VAT'S UP
VAT NEWSLETTER

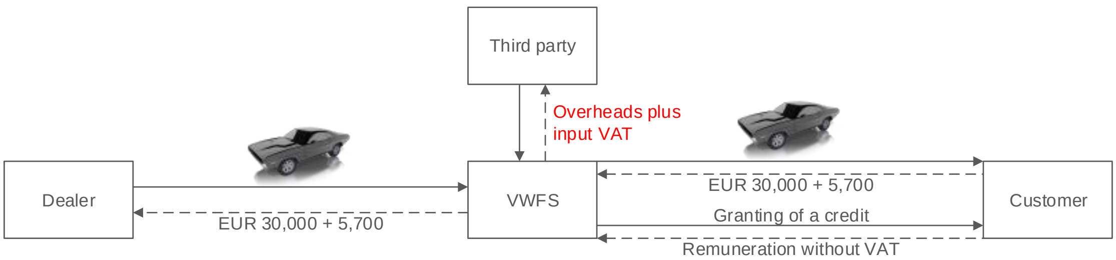
Input VAT deduction from general costs

41 I 2018

1 Facts

Volkswagen Financial Services (VWFS) buys the car selected by the customer from the dealer. VWFS then sells the car to the customer subject to VAT. The purchase price and the sale price are the same. In the agreement between the parties, VWFS grants the customer an exempt credit for the purchase price. As regards the interest rate, VWFS adds its own financing and general costs, as well as a profit margin.

It was disputed whether VWFS was entitled to deduct input VAT (pro rata) from its general costs, which concerned input supplies such as IT infrastructure, offices and office supplies. This question arose because VWFS financed the expenses for the general costs exclusively from the profits resulting from the granting of exempt credit.



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2 ECJ decision

A taxable person is entitled to deduct input VAT if a particular input transaction is directly and immediately linked to one or more particular output transactions. The same applies where the cost for the input supply is part of the taxable person's general expenses and is a component of the costs of the goods or services supplied by him. If these costs for an input supply also represent cost elements of output supplies that do not qualify for input VAT deduction, then they only qualify for input VAT deduction on a pro rata basis.

Accordingly, input VAT deduction, on a pro rata basis from general costs, is possible. In particular, it cannot be excluded merely because VWFS finance the input supplies with funds, which it obtains from exempt output supplies (granting of credits). The decisive factor is that VWFS partly incurs the general costs for the purposes of the provision of the vehicles. The general costs are, in this case, cost elements of these taxable output supplies. Therefore, the general costs do not necessarily need to be reflected in the purchase price of the vehicle.

When determining the pro rata rate, it must be considered whether or not there is a more precise method than the turnover-based allocation key. The referring court acknowledged that VWFS had used the input supplies for taxable output supplies. If the desired key ensures that input supplies, related to taxable output supplies, are not factually taken into account, it must not be applied.

3 Consequences

The ECJ clarifies the term “cost element“ in connection with input VAT deduction from general costs. It is irrelevant that an input supply is paid for with profits from taxable output supplies. The funds may also be derived from output supplies, which do not give rise to the right to deduct input VAT. The only decisive factor is that the taxable person received the input supply on the basis of the taxable output supplies.

This portion of the decision is relevant in all cases of input VAT deduction, which involve a mixed use of input supplies. Generally, in the case of instalment purchases, a financing credit institution delivers and grants a loan in accordance with sec 3.11 of the German VAT Circular. Further, the decision shows that capital management companies, with investment funds in the form of a special fund, which pay the general costs from exempt transactions, may deduct input VAT due to e.g. taxable rental sales (pro rata).

The ECJ judgment demonstrates the necessity of being able to prove that input supplies are used for taxable output supplies. In this respect, German law requires an economic allocation in accordance with sec 15 para 4 sentence 1 German VAT Act. As various recent decisions (C-126/14 - *Sveda*, C-432/15 - *Bastova*, C-132/16 - *Iberdrola*, BFH - XI R 3/16) show, this connection has to be viewed quite broadly.

When determining the deductible proportion of input VAT in an individual case, the turnover-based allocation proportion is to be applied if there is no alternative more precise method available. The tax authorities are not permitted to exclude input VAT deduction through the “back door” by not including taxable output supplies in the calculation due to modifying the turnover-based allocation proportion.

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