



Break-out Session 1b

Is your input VAT recoverable?

Sweden



Agenda

Is your input VAT recoverable?

Pro rata methods

- EU case law
- Sweden
- What next?
- Nordic overview

Branch structure and pro rata

Nordic FS Tax Conference 6-7 October 2016

EU legislation and ECJ case law

EU VAT Directive Art 173 – 175 regulates proportional input VAT recovery

Main rule

- The deductible proportion of input VAT shall be determined, in accordance with Articles 174 and 175, for all the transactions carried out by the taxable person
- Turnover based calculation (Art 174) on an annual basis with provisional proportion during the year on the basis of preceding year figures (Art 175)

Options

- (a-b) determine a proportion for each sector of his business, provided that separate accounts are kept for each sector
- (c) make the deduction on the basis of the use made of all or part of the goods and services;
- (d) make the deduction in accordance with the rule laid down in the first subparagraph of paragraph 1, in respect of all goods and services used for all transactions referred to therein;
- (e) where the non deductible VAT is insignificant, it is to be treated as nil

EU legislation and ECJ case law – Banco Mais (C-183/13)

Background

- Banco Mais (“BM”) is a bank which also carries out leasing activities (finance lease) in the automotive sector
- BM applied a turnover based pro rata including full customer payment on finance leases => 39% pro rata
- The Portuguese TA took the view that VAT able turnover should be reduced with the part of rental payments offsetting the acquisition cost of the vehicles

ECJ ruling

- From wording in Directive), a MS is allowed to provide for a deduction scheme that takes into account the specific use of all or part of the goods and services concerned
 - The Directive does not preclude a MS from using, for a given transaction, another method/formula than a turnover-based method, *provided that the other method guarantees a more precise determination of the deductible proportion of the input VAT*
 - As for BM (a bank carrying out leasing transactions in the automotive sector) with certain mixed use of goods or services, most often that use is primarily a consequence of the financing and management of the contracts entered into by the lessor and its customers, not of the provision of the vehicles. This is for the national court to determine
- => To use the turnover-based method as BM, gives in this case a pro rata that is less accurate than the method applied by the PTA

EU legislation and ECJ case law – Wolfgang und Wilfried Rey (C-332/14)

Background

- Wolfgang und Wilfried Rey (“WWR”) constructed a mixed use building and calculated the recoverable VAT treating all of its input tax as residual and applying the turnover based method to identify the recovery rate. This gave a 78% recovery rate, while using a floor area based calculation only gave a 39% recovery rate.
- In January 2004 the German authorities introduced a rule that stated that a turnover based method is only permitted if there is no other method available. The issue was whether all the VAT could be viewed as residual or had to be directly attributed as far as possible

ECJ ruling

- According to ECJ a MS must require a taxable person with mixed activities to perform a two-step method;
 - Step 1; direct attribution to output transactions => 100% or 0% input VAT recovery. If such direct allocation is, *in practice, difficult to carry out* the next step becomes applicable,
 - Step 2; the pro rata method under Art 173-175. To apply other method then turn-over based (in this case area) merely requires that a more precise result is guaranteed

EU legislation and ECJ case law - Mercedes Benz Italia (C-378/15)

Background

- Mercedes Benz Italia (“MB”) provided VAT able transactions as main activity. In addition MB provides intra-group loans. The VAT exempt interest amounts to >70% of MB income
- MB argues the interest is incidental, i.e. should be excluded from pro rata calculation
- ITA disagrees and applies pro rata on all goods/services purchased (under Italian VAT Act)

AG Opinion (29 June 2016)

- First of all, the AG considers the main question referred by the local court to be if a pro rata can be applied on all input VAT occurred rather than if the interest income qualifies as “incidental”
- Secondly, a MS are not allowed to apply the pro rata rules in a way that Italy does (with reference to e.g. Portugal Telecom-case). If input VAT is attributable to a VAT able transaction this VAT should be 100% recoverable
- According to AG the purpose with the turnover based method is to simplify the input VAT recovery determination for the taxpayer, while the purpose with the options in Art 173.2 is to correct differences that may occur in the turnover method

Guidance from the STA

Public guidance issued by the Swedish Tax Agency in 2015 relating to interpretation of 8:13 of the Swedish VAT Act

