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Input VAT newsletter

Holding company VAT deduction: Luxembourg's Court of Cassation's important decision

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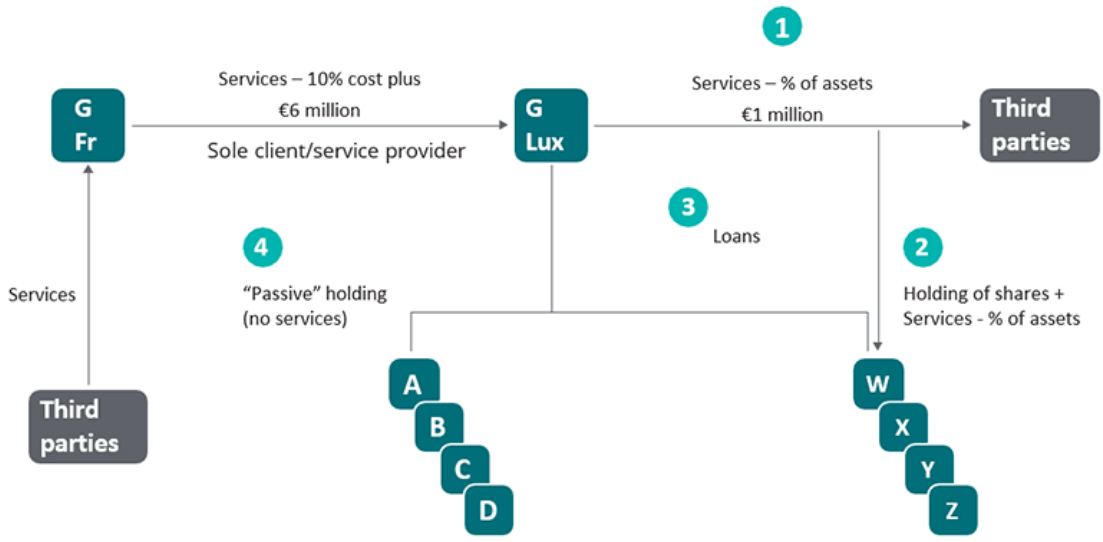
On 17 March 2022, Luxembourg's Court of Cassation, the highest national jurisdiction for civil cases including VAT, confirmed that the deduction of the input VAT on costs by an "active" holding company could not be limited to the quantum of the services it performs[1].

Background

Luxembourg "company G" performs the following activities:

1. Company G holds minority participation in different companies that own directly or indirectly (via other companies) properties in France. Company G has a management services agreement with these companies for which it receives management fees computed on the value of their assets ("active" holding activity).
2. Company G also renders similar services to other investors in these companies.
3. Company G owns shares in companies to which it does not render services ("passive" holding activity).
4. Company G also grants loans to the companies in which it owns shares.



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For activities under 1 and 2, Company G does not itself perform the services but delegates them to a French-affiliated company which receives advisory, management, and investment services from various third-party services providers. The French-affiliated company is remunerated for its services on a cost plus 10% basis.

Company G is the sole client of the French company while the latter is company G's sole provider for this type of service. Company G's employees do not intervene in activities 1 and 2 but do in activities 3 and 4.

Company G qualifies as a taxable person for activities 1, 2 and 4. Considering that only activities 1 and 2 open the right to deduct VAT, company G has determined, based on a complex methodology, a VAT deduction right of 94% for 2004 and 91% for 2005 applicable to its different costs.

On 22 October 2012, the Luxembourg VAT Authorities reassessed company G's position and limited the deduction of the VAT incurred on costs to the quantum of company G's turnover (i.e., services rendered). For example, in 2004, company G incurred around €6 million in costs and had a turnover of approximately €1 million, and the VAT authorities limited the right to deduct VAT on €1 million considering that the other €5 million were used for activities not open to the right to deduct VAT (activities 3 and 4).

Company G explained that this disproportion between costs and turnover was due to the difficult economic situation and would diminish over time as most costs are incurred at the beginning of activities while income is collected during a longer time period.

On 13 January 2021, the Luxembourg Court of Appeal, confirming the three decisions of the Luxembourg Civil Tribunal[2], found that:

- By accepting the VAT deduction up to the turnover amount, the VAT authorities accepted that costs are incurred for the purposes of economic activity;
- An expert report confirmed that all costs incurred by company G were in relation with its economic activity; and
- Limiting the deduction to the turnover would subject the deduction to the result of the economic activity which is contrary to the VAT principles as reinforced by the Court of Justice of the European Union in its decision "Marle" (C-320/17, 5 July 2018).

The decision of the Court of Cassation

Unsatisfied by the decision of the Court of appeal, Luxembourg's VAT authorities brought the case before the Court of Cassation.

The Court of Cassation refused the VAT authorities' plea[3] that the decision of the Court of Appeal was deprived of a legal basis because the Court of Appeal would not have verified nor established that the cost of services acquired by company G was fully integrated into the price of the services supplied by company G though it is one of the preconditions of the right to deduct. It thus ruled that the Court of Appeal is right when confirming the conclusions of the judicial expert who had found the existence of a direct and immediate link between the costs incurred by company G and its economic activity. Consequently, the Court of Appeal held rightly, by a statement of reasons free of insufficiency, that company G is entitled to deduct the VAT on its costs to the extent that the costs are linked to its economic activities.

The Court of Cassation also rejected the request of the VAT authorities to refer the case to the Court of Justice of the European Union.

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Comments

This important decision is a favorable step for concerned holding companies. However, it reinforces that taxpayers must be able to document that the costs for which they intend to deduct the input VAT incurred are linked to the economic activity and that, when calculating their input VAT deduction right, they also need to consider activities ineligible for VAT deduction (e.g. interest) where relevant. The importance attached by the Courts to the expert report highlights the key role of proper documentation in demonstrating that the VAT deduction right has been correctly determined. This documentation includes various elements, such as business plans, transfer pricing studies, agreements, invoices, payment documents, reconciliation tables, board decisions, etc.

All concerned taxable persons should anticipate the consequences of this decision on their VAT deduction right and possibly consider actions for filings within the 5-year statute of limitation.

The Deloitte Luxembourg indirect tax team remains at your disposal to discuss the potential impacts of this topic on your organization.

[1] In this newsletter, we focus on this specific question while other interesting ones are discussed in the 98 pages of the five concerned decisions i.e. the three decisions of the First Tier Tribunal (1st June 2016, 13 June 2018 and 15 May 20199, the decision of the Court of Appeal (13 January 2021) and the decision of the Court of Cassation (17 March 2022).

[2] 1st June 2016, 13 June 2018 and 15 May 2019.

[3] The Luxembourg VAT authorities brought another plea that we do not examine because it was found as inadmissible.

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