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Case alert

Ryanair Ltd

May 2018

Summary

This case – a referral to the Court of Justice by the Irish courts – concerns the recovery of input VAT by the Irish airline Ryanair Ltd on its failed bid in 2006 to acquire rival airline Aer Lingus. Ryanair incurred substantial professional fees in relation to the proposed takeover and sought to reclaim the VAT incurred.

In the end, the European Commission blocked the proposed takeover on competition grounds and the Irish tax authority refused Ryanair's claim on the basis that, as the takeover was aborted, there was no direct link between the costs incurred and any taxable supplies made by Ryanair.

Advocate General Kokott has issued her opinion. She considers that Ryanair is entitled to reclaim the input VAT. This is not just based on the fact that there was a clear intention to provide management services, but also that the cost of acquiring the shares in Aer Lingus was to bring about a direct, permanent and necessary extension of its own taxable activity of providing air passenger transport services.

This is the case even if, as here, the takeover of the target company is aborted and the management services could not be supplied.

Advocate General's Opinion dated 3 May 2018

Advocate General Kokott has delivered her opinion in the case concerning the Irish airline Ryanair and its failed takeover of rival airline Aer Lingus. In 2006, Ryanair launched a bid to acquire the share capital of Aer Lingus and incurred significant professional fees in relation to the bid. Ryanair sought to reclaim the VAT incurred on those fees but the Irish tax authority denied the claim on the grounds that there was no direct link between the costs incurred on the proposed takeover and any taxable supplies made by Ryanair.

During the ensuing litigation between the parties, the Irish Circuit Court found as a binding fact that Ryanair intended to make supplies of management services to Aer Lingus in the event that the takeover was successful. However, the European Commission blocked the takeover bid on competition grounds and, as a result, neither the takeover nor the supply of management services took place. The question to be resolved by the CJEU is whether, in such circumstances, Ryanair was entitled to reclaim the VAT incurred.

The case law on the recovery of VAT by holding companies has developed over many years. The mere acquisition of shares in subsidiary undertakings and the receipt of dividends is not regarded as an 'economic' activity for VAT purposes but where a holding company also intends to provide management services to a subsidiary, the provision of those services is regarded as an economic activity which gives rise to a right of deduction. The problem identified by the European Commission in its submissions to the court in such cases is the potential imbalance between the quantum of the potential input tax claim and the amount of output VAT to be charged in relation to the intended management services.

AG Kokott makes a distinction between the acquisition of shares by a pure holding company and an acquisition by a trading company such as Ryanair. In her opinion, the question of deductibility where an operating company acquires the shares should not, in fact, be linked to the intention to supply management services. In her view, the correct test to apply is whether, on a functional analysis, the expenditure made in connection with the acquisition of the shares constitutes a cost component of Ryanair's intended taxable activity (passenger transport services) after the shares are acquired. She points out that, if Ryanair is to operate profitably after the acquisition, then the cost of acquiring Aer Lingus' share capital would need to be factored into future airfares and, thus, they would become cost components of that activity. In the circumstances, if the acquisition of the shares is intended to bring about what the AG refers to as a direct, permanent and necessary extension of taxable activities of the acquirer, that constitutes an economic activity for VAT purposes and, if that economic activity generates only taxable outputs, the acquirer is entitled to deduct the input tax in full.

Comment – The AG's opinion is in line with HMRC's current policy for the recovery of input VAT by companies acquiring target businesses. A pure holding company (ie a company that does not have any trade of its own) will still need to demonstrate an intention to supply management services but, where a trading company (like Ryanair in this case) acquires a business for the purposes of extending its taxable activities, that acquisition should be regarded as an economic activity which gives rise to full deduction of input VAT on the acquisition costs. This will be the case, even if the intended acquisition is abandoned for any reason.

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