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VAT: DEDUCTIBILITY OF THE COSTS OF ISSUING NEW SHARES - THE 'DIRECT AND IMMEDIATE LINK' TESTS

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1. Introduction

Companies seeking to issue or list shares can incur substantial associated costs, with important VAT consequences for supplier and issuer alike. The supplier of, for example, legal services, investment analysis, market sector research and consultancy, has to determine whether the services supplied are taxable, and, if so, when and where they are taxable and, possibly, who is liable for the tax. These are complicated matters as the 'making arrangements for or negotiation of a transaction in securities' [2] is interpreted in various ways by the tax authorities of the Member States.

Place of supply alone is a complex issue[3]. Furthermore, Member States are able to lay down who is the person liable to pay the VAT where the supplier is not established in the Member State where the supply takes place[4]. In addition, when the services supplied are otherwise exempt, the nature of the supply will be affected

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2 See Peter Landon, *VAT and The City*, CCH, 4th edition p. 170.

3 More than 25 criteria may apply and this has led to complex solutions such as in the following: Case C-327/94 *Dudda*, [1996] ECR I-4595; Case C-167/95 *Linthorst* [1997] ECR I-1195, Case C-145/96 *von Hoffman* [1997] ECR I-4857. See Amand C. 'TVA Communautaire et Arbitrage', *Revue de l'Association Suisse de l'Arbitrage*, [1999] Issue 1 p. 13.

4 See Art 21 Sixth Directive.

if the customer is established outside the EU.[5] It is also important to decide whether the service relates to the issue of shares or to preliminary or general but associated matters.[6]

The present study will be restricted to an analysis of the input tax position of the issuer. From a survey of the various Member States, it emerges that VAT paid on services linked with a share issue by a fully taxable business is deductible in some but not in others. It will be argued that input tax on share issue costs is deductible in the normal way by fully taxable businesses and is subject to the normal restrictions when incurred by a business which is not fully taxable.[7]

The central point is whether the costs of raising capital by an issue of new shares 'are part of the undertaking's overheads and hence of the cost components of the products'.[8] It will be argued that an issue of shares is an activity outside the scope of VAT because there is no direct link between the business and the consideration received. However VAT incurred in relation to the issue is deductible where there is a direct and immediate link with the taxable activities of the issuer's business.

2 A Variety of National Interpretations Based on a Common Directive

Some Member States treat the issue of shares as exempt, others categorise it as outside the scope of VAT albeit carrying with it the right to deduct input tax and a third group treat it as an activity whose related costs are treated as overheads. Such

5 Art 17(3)(c) Sixth Directive provides that suppliers of certain financial services to customers established outside the EU have the right to deduct the associated input tax.

6 S Holt BA *Tolley's VAT Planning* 1996-1997 p. 667 and *Banner Management Ltd* [1991] VATTR 254; *RAP Group Plc* [2000] STC 980.

7 The situation of the company acquiring shares in another company will not be considered here, however it can be argued that the solutions would be very similar – see Tribunal Administratif de Poitiers Deuxième Chambre, 25th February 1999, req. 96-685; SA Rémy Cointreau, *Droit Fiscal*, 1999 comm. 497 and TA Besançon, Première Chambre, 6th April 2000, req. 98/789; SA Christian Dalloz, *Droit Fiscal* 2000, comm. 1067; see also Confédération Fiscale Européenne - Opinion Statement on Changes in Ownership of Taxable Businesses by means of Share Transfers (1999). See also Case C-6/00 *Cibo Participations SA*, judgment dated 27th September 2001.

8 Case C-4/94 *BLP Group plc*, [1995] ECR I-983. Interestingly this interpretation has been challenged by the Finnish Supreme Administrative Court ('SAC'), 21st March 2001, no 513. In this case the sale of shares had taken place in 1994, (before Finland acceded to the EU in 1995) so the fact that the SAC decided to publish this judgment in its annals for 2001 strongly indicates that even if the EC law had been in force in Finland at the time of sales of shares it might not have affected the final outcome.

differences of interpretation do not seem to be caused by any exceptions allowed by the Sixth Directive or differences in linguistic versions of the Sixth Directive, but rather by a different understanding of the fundamental common concepts of the VAT system, in particular, of what is exempt and what is outside the scope of VAT.

2.1 Member States Where VAT on Costs of Share Issues is Not Deductible.

2.1.1 Denmark[9]

Following the *BLP* case, Danish practice in relation to the deductibility of expenses incurred in connection with exempt transactions has tightened with the consequence that the tax authorities have refused deduction for expenses paid in connection with share flotations. The Danish National Tax Tribunal has recently confirmed this position. The National Tax Tribunal argued that the sale of shares issued to raise additional capital was exempt under Art 13B(d) of the Sixth Directive. Expenses paid in connection with the raising of capital by way of a share issue/flotation were seen as directly and immediately linked to the exempt transaction - the share issue. Consequently those expenses were not deductible applying the *BLP* case.

2.1.2 Germany[10]

The issue of shares is generally treated as exempt without credit for input tax[11]. Input tax incurred in the formation of a new corporation is, however, generally deductible as incorporation is regarded as the first and necessary step for the commencement of a taxable activity. According to the German tax authorities, future share issues are not sufficiently closely linked to future taxable transactions (for example, the expansion of the business) to allow input tax recovery.

German law gives effect to options for taxation based on Arts 13(C) and 28(3)(c) of the Sixth Directive.[12] The issuer of shares can opt to tax the deemed transfer of shares if the transfer is to a taxable person and the shares are used for the purposes of taxable transactions by the acquirer. As a matter of general principle, the option can be exercised separately vis-à-vis each shareholder. However, the holding of shares is generally not seen as a taxable activity as shares are primarily regarded as

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9 With thanks to Claus Kilketerp of KPMG Jepersen, Copenhagen.

10 With thanks to Axel Scheller of KPMG Zurich and Hamburg and Stephan Raab from KPMG Frankfurt.

11 Under para 2.1.3 of the decree of the Saarbrucken Inland Revenue Office dated 20th April 1995 as well as under corresponding decrees by other Inland Revenue Offices.

12 § 9.1 UstG.

being held with a view to obtaining dividends rather than as the subject of a supply. In most circumstances, the option to tax will, therefore, be unavailable to the issuer so that input tax incurred in the issue will be a 'sticking' cost.

There are currently no specific rules in Germany excluding VAT incurred in debt financing from input tax recovery.

