

VAT – Circular 765-1 on VAT deduction

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On 11 June 2018, a new circular (765-1) was issued by the Luxembourg VAT authorities (Administration de l'Enregistrement et des Domaines) in order to clarify the application of circular 765 issued on 15 May 2013 regarding the calculation of deductible input VAT for companies that have a partial VAT activity (i.e. an activity that is partially out of the scope of VAT).

Who is concerned?

A typical example would be a Luxembourg holding company which, alongside its holding of participations (which is considered to be out of the scope of VAT), has a financing activity within the EU (which should be exempt of VAT) as well as a provision of management services activity (which is a VAT taxable activity).

What was the issue before?

A well-known problem for such kind of companies was to determine the amount of deductible input VAT for VAT on overhead costs, which could not be allocated to one of the different activities. The previous circular 765 clearly stated that the companies concerned should, as a matter of principle, apply a two-step approach. The first step being a direct allocation of costs where possible (i.e. costs in direct relation to the exempt financing are 100% non-deductible whereas costs in relation to the taxable management services should be 100% deductible). In a second step, a pro rata of input VAT deduction has to be computed and applied to the non-allocated costs. However, in the past it was not clear how the proportion of (non-allocated) overhead costs, which clearly also served the holding activity, should be treated. Normally, such costs should not allow for any input VAT recovery but it was almost impossible to find a computation method which properly represents such proportion.

A new approach?

In the current new circular 765-1, the VAT authorities seem to extend the application of circular 765 to this specific type

of entities. Unfortunately, it is not very clear what is aimed by this new circular. In our view, it could be understood in a way that the pro rata of deduction computed for the overhead costs based on the proportional turnover between the VAT exempt activity (e.g. financing) and the taxable activity (e.g. management services) would be applicable for all overhead costs, including the proportion of costs for the activity out of the scope of VAT (e.g. holding activity). If that is the correct interpretation of circular 765-1, it would be a valuable simplification and increase in legal certainty for input VAT deduction for such kind of businesses.

However, it could also just aim at clarifying that the cost incurred by such companies for their holding activity should be subject to the direct allocation method (i.e. being 100% non-deductible). If this would be the intention of the circular, it would not reflect any change in the current approach, as it would be in line with the general principles which are anyway already applied.

We will seek further clarification about the correct interpretation from the VAT authorities.





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