



Italy: VAT on MLBO transaction costs now recoverable

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In judgment no. 22608, published on 9 August 2024, the Italian Supreme Court held that a special purpose vehicle ("SPV") is entitled to recover the VAT incurred on consultancy services ("transaction costs") as part of a merger leveraged buyout ("MLBO").

According to the Supreme Court, when VAT is incurred by an SPV on goods or services which are used for a merger following the acquisition of a target company, the tax is in principle recoverable if the company resulting from the merger is a taxable person with the right to recover input VAT.

The Supreme Court judgment opens up interesting opportunities to recover the tax in MLBO transactions. This is an area of law that the Italian Tax Authority ("ITA") had previously interpreted narrowly, disallowing the recovery of input VAT by SPVs on the grounds that they are not taxable persons but merely "passive holding companies" that acquire and hold shares without engaging in economic activities (see ITA Circular no. 6/E/2016 and ITA rulings no. 758/2021 and no. 529/2022).

The Supreme Court judgment

The dispute arose from the rejections by ITA of refund claims submitted by the company resulting from a reverse merger in an MLBO. The case involved an MLBO in which a newly established SPV resident in Italy, partially financed by bank loans, acquired the entire shares in a target company, also resident in Italy, and was then merged into the same acquired company.

After the reverse merger, the target company, as the entity that had absorbed the SPV, submitted refund claims to recover the VAT on the transaction costs incurred by the SPV. ITA's rejections of the claims were promptly challenged by the company and the appeals were upheld by the first- and second-level tax courts. ITA then filed an appeal with the Supreme Court against the second-level decision.

The Supreme Court, rejecting ITA's appeal, held that (in line with the CJEU decisions in Case C-42/19 - Sonaecom SGPS SA and Case C-249/17 - Ryanair Ltd) the SPV established for the MLBO transaction should be considered a taxable person, noting that *"(...) for VAT purposes, the acquisition of the target company amounts to preparatory activity for the economic activity that will be engaged in following its acquisition. The fact that the special purpose vehicle incurs investment expenses in order to acquire shareholdings makes it a taxable entity, even if the goods and services acquired are not immediately used for the economic activity but are preparatory to its commencement"*.

Therefore, in an MLBO, VAT on consultancy services charged to the SPV is recoverable (or, in the case in question, refundable) to the extent that these services are preliminary to and intended for the start (or continuation) of an economic activity engaged in by the target company after the combining of these entities in the last phase of the MLBO.

Importance of the judgment and new opportunity

Based on the principle formulated by the Supreme Court, the VAT on transaction costs incurred by an SPV should be deemed recoverable, even if, before the merger, the SPV has not engaged in any VAT-relevant activities.

Taxpayers in similar situations should now consider filing refund claims with ITA, relying not only on settled CJEU case law but also on this important precedent established by the Italian Supreme Court.

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