2.1.3 Ireland[13]

There is no entitlement to input tax recovery in respect of any expenses incurred in relation to any transaction in shares apart from those involving non-EU clients where the services are deemed to be supplied outside of the EU. A Statement of Practice was issued by the Irish Revenue following discussion and the issue of guidelines on the matter by the VAT Committee in Brussels in July 1990.[14] The position is that VAT on costs incurred by a company on accountancy or legal services, stationery, printing, etc., in connection with, for example, an issue of shares under the Business Expansion Scheme, is not deductible.[15]

2.1.4 Spain

According to, Art 20 uno 18 l Ley del Impuesto sobre el Valor Añadido, exemption applies to the transfer of 'valores y servicios relaciaonados con dicha transmission, incluso por causa de su emission' (transmission of securities, including their issue).[16]

2.1.5 Sweden[17]

In December 1996, the Swedish National Tax Board determined that input tax incurred on the costs of raising share capital should be deductible in the same way as input tax on overhead costs.[18] The argument for allowing the deduction was based

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13 With thanks to Niall Campbell, KPMG Dublin.

13 According to the answer of Mr. Bolkenstein to written question E-3729/00 (OJ 19 June 2001): 'The Commission can confirm that delegations at the July 1990 meeting of the VAT Committee were unanimous in the view that VAT on costs relating to share transactions is not deductible, such transactions being exempted under Art 13(B)(d)(5)'.

15 'VAT and Financial Services' June 1999, Appendix VIII, p 102.

16 With thanks to Jesus Ricard.

17 With thanks to Pär Sundberd of KPMG Stockholm. For an extensive overview of the Swedish situation see Sundberg P. *Svensk Skattetidning* SvSkT 8/2000.

18 DNR 9623-96/900.

on a comparison with the case where the company, instead of issuing new shares, borrowed the money from a bank. According to the National Tax Board, the method of financing should not result in a different VAT treatment.

The tax authorities accepted the standpoint that was taken by the National Tax Board. In late 1999, however, the National Tax Board decided to obtain an advance ruling on a closely connected issue, namely, whether input tax credit should be given on the costs incurred when a company acquires a listing for its shares. The Board for Advance Ruling concluded that such costs could not be directly connected with a taxable business activity carried out by a taxable person. The Board's conclusions were based on the following arguments:

- according to Art 17(2) Sixth Directive, input tax credit is only given for a cost which is directly 'consumed' in making a taxable supply - the costs subject to the advance ruling were not of such nature

- the costs under consideration could not be looked at as costs necessary to provide a taxable supply of goods or services but rather as costs incurred outside a taxable business activity.

In line with this ruling, the National Tax Board changed its view on the VAT deductibility on costs incurred when increasing the share capital etc. and input VAT credit is no longer given. The advance ruling in question is on appeal to the Supreme Administrative Court.

2.1.6 United Kingdom[19]

The issue of shares and securities and their transfer is treated in the same way for UK VAT purposes. While there is a view that the issue of shares does not give rise to a supply by the issuer as the subscriber is merely contributing capital rather than buying something of value, this is not accepted by HM Customs and Excise.[20]

Item 6 Group 5 Schedule 9 to the Value Added Tax Act 1994 ('VATA') exempts:

> 'The issue, transfer or receipt of, or any dealing with, any security or secondary security being:

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19 With thanks to Tony Lynne of KPMG London for the information he provided and his very useful comments on this paper.

20 Connolly P., 'VAT aspects of corporate finance transactions', Tax Digest May 1997, Issue 169 p. 6.

(a) shares, stocks, bonds, notes (other than promissory notes), debentures, debenture stock or share in an oil royalty; or

[...]

(d) any letter of allotment or rights, any warrant conferring an option to acquire a security included in this item, any renounceable or scrip certificates, rights coupons, coupons representing dividends or interest on such a security, bond mandates or other documents conferring or containing evidence or title to or rights in respect of such security; or ...'

The UK legislation has been challenged unsuccessfully until recently. In *Mirror Group Newspaper Ltd v CEC* [2000] STC 156, it was decided by the UK High Court that an issue of shares constituted a supply for VAT purposes. It was submitted by Customs and accepted by Mirror that for an issue of shares to constitute a supply of services, it must bear the six characteristics of a supply of services:

1. It must constitute a transaction;

2. Something must have been done by the person said to have made the supply;

3. What was done must not fall within the definition of a supply of goods;

4. What was done must have been capable of being used by and for the benefit of an identified recipient;[21]

5. The benefit given to an identified recipient must be capable of being regarded as a cost component of the activity of another person in the commercial chain;[22]

6. What was done must have been done for a consideration, namely:

   (a) there had to have been a legal relationship between the provider of the service and the recipient;

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21 See Case C-215/94 *Mohr v Finanzamt Bad Segeberg* [1996] STC 328 at 336, para 21.

22 See Case C-384/95 *Landboden-Agrardienste GmbH & Co KG v Finanzamt Calau* [1998] STC 171 at 179-180, para 23.

(b) pursuant to the relationship in (a) there must have been reciprocal performance;

(c) the remuneration received by the provider of the service must constitute the value actually given in return for the service supplied[23] and must be capable of being expressed in monetary terms.[24]

Customs submitted that an issue of shares bore all the six required characteristics, and again Mirror agreed. The critical question was whether, as Mirror alleged, the issue of shares must bear some other and if so what characteristics.

Customs argued that there was no further characteristic to be borne by an issue of shares in order to qualify as a supply of services that could be found in the Sixth Directive or any European Court judgment. Some support for Customs' claim that an issue of shares does qualify as a supply of services can be found in the language of Art 13B(d)(5) of the Sixth Directive which expressly exempts 'transactions in shares', a term apt to include issues of shares, and a term spelt out to include issues of shares in Schedule 9 to VATA. The exemption is a dispensation from an otherwise presumed liability for VAT, a liability which may be reinstated under Art 13C if the appropriate national legislation is passed and the option exercised.[25]

Mirror contended before the High Court that the conferment of exemption did not itself establish that an issue of shares was a supply of services. It submitted that a further characteristic was required, namely that there must be some transfer of the resources of the person making the supply to the other party, or at least some depletion of the resources of the person making the supply. Thus the sales of shares in the course of his business by a taxable person will constitute a supply, for it involves such transfer. By contrast the issue of shares in the course of his business by the taxable person involves neither a transfer nor depletion of resources.

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23 See Case C-16/93 *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* [1994] ECR I-743 at 759, para 14.

24 See Opinion of Advocate General Lenz in Case C-16/93 *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* [1994] ECR I-743 at 748, para 14.

25 See Case C-283/95 *Fischer v Finanzamt Donaueschingen* [1998] STC 708 at 721, para 18.

According to the High Court in the *Mirror* case[26] to recognise an issue of shares as a supply was:

> 'to treat the issue of shares in the same way as the sale of shares from which it is for the purposes of Community VAT legislation indistinguishable. Issues and sales have the same essential ingredient, namely the vesting by the 'vendor' in the 'purchaser' for monetary consideration of like intangible property. As the Tribunal aptly put it (at para 50[27]):'If the purchasers of shares in BLP were consumers, I see no logical reason for distinguishing the subscribers in the present case. Art 13B(d)(5), 13C(b) and 17(3)(c) of the Sixth Directive (and for what it is worth s.31 (1) and item 6(a) of Group 5 of Sch 9 to the 1994 Act) confirm that the wide scope of concept of supply of services is quite sufficient to embrace the issue of shares.'

