:2013:99, paras 22-23.
[150] CJEU Judgement of 8 November 2018, *C&D Foods*, C-502/17, ECLI:EU:C:2018:888, para 36.
[151] Ibid, para 37; CJEU Judgment of 21 February 2013, *Becker*, C-104/12, ECLI:EU:C:2013:99, para 29.
[152] Ad van Doesum (2020), 14.
[153] Ibid, 20.

VAT treatment of share disposals across the Member States (MSs), it has effectively tasked itself with the determination of a complex criteria.

However, whether the Court is able to give proper guidance as to the determining factors in this matter is debatable. This, perhaps harsh, statement has its basis in the observations of the Court in *Ryanair*, a case about deductibility of input VAT, where Ryanair incurred costs in relation to an intended, but failed acquisition of its competitor.[154] As Ryanair had stated its intention for the attempted acquisition having been the opportunity to provide management services to the target company, the Court allowed the deduction in full.[155]

This conclusion of the Court would seem to be quite dismissive of other, arguably more prevalent business reasons motivating the intended share transaction. Indeed, prior to the Court's judgement in *Ryanair* the Commission even declared the concentration incompatible with the common market for significantly impeding competition and resulting in the creation or strengthening of a dominant position for Ryanair and its target on multiple flight routes.[156] As such, notable motivators in the takeover bid, including an increase in the company's market share and buying out its competitor, although acknowledged by AG Kokott in her opinion[157], were not considered by the Court. Yet, these motivators could well be claimed as common reasons for takeovers from a business perspective, much more so than the intention to provide remunerated management services for the intended subsidiary, which, as AG Kokott observes, seems to be the primary condition for the recognition of economic activity in such a situation.[158]

Thus, although about acquisition of shares and not disposals, in a broader picture *Ryanair* could be seen as demonstrating the Court's lack of understanding of how business operates and accordingly even questioning its very ability to determine objective purposes for such transactions. Instead, any attempt by the Court to do so might even result in distorting the concept of objectivity in this context, as with *Ryanair* the Court seems to have inadvertently taught companies what to say (and do) in order to enjoy the deduction right even in cases where it might not in fact be warranted by the VAT Directive.

Following *Ryanair*, it is hardly reassuring that on the basis of *C&D Foods*, the objective criteria the Court seems to have chosen for determining the direct and exclusive reason for a share sale is the allocation of its proceeds.[159] According to van Doesum, while this is a useful clarification, in practice its effect is limited, as it is quite difficult to determine the proceeds' allocation,

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[154] CJEU Judgement of 17 October 2018, *Ryanair*, C-249/17, ECLI:EU:C:2018:834, paras 8, 11.
[155] Ibid, para 31.
[156] Decision C(2007) 3104 of 27 June 2007 (Case COMP/M.4439), para 1240; Opinion of Advocate General Kokott delivered on 3 May 2018, *Ryanair*, C-249/17, ECLI:EU:C:2018:301, para 9.
[157] Opinion of Advocate General Kokott delivered on 3 May 2018, *Ryanair*, C-249/17, ECLI:EU:C:2018:301, para 21.
[158] Ibid, para 22.
[159] CJEU Judgement of 8 November 2018, *C&D Foods*, C 502/17, ECLI:EU:C:2018:888, para 38; Ad van Doesum (2020), 20.

unless they are clearly used to, for example, grant a dividend to the shareholders.[160] This interpretation would also seem to leave open the question if the mere intention to allocate the proceeds thusly is enough to fulfil the criteria.

In *Sonaecom*[161] the Court seems to have provided an answer to that. In *Sonaecom* a question was put to the Court regarding the priority of using either the taxable person's initial intention for incurring the costs (linked to taxable activity) or the actual use of the costs (linked to exempt activity) as the basis for a right to deduct.[162] Following AG Kokott's opinion, the Court chose actual use, essentially arguing that 'used for' must, in accordance with its literal interpretation and the principle of fiscal neutrality be interpreted as the actual use within the tax period on which the deduction right arose taking precedence over the taxable person's initial intention.[163]

