

Italian Supreme Court confirms deductibility of VAT paid on transaction costs in the context of MLBO transactions

Overview

With decision No. 22608 of 2024, the Italian Supreme Court for the first time upheld the deductibility of VAT on transaction costs borne by the SPV in the context of MLBO transactions.

The Supreme Court decision represents an important opportunity to consider filing a request for the refund of input VAT paid by SPVs in the context of MLBO transactions.

I Background

The deductibility of VAT on transaction costs (e.g., cost for consultancy, due diligence activities on the target, legal fees, etc.) has been one of the most discussed aspects of merger-leveraged buyout ("MLBO") transactions, also due to the restrictive view adopted by the Italian tax authorities ("ITA") in this regard.

Based on the official guidelines provided by the ITA¹, special purpose vehicles (SPVs) incorporated with the sole purpose of carrying out the acquisition of target companies should not be allowed to deduct VAT on transaction costs incurred in the context of MLBO transactions. This is because SPVs do not carry out an effective business activity relevant for VAT purposes according to Article 4 of Decree 633/1972 (the Italian VAT Code). According to the interpretation of the ITA, the activity carried out by the SPV is similar to that carried out by s.c. "static" holding companies² which - unlike s.c. "dynamic" holding companies - do not qualify

¹ See, Circular Letter 30 March 2016, No. 6, and Circular Letter 31 October 2018, No. 19.

² In particular, the activity of "static" holdings consists of passively owning the shares, without being involved in any decisions related to the investments. Thus, "static" holdings: (i) do not carry out any activity of direction and coordination of its subsidiaries and (ii) are not engaged, even ancillary, in other business activities.

as VATable persons within the meaning of Article 9 of the VAT Directive, and therefore are not entitled to recover input VAT paid.

The view of the ITA has been criticized by scholars and practitioners. It was noted that the activity carried out by SPVs cannot be ascribed to the activity of “static” holdings. In particular, it has been pointed out that the activity carried out by the SPVs in the context of MLBO transactions qualifies as a preparatory activity which - based on the interpretation of the Court of Justice of the European Union adopted, *inter alia*, in the Ryanair Case (C-249/17) – qualifies as an activity subject to VAT, thus allowing the deductibility of input VAT paid on expenditures related to such preparatory activities.

The same stance was endorsed by a recent decision adopted by the Tax Court of Second Instance of Milan that, in line with the decision of the Tax Court of First Instance, overruled the position put forward by the ITA and confirmed the VAT deductibility on costs incurred by an SPV in the context of an MLBO transaction.³ The case was brought to the Supreme Court by the ITA.

II Italian Supreme Court – Judgment 22608 of 2024

The case involved a leading industrial group that carried out a MLBO transaction through a newly incorporated SPV financed with external debt to carry out the acquisition of the target. After the acquisition, the SPV was incorporated by the target.

In this context, the target - in its quality of incorporating entity – submitted a refund request to the ITA concerning the VAT on transaction costs (*i.e.*, consulting services purchased from Italian and extra-EU service suppliers) incurred and not deducted by the SPV.

The Supreme Court confirmed the right of the SPV to deduct input VAT on transaction costs.

The Supreme Court recalled that MLBO transactions are articulated according to a predefined order - *i.e.*, (i) incorporation of the SPV, (ii) recourse to external debt, (iii) acquisition of the target, and (iv) subsequent merger of the SPV into the target or *vice versa* – according to which the acquisition of the target by the SPV represents a merely transitional and instrumental stage of the subsequent reverse merger.

The merger between the SPV and the target represents, *ab origine*, a necessary step of the entire transaction, since it is functional to the conjunction of the debt incurred by the SPV with the assets of the target.

In light of the above, the Italian Supreme Court maintained that the SPV does not qualify as a “static” holding companies, since it is not incorporated to simply hold equity investments but rather to collect the financing resources necessary to fund the acquisition of the target and to be subsequently merged with the latter.

On this basis, the Italian Supreme Court concluded that the costs incurred by the SPV, before

³ See, Tax Court of Second Instance of Milan, Decision of 5 December 2022, No. 3361.

the merger, are intimately preparatory for carrying out an economic activity relevant for VAT purposes. Indeed, the SPV incurs the transaction costs with the sole purpose of using the purchased goods or services for the continuation of the target's economic activity. On this ground, the SPV is entitled to deduct the input VAT on transaction costs incurred in the context of MLBO transactions.

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For more information, please contact Chiomenti's tax law department.

Tax@chiomenti.net