The case was the subject of a further appeal.[28] The UK Court of Appeal has refused to make a reference to the European Court [29] since the Court's view was that it had been clearly decided in the *BLP* case[30] that input tax incurred in relation to a transaction in shares was not recoverable and there was no doubt that the issue of shares was an exempt supply.

2.2 Member States Where Deduction of VAT Costs of Share Issues is Allowed

2.2.1 Austria[31]

The issue of shares was considered to be a taxable event but exempt (Art 13(B)(d)(5) Sixth Directive). There used to be no right to deduct input VAT on the expenses

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26 See *Trinity Mirror Case* [2000] STC 156 at p. 1162 para 10.

27 Of unpublished Tribunal decision number 15725.

28 *Trinity Mirror Plc v Commissioners of Customs and Excise* [2001] STC 196.

29 When UK Courts see the matter as acte clair they refuse to refer to the European Court for a preliminary ruling even when evidence of divergence of interpretation in various EU Member States is submitted and when it is argued that a preliminary ruling could clarify an issue at European level. For a similar approach to the complex topic of place of supply of services see Hoge Raad der Nederlanden, nr. 34.973, 10th January 2001. The European Commission does not seem able to detect and curb major differences in interpretations, even when this affects the proper functioning of the internal market.

30 Case C-4/94 *BLP Group plc,* [1995] ECR I-983

31 With thanks to Johann Muehlehner, KPMG Vienna.

directly connected with the issue (such as fees for brokers and marketing fees).[32] After the *Abbey National* case[33] the Austrian authorities took a different view - that the VAT was deductible.

2.2.2 Belgium

It appears from Belgian administrative statements that the Belgian authorities consider that input tax incurred on the valuation of assets made with a view to the issuing of shares or an increase in capital is deductible.[34]

According to the Belgian Minister of Finance in an answer given to a member of parliament, the issue by a taxable person of shares representing shareholders' equity is merely an internal financing activity and not an economic activity as described in Art 4 of the Belgian VAT law. Such an operation is therefore outside of the scope of VAT.[35] The import of the statement was not entirely clear as the Minister did not say that the VAT on related costs was not deductible. However, local VAT inspectors have concluded on the basis of the *Polysar* case[36] that VAT incurred in relation to activities outside the scope of VAT is not deductible. The Minister of Finance has subsequently stated, in reply to a further question, that such VAT is deductible according to the normal rules, where the finance raised by the share issue is used in the course of an activity giving the right to deduct input VAT[37].

2.2.3 Finland[38]

The Central Tax Board has ruled[39] that input tax on costs related to the issue of shares (e.g. marketing costs, fees charged by lawyers and auditors and fees paid to

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32 Supreme Court rulings (VwGH 29. 5. 1996, 95/13/0056; VwGH 13. 10. 1999, 94/13/0120).

33 Case C-408/98 *Abbey National plc* [2001] ECR I-1361

34 Manuel de la TVA, no 336.

35 Question no 654 of 29th November 1996 of Louis Michel, *Rev. TVA* n° 127 p. 297.

36 Case C-60/90 *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen, Arnhem* [1991] ECR I-3111.

37 Question of 15th May 2000 of Senator de Clippele, *Q et R Parl.* n° 2-25, Session 2000-2001, p. 1176.

38 With thanks to Ari Nielsen, Marko Ojala and Mika Kallio of KPMG Helsinki and to Timo Kanervo, KPMG Tax Advisers Brussels, Finnish Desk.

39 KVL 25th August 1997, 166/1997.

the bank which have arranged the subscription for shares) was deductible for an issuer effecting taxable supplies. The Central Tax Board's ruling has legal force.

The National Board of Taxes has taken the same view of the matter in its written instructions.[40] It argued for its interpretation by referring to the decision of the Central Tax Board. In addition, the Central Tax Board stated that a share issue, or other arrangements related to the increasing of share capital (such as a capitalisation issue), does not constitute a supply of services or any other transaction subject to VAT. Therefore, an issuer making taxable supplies may be able to recover the input VAT as overhead costs.

The deductibility of VAT incurred on the costs of a share issue has been challenged by the Finnish tax authorities. The Supreme Administrative Court considered that a share issue fell outside the scope of VAT and the associated costs were seen as overheads of the business. Consequently an issuer carrying out only taxable supplies was entitled to a full recovery of VAT incurred on such costs.[41]

2.2.4 Italy[42]

As in the other countries where VAT deduction is allowed, it is difficult to find a definitive statement of the official position. The only mention is in an administrative instruction.[43]

2.2.5 France

Art 261-C §1 of the Code Général des Impots has adopted the wording of Art 13(B)(d)(5) of the Sixth Directive. In an instruction of 31st January 1979[44] the French tax authorities refer, for example, to a stock exchange brokerage fee (commission sur ordre de bourse), commission paid for the sale of shares issued by other companies (commission de placement), and the profit on the sale of shares. Interestingly, the issue of shares is not mentioned in the administrative instructions or the official tax literature. In the opinion of French tax advisors, deductibility is

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40 30th March 1998, 916/40/98.

41 Supreme Administrative Court, 21st March 2001, n° 514.

42 With thanks to Sefania Fregonese, Studio Associato Rome and to Raffaele Rizzardi.

43 Circolare 24 diciembre 1997 Numero 328/E, capitolo I - presupposti del Tributo.

44 Instruction du 31 janvier 1979 de la Direction générale des Impôts relative aux régimes spéciaux de TVA: Opérations bancaires et financières.

not an issue[45] and VAT deduction in these circumstances has never been challenged by the French authorities.

2.2.6 Netherlands[46]

The Dutch tax authorities clearly state that the sale of shares is exempt.[47] Van Hilten considers that this does not mean that an issue of shares is also exempt – in an issue, the issuer does not engage in an operation with another person, he grants the evidence of a 'participation' (shareholding).[48]

The deduction of input tax will not be restricted when a holding company is actively involved in the management of a company it controls.[49]

2.3 The Remaining Member States

In Portugal[50] and Greece,[51] the tax authorities have never disputed the deduction of VAT on supplies related to the issue of shares. The Luxembourg authorities have never expressed an official opinion.[52]

3 The Sixth Directive

The Sixth Directive mentions shares in Art 5 (definition of supply of goods) and Art 13 (VAT exemption).

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45 With thanks to Pascal Dewavrin, Fidal Paris et International.