Considering *Sonaecom* together with *C&D Foods*, it could be argued that the mere intention to allocate the profits for business activities is not enough, but instead the actions of a taxable person will trump over any such intentions. *DTZ Zadelhoff* would seem to support such a conclusion.[164] Yet, it also emphasises those practical issues raised by van Doesum in connection with *C&D Foods*: how is such an allocation to be determined in practice. Thus, while *Sonaecom* could fix some of the subjectivity issues raised by this aspect of *C&D Foods*, the practical issues of the tax authorities having to follow the money in this manner are highlighted. Not to mention, in some cases it could even not be possible to determine the allocation of the profits in practice, making the underlying purpose test not the most objective, but instead quite a selective method to follow. Should in these cases the intention as the only lead to follow be enough then? This would hardly qualify as an option that adheres to fiscal neutrality. Additionally, even if despite the difficulties the actual use of the proceeds can be determined, the deduction right is supposed to arise when the tax becomes chargeable, even in case of preparatory activities.[165] Waiting for the actual allocation of the proceeds seems quite at odds with this as well.

Thus, the underlying purpose test seems to mean determining the direct and exclusive reason for the share disposal by way of establishing where the proceeds from such a sale are used for, both of which need to be objective conclusions, supposed to be made by taking into account all the circumstances of a particular case and the overall impression that they provide. This is hardly a definition promoting legal certainty. Not only does the Court itself seem inconsistent in applying the underlying purpose test in the first place, but as mentioned, this line of argumentation includes various notable practical

[160] Ibid.
[161] CJEU Judgement of 12 November 2020, *Sonaecom*, C-42/19, ECLI:EU:C:2020:913.
[162] Ibid, paras 17-18, 26, 50.
[163] Ibid, paras 52-54, 59, 61-62, 66; Opinion of Advocate General Kokott delivered on 14 May 2020, *Sonaecom*, C-42/19, ECLI:EU:C:2020:378, para 61.
[164] CJEU Judgement of 5 July 2012, *DTZ Zadelhoff*, C-259/11, ECLI:EU:C:2012:423, para 25.
[165] CJEU Judgement of 12 November 2020, *Sonaecom*, C-42/19, ECLI:EU:C:2020:913, para 36.

difficulties. Thus, this conclusion is certainly not one beyond criticism and change by the Court in its future case law.

4.2 Significance of the underlying purpose test

With *BLP*, the Court made it clear that where the input costs are objectively linked to an exempt activity, such as a sale of shares, there is no right to deduct, irrespective of the ultimate aim pursued by the taxable person.[166] Only tax directly borne by the taxable transaction's various cost components may be deducted, as another interpretation would jeopardize legal certainty and efficiency, while also being costly.[167] This stance is one the Court to a large extent reaffirmed in *Becker*.[168] Thus, *BLP* and *Becker* seem to be anything but promoting the usage of the underlying purpose test (as defined in this thesis), despite Becker also referring to the direct and exclusive reason for the transaction.[169]

However, in *SKF*, the Court seems to have used *Kretztechnik* as a way to deviate from its judgement in *BLP*. Although the relevant facts of the case correlate with those of *BLP*, in *SKF* the Court decided that as the company was providing management services for consideration to its subsidiary, the costs regarding the sale of those shares can be regarded as general costs, where those costs are incorporated in the share prices or into the prices of SKF's products. Accordingly, there may be a right to deduct.[170] *C&D Foods* promotes this line of thinking, as in that judgement the Court, building upon the direct and exclusive reason considered in *Becker*, brought that concept to the sphere of a more economic-based reasoning and defined it as a focus on what the proceeds would be used for in order to determine the possibility of deduction.[171] Thus, it seems that to a certain extent, despite their ties to *BLP* and *Becker*, *SKF*, *Kretztechnik* and *C&D Foods* promote the concept of an underlying purpose test.