- 8:13 of the Swedish VAT Act means that the *actual use* of each purchase has to be investigated. If it is not decidable at the time of purchase the recovery has to be decided based on reasonable grounds (SE; skälig grund)
- The STA argues that turnover is the starting point for pro rata calculation (and if so following Art 174 and 175 of the VAT Directive). However, if there is a allocation key that more accurately reflects use of resources this should always be applied.
- Other allocation keys then turnover can be used and multiple keys are ok, but “time spent” only if the staff works 100% in taxable or 100% VAT exempt activities or the staff applies timesheets (such as lawyers and audit firms)
- The STA also gives its opinion on allocation keys in situations where turnover does not reflect use of resources, noting that certain income (or part thereof) should be *left out* from the pro rata calculation (“adjusted turnover”). An example involving a Leasing company with HP transactions is mentioned
- Pro rata also to be applied if “out of scope-business”
- The tax payer has the burden of proof => supporting documentation requirement

Swedish Administrative Court of Appeal; pro rata methods

There has been a number of rulings from the Swedish Administrative Court of Appeal on pro rata calculations from 2014 and up until 2016

Case	Year	Activity subject to appeal	Courts finding on tax payer's pro rata method	Courts finding on STA pro rata method	Ruling
SHB VAT Group	2014	Hire Purchase	HP activities generate VAT exempt income only for pro rata purposes (even though HP sale per se is VAT able) => the method used is misleading	STA method, where the HP sale is kept only in denominator, is fair and reasonable	In favor of STA
VW Finans	2015	Consignment sales	Consignment sales generates a minor VATable fee. A turnover based method including the value of the sales is not fair and reasonable	The sectorized method, based on products, applied by STA guarantees a more precise result	In favor of STA
Nasdaq VAT Group	2016	Electricity	The sale of electricity generates a minor VATable fee. A turnover based method including the value of the electricity is misleading	STA method, where sale of electricity is left outside calculation, is <i>more fair and reasonable</i>	In favor of STA
Danske Bank VAT Group	2016	Hire Purchase/leasing	The taxpayer has not been able to demonstrate the calculation used to split costs between HP and leasing contracts in the sectorized method	The sectorized method, but less difference in split of costs between HP and leasing is fair and reasonable	In favor of STA
Nordea VAT Group	2016	Hire Purchase	(See SHB VAT Group-case). To include HP sales in numerator or to exclude HP sales in full from the calculation => input VAT attributable to VAT exempt income is recovered	STA method, where the HP sale is kept in denominator, is <i>more fair and reasonable</i>	In favor of STA

We note that many of the above rulings refer to case nr 6980-12 issued by the Supreme Administrative Court ("SAC") in 2014. In its ruling, SAC does give a view on reasonable grounds. However, SAC sets aside the advance ruling by the Council for Advanced Tax Rulings subject to appeal.

Nordic overview - Denmark pro rata



Pro rata

$$\frac{\text{VAT taxable turnover (ex VAT) + VAT exempt turnover from customers outside EU}}{\text{Total turnover (ex VAT)}}$$

Taxable turnover

- The full leasing payment
- Turnover from disposal of leasing asset
- 'VAT exempt turnover from customers outside EU'
 - Gross revenue from sales of shares/securities to costumers established out side EU

Concept of VAT exempt turnover

- Net margin
 - Interest received minus interest paid
 - Gross premium minus claims paid (e.g.)

Nordic overview – Finland pro rata

The over-riding principle in the Finnish VAT law as regards VAT deduction is actual use

- Direct attribution: costs and related input VAT attributable directly and exclusively to taxable / exempt supplies
- Applies also to partial VAT recovery i.e. goods/services which are not a direct cost of any individual supply (“overheads”) - Article 173(2)(c)
 - The standard pro-rata method of the VAT Directive does not apply as such – e.g. the rounding up rules of the VAT directive do not apply and there are specific situations when the turnover-based method cannot be applied at all (SAC:2015:183)
 - the amounts of turnover which can be excluded from the calculation – applies also in Finland
 - Normally any method which fairly and reasonably represents the actual use (turnover, staff number, working hours etc.), sectorial approach is possible
- Defence file is highly recommended, it is not possible to apply for a ruling or otherwise agree on the proportional deduction method with FTA
- Practices applied by Finnish banks and other financial firms are pretty moderate. Finnish insurance companies do not normally make any proportional VAT deduction at all on overheads

Nordic overview – Norway pro rata

In Norway input VAT on costs for use in business activities falling outside of Norwegian VAT scope cannot be deducted

The input VAT recovery depends on the assumed use of the cost in the VAT liable activity.

- The right to perform partial exemption is in principle only possible when the VAT liable supplies normally exceeds 5%. This limitation does not apply for financial services businesses
- Different factors can be used to find “assumed use”. Multiple calculation factors can be used. The general requirement is that the calculation represents a businesslike reasonable assessment. The assessment must be documented.
- Usually, pro rata deduction rates seem to be calculated based on estimated time use/actual time consumption or/and turnover
- Several audits where businesses have applied turnover based method only. In one judgment related to a finance company performing car administration, loan for purchase of cars and leasing of cars, the court agreed with the tax office that turnover could not be used as basis for pro rata deduction (not reasonably reflect the use of the costs)

Challenges going forward re pro rata?