46 With thanks to Gilbert Kortenaar, KPMG Meijburg Rotterdam.

47 Resolutie of 25th July 1979, reprinted on 4th March 1983, no. 283-3331.

48 Van Hilten, M.E. *Bancaire en financiële transacties in de Europees BTW*, Kluwer 1992, p. 144; see also Besluit staatsecretaris van Financiën 8th November 1999, nr. VB 1999/2277, VN 1999/58.18.

49 Decree of 18th February 1991, VB91/347, Para 11 in *Wet Omzetbelasting 1968*,Kluwer, artikel 7 nr. 36A; Hoge Raad 17 February 1988, Case 24275; Hoge Raad 1st April 1987, Case 23732.

50 With thanks to Candida Peixoto, KPMG Lisbon.

51 With thanks to Constantine Papacostopoulos, KPMG Athens.

52 With thanks to Sophie Weyten and Laurence Lhôte, KPMG Luxembourg. They suggest that based on the accounting principles, VAT on costs of the issue of new shares should be deductible. This is certainly an argument, which should be developed in more detail.

Art 5(3)(c) provides that Member States may consider shares or an interest equivalent to shares giving the holder thereof de jure or de facto right of ownership, or possession over immovable property or part thereof to be tangible property. This is however not relevant here.

According to the English text of Art 13(B)(d)(5), exemption applies to 'transactions, including negotiation, excluding management and safe-keeping, in shares, interests in companies or associations, debentures and other securities, ...' The French version refers to: 'les opérations, y compris la négociation mais à l'exception de la garde et de la gestion, portant sur les actions, les parts de sociétés ou d'associations, les obligations et les autres titres'. The German version refers to exemption for: 'die Umsätze - einschließlich der Vermittlung, jedoch mit Ausnahme der Verwahrung und der Verwaltung - die sich auf Aktien, Anteile an Gesellschaften und Vereinigungen, Schuldverschreibungen oder sonstige Wertpapiere beziehen, ...'.

A comparison of the different language versions of the Sixth Directive does not reveal any reason for the differences of interpretation in the various Member States.[53] The differences in interpretation cannot be explained by the fact that Art 13(C)(b) enables Member States to give taxpayers a right of option for taxation as only Germany, France and Belgium[54] have taken advantage of this provision.[55] Furthermore there are no relevant simplification measures under Art 27 or exceptions under Art 28 of the Sixth Directive.[56]

During its twenty-third meeting on 1st and 2nd February 1988, the EC VAT Committee discussed the VAT treatment of capital increases by way of share issue. The VAT Committee unanimously considered that such operations were either 'outside the scope' of VAT, or exempt as financial operations. The great majority of the delegation considered that the associated inputs of the issuer were attributable to its general activity and that the input tax should be deductible according to the general rules however, the Sixth Directive made direct attribution a possibility.[57]

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53 A careful comparison of the various language versions of the Sixth Directive reveals some major difficulties. For example, the Spanish version still contains more than 120 differences from the French version, despite repeated attempts by the Spanish tax authorities to convince the Commission to correct this situation.

54 For activities of payment and cashing.

55 See First Report from the Commission to the Council on the application of the common system of value added tax, submitted in accordance with Art 34 of the Sixth Directive COM(83) 426 final, Brussels 14th September 1983 p.93.

56 For a summary of such simplification measures by Articles of the Sixth Directive see Amand C and Van Besien J, *EU Law Report, Taxation* CCH.

57 Compare with the orientation quoted above under 2.1.3, footnote 13.

4 The 'Direct and the Immediate Link' Tests

Art 17(2) of the Sixth Directive provides that input VAT is deductible as long as goods and services are used for the purpose of taxable transactions. In order to disallow the deduction of input VAT incurred in relation to share issues, it is generally argued that an issue of shares is either an exempt supply or an operation outside the scope of VAT.

4.1 VAT Exemption - The 'Direct Link with Consideration' Test

It is argued that the issue of shares is not an exempt operation, because it is not an activity of an economic nature. It is considered that even in the case of transfer of resources, an operation may be outside the scope of VAT because there is no direct link between the operation and the consideration,[58] and in particular because there is no reciprocal obligations. It is not agreed that the issue of shares is 'the vesting by the vendor in the purchaser for monetary consideration of like intangible property'.

4.1.1 Raising of Capital by Issue of Shares is not a Sale of Shares

According to Esajas,[59] the issue of shares can be distinguished from the disposal or sale of shares in that an issue involves the creation of equity for the company, while disposal involves the transformation of one asset into another (shareholding into cash or kind). But curiously, Esajas does not see any difference between the issue of new shares and the re-issue of shares after a share repurchase. Both create new equity. The fact is that a share disposal may create profit, which is in a sense new equity. It is merely a matter of asset evaluation. The same view is to be found in the *Mirror Group Newspaper Ltd* case[60] where it was considered that any transfer of resources was a supply for VAT purposes.

It is not disputed that the sale of a shareholding in another company is a VAT exempt activity.

In the *BLP* case,[61] a management/holding company (BLP) sold its shareholding in another company (Berg Mantelprofilwerk GmbH). The money raised by the sale

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58 See Amand C. 'When is a Link Direct?' *International VAT Monitor*, 1996 p. 3.

59 Stanley A. Esajas, *International VAT Monitor* 1999, p. 162.

60 [2000] STC 156.

61 C-4/1994 *BLP Group plc* [1995] ECR I-983.

was used to pay BLP's debts, in order to safeguard the continuation of its taxable activities.

BLP claimed the deduction of input tax related to the sale of shares, on the grounds that the sale was subservient to their main taxable activity. The UK tax administration argued that the sale of shares was exempt and therefore no deduction was allowed. The European Court ruled that where a taxable person makes supplies to another taxable person who uses them for an exempt transaction, the latter is not entitled to deduct the input VAT paid, even if the ultimate purpose of the transaction is the carrying out of a taxable transaction.

In *BLP*, the important factual element was that the sale was of an existing share holding in another company. There is a critical difference between the issue of new shares and sale of shares which is examined below. Only shares which have been issued can be sold. A company may sell its own shares, after having purchased them but a share can be sold only after it has been issued.

The criterion of 'direct link with consideration'[62] was met in *BLP*. BLP sold existing shareholdings in a business and had an immediate right to receive assets from the purchaser. The price of such existing shares was determined by the market and was independent of the possible distribution of future profits or the objective value of the assets of the company.

The criterion of a 'direct link' between the price (the transfer of resources) and the supply (the issue of new shares) is not met in the case of the issue of new shares because they have no direct value in relation to the acquirer and issuer of the shares at the moment of the issue of the shares. Before dealing with the direct link issue (see 4.2 below), it is necessary to clarify what the acquirer of the new shares receives in exchange for the transfer of resources.