Clearly, the case law of the CJEU is far from consistent as it regards the significance of the underlying purpose test. Yet, this differentiation in its effect does seem somewhat consistent with Jensen and Stensgaard's compartmentalization between reasoning following the consumption-based test and that adopting a more economic-based approach.[172] When considering the wording of Article 168 of the VAT Directive from a consumption-based perspective, the taxpayer's ultimate purpose for incurring the costs does seem irrelevant. Objectively, the costs incurred in connection with a share disposal, even where the proceeds are used for the taxable activity of a taxable person, are *consumed* due to the share disposal. On the other hand, (where it can be determined) those costs could still be *allocated into the prices* of a taxable person's output supplies as a part of his overall economic activity. In

[166] CJEU Judgement of 6 April 1995, *BLP*, C-4/94, ECLI:EU:C:1995:107, paras 19, 28.
[167] Ibid, paras 21, 24; Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 78.
[168] Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 79.
[169] CJEU Judgment of 21 February 2013, *Becker*, C-104/12, EU:C:2013:99, para 29.
[170] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, paras 62, 65, 68, 71-72.
[171] CJEU Judgement of 8 November 2018, *C&D Foods*, C 502/17, ECLI:EU:C:2018:888, paras 38-39.
[172] Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 72-73, 78-81; Ad van Doesum (2020), 19.

accounting theory, a cost is routinely defined as 'a resource sacrificed or foregone to achieve *a specific objective*'.[173] Thus, when considering Article 168 from an economic-based perspective, the purpose for the costs does seem to constitute a relevant, almost inherent factor for determining the direct and immediate link.

Although the more recent connections the Court has managed to build between cases of these differing approaches could also lead to the tempting and certainly needed conclusion that the Court has managed to bring these approaches together into one single interpretation of Article 168, considering the noteworthy differences between the approaches, this is perhaps an overly optimistic conclusion. Instead, it is more likely that the Court, at least for now, seems to favour an economic-based approach. Accordingly, the significance of the underlying purpose test seems quite reliant on the Court's interpretation of the wording of Article 168 of the VAT Directive in a particular case and ultimately the relevance of the test seems to come down to the approach the Court adopts in a particular case: consumption or economic. It is thus appropriate to discuss the test's significance from the wider perspective of the usage of these two approaches.

Being a part of the economic-based approach would seem to indicate that the underlying purpose test does have a place in the considerations of a direct and immediate link at the moment. Although the Court has hardly abandoned *BLP*,[174] its judgement in for example *SKF* and *X BV* seemingly disregarding the similarity of those judgements' facts with those in *BLP* and instead significantly deviating from its conclusions in *BLP* with those later cases could to an extent be considered as the Court setting the economic-based test as the dominating approach for now. This conclusion would be in line with *C&D Foods* but recently again confirming the Court's more economic-based test of *SKF*[175] and even adapting *Becker*'s concept of a direct and exclusive reason to fit this economic-based approach. This in turn could result in a careful conclusion that currently the underlying purpose test might be a viable option for companies to establish a direct and immediate link.

However, as Jensen and Stensgaard argue, the economic-based test does not hold water. As already explained, in this approach the distinction between direct and general costs depends on the costs' allocation in the business – do they influence the price of particular output transactions or the supplies of a taxable person as part of his overall economic activities. This allocation of the costs' economic burden based entirely on the choice of the taxable person not only compromises fiscal neutrality, but also guarantees an endless battle between companies and tax authorities regarding deductibility. It also seems to blatantly disregard basic economic theory: prices are determined by the relationship between supply and demand on the relevant market.[176] Accordingly, already in 1995 with his opinion regarding *BLP*, AG Lenz

[173] Charles T Horngren, Srikant M Datar and George Foster, *Cost Accounting: A Managerial Emphasis* (11th edn, New Jersey: Prentice Hall 2003) 30 [emphasis added]. See also Dennis Ramsdahl Jensen and Henrik Stensgaard (2012), 4 (footnote 4).
[174] Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 83.
[175] Ad van Doesum (2020), 19.
[176] Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 85.

seemingly disregarded this approach.[177] After considering both approaches in her opinion on *PPG Holdings*[178], AG Sharpston came to the same conclusion (although the Court did not follow her opinion).[179] Thus, it is doubtful how long the Court can continue approaching Article 168 in this manner.