Adjusted turnover – Banco Mais and leasing

Increased focus on direct allocation (e.g. demonstrate that costs is not directly attributable to VAT exempt transactions)

FAT (the potential Swedish “lönsumsavgift”) and relationship to VAT pro rata rules

Other?



Partial deduction - Head office - branch

Credit Lyonnais (c-388/11)

- EU Head Office cannot recognize turnover in EU/non-EU branches when calculating pro rata in HO jurisdiction or vice versa

ESET case (C-393/15)

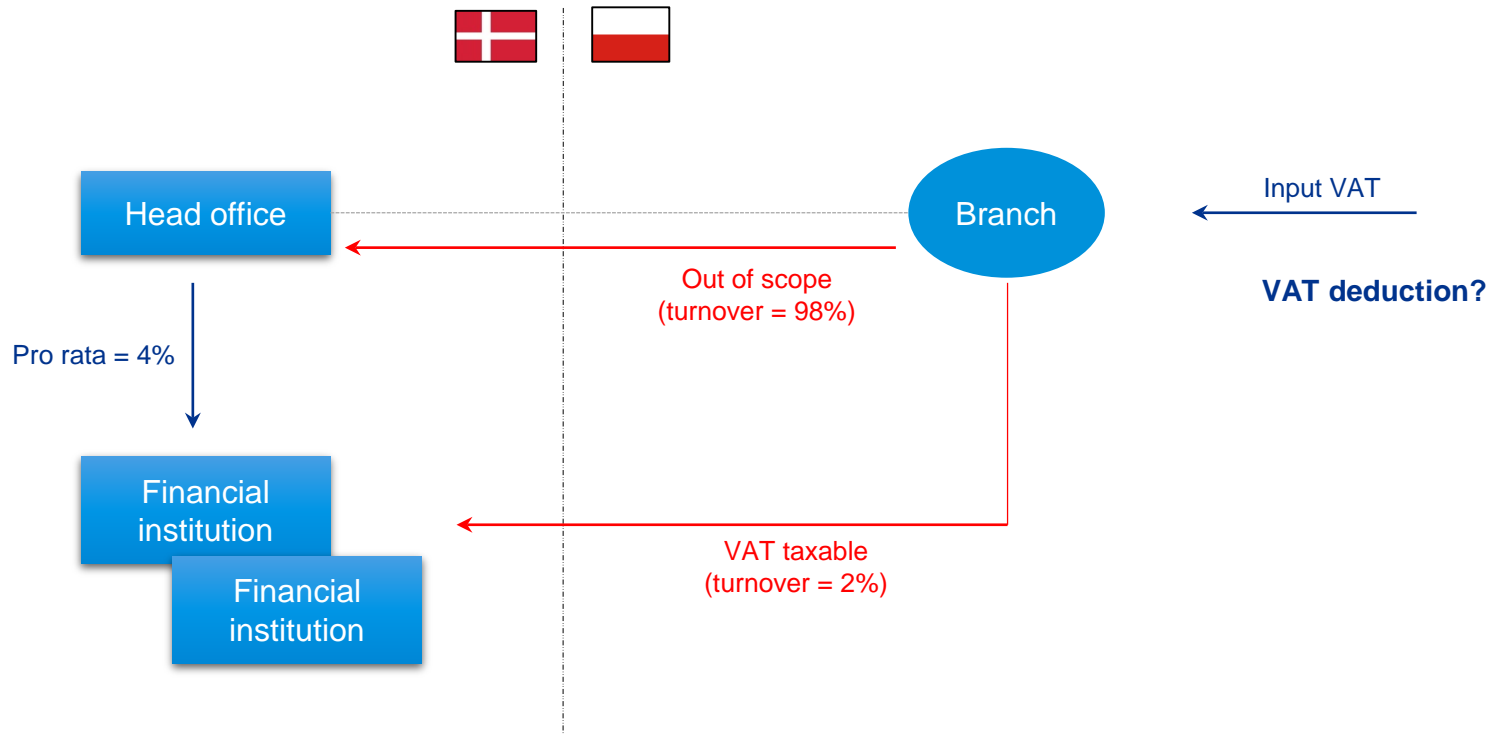
- Branch was allowed to recover input VAT although majority of income from (out of scope) transactions to its EU Head Office
- Fully VAT able activities

VAT Grouping impact



Partial deduction - Denmark

Case study





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