4.1.2 Issue of Shares means Creation of Rights but not of Reciprocal Obligations

According to Art 4(1)(d) of Directive 69/335/EEC, an issue of shares is the means of acquisition of rights in the capital of a company. The creation of such rights is not the same as the transfer of them. Every person may (with some restrictions) acquire and transfer such rights in the capital of a company, for example, on the Stock Exchange, but the creation of such rights may be effected only by the company itself. The company does not grant rights such as a right to a dividend or a right to refund the money paid for a share after a certain period. The right to receive dividends if dividends are declared does not mean that the company has the

62 See Amand C. When is a Link Direct? *International VAT Monitor*, 1996 p. 3.

obligation to pay dividends.

The concept of an issue of shares was defined by the French Cours de Cassation as the flotation or offer of new shares or shares to be issued. It is the creation of a link between the issuer and the acquirer of the shares. It is not relevant that the shares are offered to the public in general, or reserved to a class, such as former shareholders.[63] According to French commercial law, a share gives a right to vote and to 'call for sharing possible benefits'.[64] Under French law, a share gives direct or indirect access to capital and the right to vote.[65] It does not give the holder de facto rights over or ownership or possession of the assets of the company and it represents rights of which a holder cannot de deprived.[66]

A fundamental question is whether or not such rights have a value in the relationship between the issuer of the shares and the acquirer of the shares. Is this question only a problem in relation to the determination of an existing value (which means that the rights have a subjective value) or, more fundamentally, do such rights have a subjective value as between the issuer and the acquirer of the shares? There is no doubt that the shares have a value for the acquirer of the shares however, the argument is that they have no direct value in the relationship between the issuer of the new shares and the acquirer of such shares.

The rights created by a company issuing new shares have no direct value as such because acquisition of value requires the hypothetical action of other persons:

- The acquirer may hope to receive dividends, but the company issuing the shares has no obligation to declare and pay dividends. As the European Court points out in the *Floridienne* Case:

  'In view, specifically, of the fact that the amount of the dividends thus depends partly on unknown factors and that entitlement to dividends is merely a function of shareholding, the direct link

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63 Cassation Française, 17 janvier 1888, *Dalloz Périodique* 1888 I 409; *Rec. Gén.* No. 15687, with a note; Donnay, Le droit de timbre sur les actions et les obligations de sociétés, *Rec. Gén.* No. 17998 § 97 et Defesche Paul, *Commentaire des droits de Timbre*, Bruxelles 1949 p. 255.

64 Hamel J. et Lagarde J., *Traité de Droit Commercial*, T I, Dalloz 1954 p. 654.

65 See Art 1er de la Loi MAF du 2 juillet 1996; de Vauplane H. et Bornet J P *Droit des Marchés Financiers*, Litec 1998 p.54.

66 Antoine J and Capiau-Huart M.C., *Titres et Bourse T1 Valeurs Mobiliéres* – Second edition – De Boeck p. 34.

between the dividend and a supply of services (even where the services are supplied by a shareholder who is paid dividends), which is necessary if the dividends are to constitute consideration for the services, does not exist'.[67]

- The acquirer may hope to sell the shares recently issued to the third parties, but such a sale depends on external factors and it may be that, in case of bankruptcy of the issuer of the shares, he will never find a person willing to pay monetary consideration for such shares.

It may be difficult to accept that a person would be ready to give resources for something which has only a subjective value in future, in a hypothetical relationship with other persons. However, this has been confirmed by the European Court in *Boots*[68] and *Argos*.[69]

In the *Boots* case the European Court acknowledged that:

> 'From the economic point of view, since the obligation assumed by Boots forms part of a promotion scheme the cost of which is borne by Boots itself, it affords Boots no advantage other than the prospect of increasing the volume of its sales of premium goods and redemption goods. It is only where the coupon surrendered to Boots is then recovered by its suppliers, when the latter bears all or part of the promotion costs, that the coupon has monetary value for Boots equal to the amount actually paid by the supplier to Boots pursuant to their own contract. In the case in question, the coupon represents for Boots only an obligation to grant a reduction, which is allowed with the aim of attracting the customer'.[70]

And later the Court observed that:

> 'It is clear from the coupon's legal and economic characteristics described above that, although a 'nominal value' is indicated on it, the coupon is not obtained by the purchaser for consideration and is nothing other than a document incorporating the obligation assumed by Boots to allow the bearer of the coupon, in exchange for it, a reduction at the time of purchase of

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67 Case C-142/99 *Floridienne SA and Another v Belgian State* [2000] STC 1044.

68 Case C-126/8 *Boots Company plc*, [1990] ECR I-1235.

69 Case C-288/94 *Argos Distributors Ltd* [1996] ECR I-5311.

70 Para. 13 of the judgment.

> redemption goods. Therefore, the 'nominal value' expresses only the amount of the reduction promised'.[71]

The coupon issued by Boots or Argos acquired a monetary value when subsequently turned to account and not when it was issued. However, Boots and Argos do increase their turnover because the purchaser finds it advantageous to acquire goods offered (at a normal price) in conjunction with vouchers. Such vouchers have a value to the purchaser at the moment of issue (otherwise the voucher would not be an incentive) but they are not a valid 'consideration' or price on issue as Boots had no obligation to grant an immediate price reduction. When Boots distributes vouchers, it distributes rights, but such rights are not yet the obligation of Boots to give something in exchange. The creation of rights does not imply the existence of immediate obligations or even future and certain obligations.

Similarly, the obligation incorporated in new shares acquires a value at a different moment from the moment of issue of those shares and will depend on events unknown at the time of issue (decision of the general meeting for the issue of shares - purchase of new goods with the voucher). Unlike in the voucher cases, the new shares may acquire a monetary value because of the shareholder/issuer relationship (the future and hypothetical possibility of dividends) and the possibility of selling the shares.

The situation of the rights represented by new shares or by vouchers is totally different from the creation of rights such as those resulting from the assignment of copyrights, patents, licenses and trade marks which imply the immediate creation of reciprocal obligations and which therefore have a value at the moment of their creation even if such rights are never used or exercised.

4.1.3 Issue of Shares is not an Exempt Activity but Outside the Scope of VAT

The words 'outside the scope of VAT' are frequently confused with 'exempt' or outside the *territorial* scope of VAT, but their concept and its consequence are totally different.

The fundamental characteristic of an economic activity (regardless of the fact that it is taxable or exempt) is reciprocal obligation - a person agrees to supply goods or services to another person in exchange for consideration. Therefore, the supplier must provide services to his customers as opposed merely to being a consumer of services. He makes something available for a consideration. Just being a consumer is not sufficient to found an economic activity.

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[71] Para. 21 of the judgment.