Arguably, in *Sonaecom* the CJEU itself might have also inadvertently highlighted some of the economic-based test's core problems. While the Court already had an apparent, strong preference for objectivity in these considerations,[180] by denying the priority of the initial intention of the taxable person over the actual use, the Court seems to have acknowledged one of the very reasons for Jensen and Stensgaard's strong criticism of the economic-based test as well: distortion of competition. As having the deduction right depend on how an individual taxable person chooses to prepare his internal accounts, the initial intention of a taxable person also represents a highly subjective criterion to base deduction on. As such, both of them have a significant chance of producing different treatment for objectively similar situations, thus jeopardizing at least the principle of fiscal neutrality.[181] Why then deny one, yet continue to promote the other?

On the whole, the significance of the underlying purpose test seems very limited. Not only is its application secondary to a direct and immediate link establishable with direct costs, but it is also a victim of numerous practical issues. Moreover, the test in its current form appears to be reliant on an approach of the Court to Article 168 of the VAT Directive which is arguably unable to stand the test of reality. As such, it appears only a matter of time before the economic-based test's internal inconsistencies will cause its collapse in favour of the consumption-based one, which contrastingly seems to garner a great deal of support. Without notable changes to the definition of the underlying purpose test, such a change of attitude is likely to take the underlying purpose test down alongside it. Regardless, for now, in specific circumstances, the underlying purpose test is a possible way for the direct and immediate link between a taxable person's input costs and taxable transactions to be established in a strong enough manner to guarantee the deduction of the input VAT on those costs. Yet, considering the uncertain environment on which the test operates, relying on this method for building the link seems more of a gamble than sound business strategizing.

4.3 Conclusion for chapter 4

This chapter uses especially the case law of the CJEU to determine the effective meaning and significance of the underlying purpose test in the field

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[177] Opinion of Advocate General Lenz delivered on 26 January 1995, *BLP*, C-4/94, ECLI:EU:C:1995:16, paras 36-37. See also Dennis Ramsdahl Jensen and Henrik Stensgaard, (2014), 82.

[178] CJEU Judgement of 18 July 2013, *PPG Holdings*, C-26/12, ECLI:EU:C:2013:526.

[179] Opinion of Advocate General Sharpston delivered on 18 April 2013, *PPG Holdings*, C-26/12, ECLI:EU:C:2013:254, paras 24-25, 28. See also Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 83-84.

[180] See for example CJEU Judgement of 8 November 2018, *C&D Foods*, C-502/17, ECLI:EU:C:2018:888, para 36; CJEU Judgement of 3 July 2019, *University of Cambridge*, C-316/18, ECLI:EU:C:2019:559, para 29.

[181] CJEU Judgement of 12 November 2020, *Sonaecom*, C-42/19, ECLI:EU:C:2020:913, para 65; Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 85.

of share disposals. For the time being, the meaning of the underlying purpose test seems to be the determination of the direct and exclusive reason for the sale of shares based on the allocation of its proceeds. Adhering to fiscal neutrality, both of these conclusions must be objective ones made taking into account all circumstances of the case at issue. This chapter argues that the explained definition for the test is far from well-established and due to its apparent disregard for the reality of business, it is likely to bestow but limited effects for the test in practice.

The significance of the underlying purpose test is very limited. As the test's relevance appears to be reliant on the Court's usage of the widely criticized economic-based approach, already the environment of the underlying purpose test is ripe with uncertainty. Moreover, the specific circumstances the definition of the test seems to require for its fulfilment make the test's application all but impossible for a significant number of taxable persons. Accordingly, this chapter argues that despite the test having some footing in the current considerations of a direct and immediate link, it is not enough to promote trust in its reliability.

5 Underlying purpose test and the common system of VAT

The underlying purpose test as a method for building the direct and immediate link is not one to inspire much confidence. While it seems to be relatively business friendly and at first glance a way to promote the neutrality of VAT, it is questionable whether these surface assumptions hold any notable merit or if the test even fits into the system of European VAT. This chapter provides a discussion on these issues and establishes the relationship between the underling purpose test and the common system of VAT.

