

Kretztechnik

How does a non-economic activity nevertheless give rise to the right to deduct?

The ECJ judgment in *Kretztechnik AG v Finanzamt Linz* Case C-465/03 [2005] STC 1118 (*Kretztechnik*), now almost exactly one year old, remains of great importance for two principal reasons: first, it remains the Court's latest word on the meaning of 'economic activity' in relation to share transactions; second, it has further developed and clarified the law of input tax deduction – and in a manner that is potentially of direct benefit to the taxpayer.

THE FACTS

The Austrian taxpayer company sold medical equipment. It wished to raise working capital by issuing new shares in itself and was professionally advised to obtain a listing on a stock exchange for that purpose. It paid a VAT-inclusive price for that and related advice.

The domestic tax authorities considered that those professional input services were exempt supplies of services, further to the domestic implementation of Sixth Directive, Article 13.B(d)(5), which exempts 'transactions ... in shares ...'. Being exclusively linked in their view to such an exempt supply, the tax authorities considered that input tax on those services was not deductible.

THE TAXPAYER'S POSITION

The taxpayer considered that input supplies used by it need not be used directly for the purposes of taxable output transactions in order to give rise to the right to deduct, provided that they were used as part of the company's economic activity taken as a whole.

THE ISSUES

The issues were thus, first, what was the true nature of the activity in connection with which the professional input services were directly used and, second, if the activity in question was a non-economic activity, could it nevertheless be equated to a general overhead of the business, so as to take advantage of the principle

One year on from the *Kretztechnik* judgment, Paul Harris, of Monckton Chambers, explains its continuing significance

elucidated in *Midland Bank* Case C-98/98 [2000] STC 501 and *Abbey National* Case C-408/98 [2001] STC 297?

Issue 1: economic activity and the nature of a share issue

The ECJ has consistently held that the mere acquisition, holding and sale of shares are not economic activities: see *Polysar Investments* Case C-60/90 [1993] STC 222 and *Wellcome Trust* Case C-155/94 [1996] STC 945.

That is because holding shares is nothing but an incident of the ownership of shares – and in order to hold shares one has to have acquired them in the first place – which of course means that someone has to have sold them.

Yet ownership by itself is not a taxable supply of any sort. It does not involve a supply by one person to another of anything in return for a consideration. There is no reciprocity in the arrangement. The yield or dividend from a share is not a *quid pro quo* for ownership. Rather, the dividend is obtained as a simple result or function of being an owner. The holding of a right of ownership, such as a share, is thus more akin to an administrative function; the administration of an asset.

Looked at another way, mere ownership or administration of an asset does not involve any turnover, or any consumption. There is no chain in which 'ownership' is somehow partly consumed and/or has value added, ending in the final consumption of the owned asset by the ultimate customer.

In the language of Sixth Directive, Article 4(2), in the case of mere holding, and related acquisition and sale, there is no 'exploitation' of the intangible property represented by the share, 'for the purpose

of obtaining an income therefrom on a continuing basis'. That is because there is no exploitation; there is simply ownership.

Accordingly, VAT, which is a tax on consumption and turnover, has no bite upon the activity of mere ownership, or its corollaries of acquisition at the beginning and sale at the end.

That contrasts with commercial share dealing in shares of existing third-party companies which is a professional activity, carried on by traders in a professional market, generally for the purpose of generating profit from the trades in those existing shares. In other words, it is 'exploiting' the activity of dealing in existing shares: see recently *BBL* Case C-8/03 [2004] STC 1643 (in particular Advocate-General Maduro, paragraphs 9-10).

Furthermore, in the case of commercial share dealing there is a reciprocal supply, namely the supply of a service of advice and expertise in the stock market trading by the dealer, in return for some kind of profit or commission on the dealing activity. Plus, there is consumption of that advice and expertise in the course of the activity.

Support for this now settled approach of the ECJ is also obtained from the wording of Article 4(2), which of course sets out the scope of economic activity for VAT purposes. That provision refers to the activities of 'producers, traders, and persons supplying services ...' (emphasis added). It does not refer to mere owners. When an owner, however, becomes a 'trader' he brings himself within scope of VAT, insofar as he is trading.

As set out above, *Kretztechnik* did involve an activity of transacting in shares, but neither of the *Wellcome Trust*