According to the Opinion of Advocate General Fennelly in *Floridienne SA and Another v Belgian State*[72]:

'I agree with the view expressed by the Advocate General (VerLoren van Themaat) is 'the *nature* of the activities in question which is relevant'(see para 3.3 of his Opinion in *Staatssecretaris van Financiën v Hong Kong Trade Development Council*[73]) for determining what constitutes an economic activity and I would reiterate the view I expressed in my own opinion in *Harnas & Helm CV v Staatssecretaris van Financiën*[74] that:

> 'Attention should be focused on the economic and commercial substance of transactions that are alleged to constitute an economic activity, as opposed to the formal financial or commercial classification (namely, in this case, as bond or share acquisitions and holdings) of those activities. It follows, in my opinion, that a person who, like [the appellant], deals in bonds may only be considered to be carrying on an economic activity if he is pursuing a business or commercial purpose; in this respect he must provide services to his customers as opposed merely to being a consumer of services.'

Advocate General Fennelly went on to state:[75]

'Transactions in shares are explicitly covered by the wording of an exemption (see Art 13B(d)(5)), while Art 4(2) covers: 'The exploitation of tangible or intangible property.' The Advocate General (Van Gerven) in his Opinion in *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen, Arnhem*[76] drew a careful distinction between the latter type of activity and simple investment when pointing out that both *Rompelman v Minister van Financiën*[77] and *van Tiem v Staatssecretaris van Financiën:* [78]

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72 Case C-142/99 [2000] STC 1044.

73 Case 89/81 [1982] ECR 1277 at 1293.

74 Case C-80/95 [1997] ECR I-745 at 754–755, para 24.

75 At para. 25 of his Opinion.

76 Case C-60/90 [1991] ECR I-3111.

77 Case 268/83 [1985] ECR 655.

78 Case C-186/89 [1990] ECR I-4363.

> '... were concerned not only with an investment, that is to say the acquisition of property ... but also with the property acquired subsequently being *made available* to a third party for consideration (in the former case by the letting of the apartment, and in the latter by the grant of building rights over the plot).'

Advocate General Fennelly then distinguished between the mere acquisition of property, on the one hand, and its being made available, on the other, for the purposes of determining whether such property has been economically exploited for VAT purposes.'[79]

The fundamental criterion to bear in mind in the supply of a service to a customer is that there are two reciprocal obligations: one is obliged to give something in order to receive something from another[80]. The mere existence of a transfer of equity is not sufficient. There is no doubt that there was a transfer of money in *Hong Kong Trade*[81] or in *Tolsma*[82] but the European Court established that the direct link was missing. This point was clear in *Floridiennne*[83] where the Court decided that:

> 'a dividend could not be consideration for goods and services because certain features of dividends account, in particular, from their exclusion from VAT. First, it is not in dispute that the existence of distributable profits is generally a prerequisite of paying a dividend and that payment is thus dependant on the company's year-end results. Second, the proportion in which the dividend is distributed is determined by reference to the type of share held, in particular by reference to classes of shares, and not by reference to the identity of the owner of a particular shareholding. Lastly, dividends represent, by their very nature, the return on investment in a company and are merely the result of ownership of that property (*Polysar*[84] para. 13).

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79 See para. 25 of his Opinion.

80 Amand, C 'When is a Link Direct?' *International VAT Monitor*, 1996 p. 3 and the references in Nieuwenhuizen A.P., 'Tolsma en het gelijk van het Hof van Justitie', *Weekblad voor Fiscaal Recht 1995* p.258.

81 Case 89/91 *Staatssecretaris van Financien v Hong Kong Trade Development Council,* [1982] ECR 1277.

82 Case C-16/93, *Tolsma v Inspecteur der Omzetbelasting* [1994] ECR I-759.

83 Case C-142/99 *Floridienne SA and Another v Belgian State* at paras 22 and 23.

84 Case C-60/90 *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen, Arnhem* [1991] ECR I-3111.

> In view, specifically, of the fact that the amount of the dividend thus depends partly on the unknown factors and that entitlement to dividends is merely a function of shareholding, the direct link between the dividend and a supply of services (even where the services are supplied by a shareholder who is paid dividends), which is necessary if the dividends are to constitute consideration for the services, does not exist.'[85]

The shareholder gives money and receives shares. One could conclude that there must be an exchange of money in order to have the right to obtain dividends. However, as the European Court mentioned in *Floridiennne,* a dividend cannot – by its nature – be the 'price' of goods and services. A fortiori a dividend cannot be the price paid for a potential right to dividends, because there is no such thing as a right to a dividend before the decision of the annual general meeting of shareholders declaring that dividend.

4.1.4 The Issue of Shares is not a Transaction in Shares nor a Negotiation of Shares

According to Art 13(B)(d)(5) transactions in shares, including negotiation, are exempt. One may ask if negotiation could include all transactions carried out by financial institutions, and conversely, if the word 'transactions' would include all transactions by financial institutions which are not specifically treated as negotiation, as for example, the issue of new shares.

The word 'transaction' is broader in scope than the word 'negotiation'. It includes, for example, the management and the safekeeping of shares. At the time of the adoption of the Sixth Directive, Member States were allowed to exempt such activities[86] which are currently taxable. Another example of a transaction which is not a negotiation is the sale of shares.[87] In the *SDC* [88]and *Card Protection Plan* [89] cases, the European Court confirmed that the supplier being a financial institution is not a pre-condition for exemption for an exempt financial transaction.

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85 *Floridiennne* at paras 22 and 23 of the judgment.

86 The right to exempt these operations on the basis of Art 28(3)(B) combined with annex F of the Sixth Directive has been abolished by the 18th VAT Directive as from 1st January 1990.

87 See Case C-4/1994 *BLP Group plc* [1995] ECR I-983.

88 Case C-2/95 *Sparekassernes Datacenter (SDC) v Skatteministeriet* [1997] ECR I-3017.

89 Case C-349/96 *Card Protection Plan* [1999] ECR I-973.

It is correct to state that the concept of a transaction in shares is broader than intermediation by a financial institution. However, this does not mean that any 'operation' (as opposed to 'transaction' in the sense used in Art 13(B)(d)(5) Sixth Directive) in shares would qualify as a transaction in shares. The word 'transaction' is not further defined by the Sixth Directive nor by the Second VAT Directive.

The word transaction was used in the report to the Belgian Parliament during the discussion about the adoption of the VAT Code of 1969. During those discussions, it was clearly stated that the issue of shares was not an exempt 'transaction', like intermediation in shares, but an activity outside the scope of VAT.[90] A transaction was an economic activity and this required a direct link between the supply and the consideration for the supply. Therefore, it can be concluded that the words 'transactions in shares' are broader than the words 'negotiation in shares' but since both are economic activities neither includes the issue of shares.

4.2 Outside the Scope v Overhead Costs - The 'Direct and Immediate Link with a Business' Test

Tax authorities sometimes argue that VAT incurred on the costs of issue of shares is not deductible because issuing shares is an activity outside the scope of VAT.