There are two main fundamental concepts of the VAT system, from the point of view of which the underlying purpose test does not seem to be acceptable: the principle of fiscal neutrality and the principle of legal certainty. Interestingly, especially as it regards fiscal neutrality, the issues appear to be something the Court itself addressed already in *BLP*. The principal argument of BLP for its right to deduct called for the attention to be shifted away from the immediate, exempt transaction and, in the name of fiscal neutrality, be focused on the wider purpose and benefit of that transaction instead – namely BLP's overall strategy to conduct its taxable transactions.[182] The Court, following AG Lenz' opinion, rejected this argumentation and instead concluded that the principle of fiscal neutrality does not have the scope BLP attributed to it.[183] In many ways, the current form of the underlying purpose test could be considered as the manifestation of an interpretation of the neutrality principle which was already denied by the Court in *BLP*. This is certainly not a glowing recommendation for the test.

Another significant problem related to the underlying purpose test is the overall great amount of confusion it is surrounded by. As discussed in the previous chapter, the test presents many issues from its unclear and in practice questionable definition, to its even less clear position as a method for establishing a strong enough direct and immediate link to guarantee deduction. In the words of Woolich, the test's application is 'ultimately *a matter of impression* based on all the circumstances'.[184] This hardly seems a practice promoting any level of certainty, even if the direct and immediate link by its nature must be considered on a case-by-case basis.[185] Accordingly, at least in its current form, the underlying purpose test is unable to fulfil the requirement of a taxable person being aware of its tax liability in advance and

[182] CJEU Judgement of 6 April 1995, *BLP*, C-4/94, ECLI:EU:C:1995:107, paras 12-13; Opinion of Advocate General Lenz delivered on 26 January 1995, *BLP*, C-4/94, ECLI:EU:C:1995:16, para 16.
[183] CJEU Judgement of 6 April 1995, *BLP*, C-4/94, ECLI:EU:C:1995:107, para 26; Opinion of Advocate General Lenz delivered on 26 January 1995, *BLP*, C-4/94, ECLI:EU:C:1995:16, paras 45-51.
[184] Richard Woolich (2019) [emphasis added].
[185] CJEU Judgement of 8 June 2000, *Midland Bank*, C-98/98, ECLI:EU:C:2000:300, para 25.

as such could hardly be argued to satisfy the principle of legal certainty to any notable degree.[186]

While at the outset the underlying purpose test in its current form appears to be business friendly, it comes at the price of administrative efficiency, legal certainty and neutrality, to the detriment of both tax authorities and businesses. The lack of clear guidelines on the test's reliability is likely to result in it being applied differently from one MS to another, hindering both legal certainty and neutrality as well as promoting distortions in competition on the common market – these are hardly consequences to aspire towards, no matter the intentions.

Furthermore, even the very concept of the test – a way to provide businesses better access to the right to deduct – seems to be rather at odds with the European VAT system. Although the test would initially appear to adhere to the nature of VAT being a tax on private consumption,[187] it could also be argued that it disregards some elements of the specific consumption tax system on which it operates. Exemptions and their negative effects on the deductibility of input VAT could also be called an integral part of the European VAT system.[188] Just as the whole economic-based test, the underlying purpose test seemingly inspired by it is also quite arbitrary compared to the positive link demanded by Article 168 of the VAT Directive.[189] An overly generous access to the right to deduct for an exempt or out of scope output transaction such as a sale of shares could thus be considered to an extent to overlook a fundamental part of the common system of VAT. Instead, it appears even somewhat of a contradiction with the very system on which it operates. As such, at least as it is defined at the moment, the underlying purpose test should be dismissed on the grounds of not being in compliance with the common system of VAT.

In its current form the underlying purpose test is more likely to create uncertainty than certainty and unjustifiably differing treatment than neutrality. If indeed, the goal is to allow wider access to deduction, this could be achieved by other means as well. In fact, the Commission is currently looking into possibly amending the rules on financial transactions.[190] While in its baseline considerations, the rules on financial services would remain unchanged, another solution the Commission is looking into is the removal of the exemption on financial services in order to tax them.[191] The removal of the exemption is an option van Doesum and van Norden promote as well.[192] Another policy option the Commission considers in its initiative is keeping

[186] CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 77.
[187] Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Articles 1, 168; *inter alia* CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, paras 55-56 and the case law cited therein.
[188] Consolidated text: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Title IX; be analogy CJEU Judgement of 29 October 2009, *SKF*, C-29/08, ECLI:EU:C:2009:665, para 59 and the case law cited therein.
[189] Dennis Ramsdahl Jensen and Henrik Stensgaard (2014), 86.
[190] Ulrika Lomas (2021) accessed 9 May 2021.
[191] European Commission, Inception impact assessment - Ares(2020)5770956, Review of the VAT rules for financial and insurance services, 3.
[192] Ad van Doesum and Gert-Jan van Norden (2011), 326, 329.

the exemption, but modifying its scope to tax only some types of services.[193] How this would be adopted in practice however, is still quite unclear.

