

(Tel Aviv), 1015/09 and (Tel Aviv), 29102-01-13  
**Elbit Medical Imaging Ltd. v. the Regional VAT Director**

### Factual Background and Main Arguments of the Parties

The appellant in this case (the "**Appellant**") is the parent company of a group of companies (the "**Group**" and the "**Companies**" respectively). The activity of the Appellant is the organisation and financing of the business activity carried out by the Companies by way of providing loans, professional services and management services. Most of the Group's activity took place outside Israel.

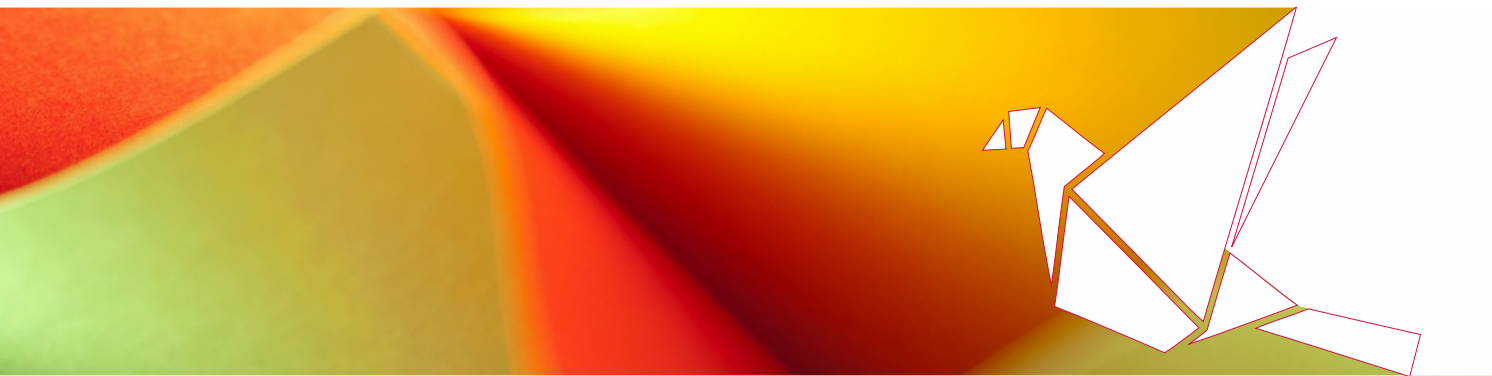
The main dispute in this case concerned the deduction of the Appellant's input tax from certain expenses: administrative and general expenses (including payments to financial advisors, lawyers, accountants, credit rating companies and payments for electricity, maintenance, cleaning, maintenance of offices, equipment and office furniture), expenses related to the issuance of bonds (including expenses for the preparation of prospectuses, legal expenses, financial audit expenses and payments to underwriters and consultants), payments for consulting and management services to private companies owned by Officers ("Wallet Companies"), and rental expenses and leasehold improvements.

The Appellant claimed that the input tax should be fully deductible since all the inputs were used in taxable transactions under Israeli VAT Law. The VAT Authority claimed that the case involves a holding company supporting the business activity of the Group's companies as part of the effort to increase the value of its holdings, the inputs of which are mixed. Accordingly, only one-quarter of the input tax should be deductible.

### The Court's Decision

As a preliminary remark, the Judge noted that in general, a holding company might have taxable transactions, the inputs of which are directly identifiable and can be quantified separately from the other inputs of the holding company. In such cases, the fact that the company is a holding company should not eliminate the full deduction of the input tax. In this regard, the Judge noted that the basis for Position 1/2016 of the Israeli Tax Authority is "unclear", a principle according to which a holding company should be allowed to deduct only two-thirds of the input tax for inputs used directly in taxable transactions.

In addition, the Judge noted that the absence of a yield (such as capital gains and dividends) during a certain period, does not necessarily lead to the conclusion that the use of inputs during that period should be attributed only to taxable transactions performed by the holding company and that in any event, the relationship between the inputs and the taxable transactions must be proven.



The Judge further added that in order to determine the "main use" of an asset or a service, it would be inappropriate to adopt the income ratio (the income derived from taxable activity compared to income derived from non-taxable activity), as an exclusive indication. Primarily, the particular use of the asset or the service must be proven, and it is only in the absence of a clear indication for a particular use that a general examination of the company's activity should be conducted. For this purpose, the income ratio should only be one indication as to the main use of the inputs, although, this is not exclusive. In this regard, the burden of proof as to the use of the input lies with the Dealer who requires the deduction of the input tax.

With regard to the administrative and general expenses, it was determined that no concrete evidence had been presented with respect to the use of the expenses in relation to providing credit and professional services. In the absence of clear signs of an orderly and documented activity in these areas, and considering the Appellant's interest as a parent company in the success of the business activities carried out by the Companies, whilst it was proven that the funding granted to the Companies was mainly made in the Appellant's capacity as a parent company and not as a Dealer in the financing business, the Judge ruled that with respect to the general inputs, only one-quarter of the input tax should be deducted.

As for the inputs relating to the issuance of bonds, it was determined that the Appellant has proven the use of these inputs. However, since not all funds raised were used to finance loans to the Companies (considered taxable transactions), only two-thirds of the input tax related to these expenses should be deducted.

Regarding the inputs related to payments made to companies owned by officers of the holding company (referred to as "wage-substitute" by the court), it was determined that these inputs are no different from other general inputs for which only a quarter of the tax is deductible. Accordingly, in principle, the deduction will be limited to a quarter of the input tax. However, with respect to part of the period, the Judge accepted the Appellant's position that a full deduction should be allowed, given the VAT Authority's past determination that these inputs could be fully deducted.

Regarding the inputs relating to rental expenses and leasehold improvements, it has been determined that all the matters regarding the lease of real estate assets, which are being sub-leased by the Appellant, should be returned to the assessment stage for further clarification. As for the rented real estate assets, not used in taxable rental transactions, only one-quarter of the input tax should be deducted.