From an input tax perspective, it can be argued that not all activities outside of the scope of VAT necessarily lead to the disallowance of the deduction of the input VAT. Disallowance would only be the case when the issue of shares could not be objectively linked with taxable supplies, i.e. the cost of issuing shares could not be included in the price of taxable transactions where those transactions are the first taxable operation in the chain of the activities of a business.

4.2.1 Scope of the *Polysar* Case:[91] No VAT Deduction if mere Acquisition of 'Financial Holding'

In *Polysar*, the European Court stated that:

> 'The mere acquisition of financial holdings in other undertakings does not amount to the exploitation of property for the purpose of obtaining income therefrom on a continuing basis because any dividend yielded by that

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90 *Pastnomie*, 1969 p. 1028.

91 Case C-60/90 *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen, Arnhem* [1991] ECR I-3111.

holding is merely the result of ownership of the property.'[92]

It should be pointed out that the European Court used the words 'mere acquisition' and noted that income received from the financial holding is 'merely' the result of ownership. It did not use the words 'acquisition alone'. It can be concluded from this that the Court does not take the view that the acquisition of financial holdings as such is outside the scope of VAT. Actually, a business may perform an activity 'outside the scope of VAT' in order to obtain income from shares or just incur costs 'outside the scope of VAT' in order to perform taxable activities: both activities are outside the scope of VAT, but the same rules regarding the deduction of the input VAT in relation to such activities do not apply.

Advocate General Fennelly referred extensively to *Polysar* in his opinion in *Floridiennne*. He quotes the following passage from the Opinion of Advocate General Van Gerven in *Polysar*:[93]

> '... Polysar's activities are concerned solely with the holding of shares in subsidiary companies. It seems to me that such activities, which are undertaken in the exercise of shareholders' rights, do not constitute 'economic activities' within the meaning of the Directive. The exercise of those rights includes, for instance, participation in the general meeting of the subsidiary's shareholders, the exercise of the right to vote at the meeting and the possibility of influencing company policy thereby and, where appropriate, involvement in the decision appointing the company's directors or officers and/or apportioning the subsidiary's profits, as well as the receipt of any dividends declared by the subsidiary or the exercise of shareholders' preferential rights or options. In addition to the aforesaid activities which a holding company carries on as a shareholder in other companies, there are activities which, like any other company, it carries on through its organs and which, in so far as they are conducted within the company (in its relations with the shareholders and the company's organs) also cannot be regarded as 'economic activities', within the meaning of the Sixth Directive. Those activities include the administration of the holding company, the making up of the annual accounts, the organisation of the general meeting, the decision to spend the holding company's profits and to declare (and possibly pay out) dividends. Nor, in my view, is there any question of economic activities independently carried on within the meaning of Art 4(1) of the Sixth Directive in the case of activities which the holding company, or persons acting in its name, carries out in its capacity as director or officer of a

92 At para 13 of the judgment.

93 [1991] ECR I-3111 at 3126, para 6.

> subsidiary company. A director or officer of the company does not act on his own behalf but only binds the (subsidiary) company whose instrument he is; in other words, where he acts in the exercise of his duties under the company instruments, there is no question of his acting independently. In that regard, his actions must be equated with those of an employee who, as Art 4(4) of the Sixth Directive expressly states, does not act independently.'

It can be concluded from this that it is not correct to argue that any acquisition of a shareholding would automatically lead to the disallowance of input VAT on costs of such operations. Input tax will be disallowed only if the holding of shares is the only activity of the acquirer. Therefore, other criteria need to be introduced in order to account for the disallowance of input VAT.

Where the acquirer of services performs both activities outside the scope of VAT and taxable activities, the criteria of the *BLP* case should be taken into account: to which output is an input related?

4.2.2 The *Midland Bank* and *Abbey National* Cases: 'Objective Link with a Taxable Business'

In order to be deductible, VAT on costs should have a direct and immediate link with taxable activities. The phrase 'direct and immediate link with the taxable person's business' has rather recently appeared in the VAT literature and is to be found in the case of *Midland Bank plc*,[94] where the European Court considered that:

> '... according to the fundamental principle which underlies the VAT system, and which follows from Art 2 of the First and Sixth Directives, VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components (see, to this effect, *BP Supergas Anonimos Etairia Geniki Emporiki-Viomichaniki kai Antiprossopeion v Greece*[95]). ...
>
> ... The costs of those services are part of the taxable person's general costs and are, as such, components of the price of an undertaking's products. Such services therefore do have a direct and immediate link with the taxable

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94 Case C-98/98 *Midland Bank plc v Commissioners of Customs and Excise* [2000] ECR I-4177 para 29.

95 Case C-62/93 [1995] ECR I-1883, para 16.

person's business as a whole ...'[96]

This objective link between the supply and its consideration is an essential element of an activity within the scope of VAT.

In his Opinion in *Abbey National*,[97] Advocate General Jacobs clarified the concept of an 'immediate and direct link with a taxable business' as follows:[98]

'According to a broader approach, where a taxable person pursues an economic activity in which he makes wholly taxable supplies, all the goods and services supplied to him for the purposes of that activity are cost components of his outputs and all the VAT borne by them should be deductible. The fact that, from a strict bookkeeping point of view, inputs are not attributed to or even apportioned among particular outputs is of no import here. Clearly not all goods and services consumed by a taxable person will be incorporated directly into an identifiable output. Some will be of the nature of general overheads and, to the extent that those overheads are cost components of taxable supplies, VAT levied on them may be deducted (See C-4/1994 *BLP Group plc*).[99] Many types of overheads may be absorbed by the business as a whole, simply influencing indirectly the range of profit margins sought.

One such type of overhead includes costs incurred on starting up a business. It is clear from the case-law of the Court that the VAT on such costs may be deducted by the taxable person, even in certain circumstances where there is no output tax for it to be deducted from, with the result that the deduction in fact amounts to payment by the revenue authority to the taxable person (see *Rompelman v Minister van Financiën*[100] together with *Belgium v Ghent Coal Terminal NV* [101] and *Intercommunale voor Zeewaterontzilting (in liq) v Belgium*[102] and most recently

96 Case C-98/98 *Midland Bank plc v Commissioners of Customs and Excise* [2000] ECR I-4177 paras 29 and 31.

97 Case C-408/98 *Abbey National Plc v Commissioners of Customs and Excise* [2001] I-1361 and see case note in ECTJ 5/1 [2001] 23.

98 See paras 42-44 and 46 of the Opinion.

99 [1995] ECR I-983 at para 25 of the judgment.

100 Case 268/83 [1985] ECR 655.

101 [1998] ECR I-1, paragraphs 17 and 24.

102 Case C-110/94 [1996] ECR I-857, paragraphs 20 and 21.

Gabalfrisa SL and others v Agencia Estatal de Administracion Tributaria).[103] Under United Kingdom legislation,[104] the same applies to VAT on costs incurred in connection with the termination of a business, and the Commission appeared to accept at the hearing that such an approach is consistent with company law.