Accordingly, even though the amending process is but at its starting point, the future does not look very promising for the underlying purpose test. The options the Commission is currently considering seem to promote neither the usage nor nature of the test as established by the CJEU's case law. In fact, the test seems quite opposite to the aims of the Commission to amend the rules to better foster neutrality and especially legal certainty, even though it is in line with the creation of neutrality between financial services and non-exempt services.[194] Yet, this early into the amending process, it cannot be discounted that the Commission would find a way to incorporate the underlying purpose test (or more likely merely something like it) into the new rules. There is also a notable possibility that the current review of the rules on financial services' VAT treatment will result in no effective amendments, as was the fate of the Commissions review on the rules in 2007 and the resulting legislative package.[195] The VAT treatment of financial services is after all a very complex and politically charged area of VAT.[196] This in turn could leave the underlying purpose test in its current form as an option for the companies to attempt to fulfil. Yet, in such a situation no change to the meaning or significance of the test hardly means that it is in line with the common system of VAT – merely that it remains a compromising part of it.

[193] European Commission, Inception impact assessment - Ares(2020)5770956, Review of the VAT rules for financial and insurance services, 3.
[194] Ibid, 2-3.
[195] Ibid, 1-2.
[196] Ibid, 1; Ad van Doesum and Gert-Jan van Norden (2011), 326, 329.

6 Conclusion

In the sphere of share disposals, the establishment of a direct and immediate link to guarantee a right to deduct is hardly an easy task. In the last 30 years, the unambiguous and ever evolving approach of the CJEU on sales of shares has not managed to make navigating its case law on the matter any easier – in fact, it had quite the opposite effect. This is evidenced by especially the more recent emergence of the underlying purpose test.

This thesis examines the provisions and concepts of the VAT Directive as well as the relevant case law of the Court that govern the underlying purpose test. These primary sources as the main material, this thesis also builds upon the works of especially Ad van Doesum, Dennis Ramsdahl Jensen and Henrik Stensgaard that establish the environment on which the underlying purpose test operates, with the purpose of identifying the meaning and significance of the test in the context of a direct and immediate link relating to holding companies' sale of shares.

The concepts of taxable person, economic activity, right to deduct and exemptions with the guidance of principles of fiscal neutrality and legal certainty have an immediate effect in these discussions. The definitions of these concepts and principles govern the case law of the Court and have resulted in the following determination by the Court: a direct and immediate link can also be established in case the costs incurred in relation to a share disposal of a taxable person acting as such can be linked with its economic activity as a whole, as part of its general costs. Yet, given the existence of two different approaches the Court has developed to Article 168 of the VAT Directive (namely consumption-based test and economic-based test), the determination of general costs is an issue requiring further research.

This thesis argues that currently the underlying purpose test means the objective determination of the direct and exclusive reason for the sale of shares based on the allocation of its proceeds. Accordingly, as an option for the establishment of a direct and immediate link with the general costs of a business, the underlying purpose test is an unreliable one. While currently the Court seems to consider the test a viable option for building the link, the test appears to operate on the erratic environment of the economic-based approach and its effects in commercial practice are arguably quite limited due to the practical difficulties, if not impossibilities, of its application.

The underlying purpose test seems to also be inconsistent with the common system of VAT. Failing to properly fulfil the conditions of both fiscal neutrality and legal certainty, the test is hardly an aspect of the direct and immediate link the Commission would aim to save. Thus, should the Commission's review of the VAT treatment of financial services result in actual amendments to the VAT Directive this time around, such amendments will most likely be to the detriment of the underlying purpose test.

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