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Case C-465/03 Kretztechnik AG v Finanzamt Linz (Judgment released on 26 May 2005)

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Share issues – Admission of a company to a stock exchange – Whether a taxable transaction for the purpose of the Sixth Directive - Deduction of input tax incurred in relation with an increase in the issued share capital

This case concerned the proper treatment, for the purpose of the Sixth Directive, of issues of shares by a company in order to increase its working capital and whether input tax incurred in relation to such share issue could be deducted by the taxpayer pursuant to Article 17 of the Sixth Directive.

The taxpayer, a company established in Austria whose object was the development and distribution of medical equipment, sought to increase its issued capital by some EUR 2.5 million. In order to achieve this increase in its working capital, the company applied for and obtained admission to the Frankfurt Stock Exchange. In so doing, the taxpayer company incurred input tax on a number of supplies of services linked with its admission to the stock exchange. The precise nature of those supplies is not specified in either the judgment or the Advocate-General's opinion but is, for present purposes, irrelevant.

The Austrian taxing authorities refused to allow deduction of the input tax incurred on supplies linked to the admission of the taxpayer company to the stock exchange and issue of additional shares. This was on the basis that the issuing of shares by the company was an exempt supply under Austrian law and, therefore, input tax could not be deducted by the company. The stance adopted by the Austrian taxing authorities is, in this respect, no different from the position in the United Kingdom, following the judgment of the Court of Appeal in *Trinity Mirror plc v CCE* [2001] EWCA Civ 65; [2001] STC 192.

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In essence, the referring court asked the ECJ to rule on whether the issuing of shares amounted to a supply for consideration within the meaning of Article 2(1) and, if not, whether a right to deduct input tax incurred in relation to listing on the stock exchange and issuing such shares nevertheless applied.

It is clear from the conflicting submissions made by the five Member States that chose to intervene that the treatment of share issues (and deductibility of input tax related to such issues) varied greatly across the Community and that, therefore, a ruling from the ECJ was not only advisable, but virtually unavoidable.

The ECJ took, as its starting point, settled case-law in relation to holding companies, according to which, the mere acquisition and holding of shares, or indeed the sale of such holdings, are not to be regarded as an economic activity within the meaning of the Sixth Directive, unless they formed part of activities which went beyond mere acquisitions of holdings, such as transactions carried out in the course of a business trading in securities. Of course, as pointed out by the Advocate-General at paragraph 36 of his opinion, that case-law only dealt with sales by a company of shares in a separate entity, not with the issue of the company's own shares.

The ECJ also made it clear that, in considering whether the issuing of shares could amount to an economic activity, the nature of such a transaction for the purpose of VAT treatment, could not differ according to whether the issue is carried out in connection with admission to a stock exchange or not.

The ECJ went on to consider whether issues of own shares could nevertheless be regarded as amounting to supplies of goods or supplies of services. It found no difficulty in holding that issues of own shares, as securities representing intangible property, could never amount to supplies of goods.

The ECJ then extended, by analogy, the principle found in Case c-442/01 *HapHag* [2003] ECR I-6851, that a partnership which admits a partner in consideration of payment of a contribution in cash does not effect a supply of services for consideration within the meaning of Article 2(1) of the Sixth Directive. Accordingly, the ECJ held that the issue of own shares by a company could not amount to a supply of services for consideration.

Adopting the reasoning of A-G Jacobs, the ECJ remarked that a company issuing new shares is increasing its assets by acquiring working capital, while grating the new shareholders a right of ownership of part of the capital thus increased. From the issuing company's point of view, the aim is to raise capital, not provide services. From the point of view of the investor, the payment made is an investment, not a payment of consideration.

Having held that the issue of new shares could not amount to a supply for consideration for the purpose of the Sixth Directive, the ECJ went on to consider whether deduction of input tax in relation to such issue should nevertheless be allowed. In this respect, once again, there appears to have been a divergence of views between a number of Member States at the hearing, confirming, once again, a divergence of application across the Community.

The ECJ, agreeing, in this respect, with the submissions of the taxpayer company, the United Kingdom Government and the Commission, concluded that, as the issue of new shares was carried out in order to increase the company's capital for the benefit of its economic activity in general, the costs incurred in relation to such issue were to be regarded as part of its overheads and, as such, component parts of the price of its products. Accordingly, an entitlement to deduct input tax on the expenses incurred arose in the same way as for any other overhead: taxable persons carrying out only taxable supply are entitled to deduct such input tax amounts in full, whereas partially exempt trader would be able to deduct the relevant percentage in the usual manner.

What is perhaps surprising about this case is the fact that, despite what appeared to be widely diverging practices across the Community, as evidenced by the differing views expressed by the five Member States that chose to intervene in this case, is that it has taken so long for the issue to first

come before the ECJ either on a reference from the national court or as a result of an action by the Commission.

This case marks a fundamentalr departure from the judgment of the Court of Appeal in *Trinity Mirror*, cited above, which had held that issues of shares constituted exempt supplies of services and that, therefore, input tax incurred in relation to such issues was not recoverable.

No doubt this judgment will lead to a significant number of claims by taxpayers who, following *Trinity Mirror*, had been prevented from deducting input tax relating to share issues and similar increases in capital. Indeed, advisers should be alert to the consequences of this judgment on their existing clients and would be well advised to review their clients' files to assess whether a claim for underc laimed input tax should now be made, bearing in mind the three-year limitation period applicable to such claims.

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