I agree. The Court stated in *Rompelman* that the deduction system is meant to relieve the trade entirely of the burden of the VAT payable or paid in the course of all his economic activities. That intention would clearly not be achieved if he were left with a non-deductible VAT bill on winding up his business. In addition, it may be reasoned that from an economic point of view the costs of winding up a business are costs of the business as a whole and thus cost components of the supplies which it makes, even if they are not specifically entered as such in the accounts. ...

Thus, both approaches led to the same conclusion: where, in the context of Art 5(8), there is a transfer of the totality of the assets of a business engaged solely in making taxable supplies, the transfer may deduct VAT incurred on inputs received in connection with the transfer because those inputs are attributable to taxable outputs and the chain linking the inputs to the outputs is not broken by an intervening in exempt transaction'.[105]

The objective link does not have to be similar in nature to the business. As the European Court pointed out in *Rompelman*, 'it is not necessary to distinguish the various legal forms which such preparatory acts may take'.[106] The taxable person is the only one who is entitled to decide how the costs may be allocated as between the acquisition of goods and services and the performance of an economic activity (exempted or not) - the tax authorities have no right to question the business about the appropriateness of the decision. This is a fundamental and most essential characteristic of VAT as a tax.

This principle is confirmed in *Midland Bank*. The European Court ruled that:

> 'A taxable person who makes transactions in respect of which value added tax is deductible and transactions in respect of which it is not may deduct the value added tax in respect of the goods or services acquired by him, provided that such goods or services have a direct and immediate link with

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103 Joined Cases C-110/98 to C-147/98 [2000] ECR I-1577.

104 See s.94(5) VATA.

105 In the judgment of 22 February 2001 the European Court followed the opinion of the Advocate General.

106 Case 268/83 [1985] ECR 655 at para 23 of the judgment.

> the output transactions in respect of which value-added tax is deductible, without it being necessary to make a distinction depending on whether Article 17 (2), (3) or (5) of the Sixth Directive is applied. However, such a taxable person cannot deduct in its entirety the value added tax charged on input services where they have been utilised not for the purpose of carrying out a deductible transaction but in the context of activities which are no more than consequences of making such a transaction, unless that person can show by means of objective evidence that the expenditure involved in the acquisition of such services is part of the various cost components of the output transaction.'[107]

4.2.3 Deductibility of Costs relating to Activities Outside the Scope of VAT

The interpretation of the European Court in the *Midland Bank* case could be found in *BLP*. As the European Court noted in the earlier case[108]:

> 'It is true that an undertaking whose activity is subject to VAT is entitled to deduct the tax in the services supplied by accountants or legal advisers for the taxable person's taxable transactions and that if BLP had decided to take out a bank loan for the purpose of meeting the same requirements, it would have been entitled to deduct the VAT on the accountant's services required for that purpose. However, that is a consequence of the fact that those services, whose costs form part of the undertaking's overheads and hence of the cost components of the products, are used by the taxable person for taxable transactions'.

In that respect it should be noted that a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system. The principle of the neutrality of VAT, as defined in the case law of the Court, does not have the scope attributed to it by BLP. That the common system on VAT ensures that all economic activities, whatever its purpose or results, are taxed in a wholly neutral way, and presupposes that these are themselves subject to VAT (see, in particular *Rompelman v Minister van Financiën*).[109]

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107 Case C-98/98 [2000] ECR I-4177 at para 33 of the judgment.

108 Case C-4/94 [1995] ECR I-983 at paras 25-26 of the judgment.

109 Case C-268/83 [1985] ECR 655, para 19.

Raising finance by selling shares does not have the same consequence as raising finance by taking out a loan. However VAT on costs of the sale of shares is not deductible, but VAT on costs of obtaining a loan is deductible. It should be noted that both the sale of shares and the raising of credit are exempt based on Art 13(B)(d) of the Sixth Directive. The only reason for the difference of treatment is, as the European Court points out, that costs of a loan form part of the overheads of the business and hence of the costs components of the product. But it has never been challenged that VAT on the costs of raising a loan is deductible by a fully taxable business. This is evidence that VAT on some of the activities which are outside of the scope of VAT is deductible in the same way as other overheads of a business.

4.3 Situations Where VAT on Issue of Shares is Not Deductible

It is not argued that VAT on the issue of shares is always deductible but that that VAT is deductible when the issue is effected for the pursuance of taxable transactions.[110] Accordingly, VAT on costs of the issue of shares is not deductible:

- In the case of a passive holding where any activity is merely holding shares;
- by a shareholder as such;[111]
- by a financial intermediary placing shares.

5 Conclusion

More than 20 years after the adoption of a common VAT system in Europe, businesses face major difficulties in determining the VAT treatment of elementary transactions.[112] Even when the treatment in their own countries appears clear, such transactions can be treated in different ways depending on the country in which they perform an activity and the nature of the legal instruments they use. As appears from the present study, it is not only the common VAT system which is crippled by more than 70 options open to Member States, more than 125 national derogations and about 25 criteria of place of supply, that differences exists.

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110 Art 17(2) of the Sixth Directive.

111 A shareholder should not be confused with a company, which is not yet registered.

112 It has been recently reported that national authorities refuse to take a position on pure technical issues because they do not want to be 'advisers of advisers'.

The European Court has shown remarkable consistency in its interpretation and has clearly decided that in order to be taxable an operation should have a direct link with the consideration (output side) and that VAT is deductible where it has a direct and immediate link with a taxable business (input side).

The European Court is the only body which provides businesses with minimal legal certainty. The Commission, as the guardian of the treaties, has very few personnel to ensure the correct application of the common VAT system. They are dealing with the preparation of opinions on behalf of the Commission in more than 40 VAT cases pending before the European Court, with the complaints of European citizens against violations of Community law by the 15 Member States (in 11 languages) and with preparing answers to parliament in respect of petitions, and answers to questions raised by the members of parliament.

In the cause of the principles of subsidiarity and democratic control, Member States strongly oppose empowering any common body – like a new VAT Committee[113] - which could give guidance to business and the national authorities on the numerous difficulties of interpretation and on factual difficulties arising in relation to identical obligations of the Member States of the European Union. The fact that similar institutions already exist for community excise and customs duties, that interpretations are made public and may be considered by the European Court is apparently not relevant for the opponents to an extension of the competences of the VAT Committee. In the VAT matters, there exists no document comparable to the commentary on the OECD Model tax treaties or the opinion of the World Customs Organisation on the Customs Valuation Code. Under such circumstances, it is difficult to understand the reference to the principle of subsidiarity as other than a means for the Member States to escape their obligations and to avoid the Commission challenging Member States' immediate financial interests.

113 Confédération Fiscale Européenne - Opinion Statement on the change of status of the VAT Committee (1998).