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## Actual use of VAT deduction allowed at bank

March 30, 2020



**Prof. GJ (Gert-Jan)  
van Norden**

Amstelveen LHZ

088 90 91025

E-mail address



**drs. IHT (Irene)  
Reiniers**

Amstelveen LHZ

088 90 91064

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On March 27, 2020, Hof Den Bosch made an interesting ruling on VAT deduction in a case of a financial institution. The court finds that the 'actual use method' of the bank has been made sufficiently plausible. Therefore, the deduction of VAT on mixed costs does not have to be determined on the basis of the legal basis according to the turnover ratios, but may be based on actual use.

This case is relevant for financial institutions, but also for other taxable persons who provide VAT-taxed and VAT-exempt services, such as parties in the public sector, education and healthcare.

## 1. Background and legal questions

The interested party in this case is a bank that provides exempt and VAT-taxed services. All costs incurred by the bank can be classified as mixed costs. Most of its sales consisted of VAT-exempt interest and commission income, the majority of which was taxed. The bank has transferred part of its mortgage receivables to separate securitization companies. The bank paid the interest received in respect of these receivables to the aforementioned companies.

The interested party made an economic analysis of the 'profit and loss' ('P&L') per product. With regard to the P&L per product, the costs are allocated to the various product groups by means of three periodically determined allocation keys (based on time registration, actual product purchase and proportional distribution). This has resulted in an allocation of the bank's mixed costs to the various revenue categories.

In its VAT return, the mixed cost claimant claimed a VAT deduction in accordance with the turnover pro-rata method, without taking into account i) the interest charges paid,



mr. J. (Jochum)  
Zutt

Amstelveen LHZ

088 90 91407

E-mail address

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paid to securitization companies. At its core, the interested party wants to apply VAT deduction in accordance with actual use through this procedure.

The dispute in the first place is whether the actual use alleged and calculated by the interested party leads to a more accurate calculation of the actual use. Second, whether the interest charges paid can be deducted from the interest income received. Thirdly, whether the interest paid to the securitization companies can be excluded from the turnover of the interested party.

## 2. Court of Appeal Den Bosch

Many market parties have been looking forward to this ruling with interest. The court's decision dates from May 9, 2018 and the court hearing has already taken place on December 13, 2018. The Court of Appeal has now finally ruled on this fundamental and fundamental case, which revolves essentially around the question of how strict deduction of VAT based on actual use should be handled in the Netherlands. The court finds the actual use method of the interested party admissible.

With regard to the application of actual use, the Court of Appeal starts with the observation that in determining the actual use, some margin must be left in the accuracy and that such a provision is not an exact science. In accordance with European case law, this is not the most accurate result.

The court agrees with the interested party, and also with the court, that the turnover of the interested party shows a distorted picture. For example, interest has fallen sharply since 2011, which has led to a significant decrease in VAT-exempt interest income. The court finds it plausible that the extent to which mixed costs have been used for the

based on actual use can lead to a more precise determination of the VAT deduction, *provided* that actual use can be determined on the basis of objective and accurately determined data.

The court sees no reason to question the P&L per product and therefore takes the allocation keys and the allocation of costs resulting from the P&L per product as a starting point. Now that the submitted P&L per product has been used to allocate all mixed costs to the various turnover categories that contain both taxed and exempt turnover, this P&L per product leads to (sufficiently) objective and accurately determined data. Compared to the regular turnover pro-rata method, these data lead to a more precise determination of actual use and thus of the VAT deduction. The fact that assumptions and assumptions have been used in parts does not change this. After all, it is not about the most accurate, but about a more accurate result. According to the court, the assumptions and assumptions used are also sufficiently objective. For example, the P&L per product has been drawn up by Register Controllers for productive reasons in accordance with international accounting standards and has been examined by DNB and the AFM in the context of their supervision, while the external auditor has also approved the financial statements.

The Court of Appeal therefore does not follow the inspector in his assertion that the interested party has not made the actual use plausible. The court also rejects the inspector's objection to the application of the ratio per category. In the opinion of the court, this is in accordance with the European Morgan Stanley judgment, from which it can be concluded that in order to determine the VAT deduction, it is necessary to link up with the different turnover categories for which the costs have been used.

With regard to the second point of dispute, the court sees no reason to allow the

link between interest income and interest charges, according to the Court of Appeal does not lead to a more accurate result than the turnover-pro-rata method.

With regard to the third point of dispute, the Court of Appeal ruled that the interest paid to the securitization companies cannot be excluded from the turnover of the interested party. In the opinion of the Court of Appeal, in the specific circumstances of this case, the interested party should still be regarded as a lender.

### 3. Impact of Dutch practice

This statement will be welcome for many market parties. European jurisprudence has long offered more scope for applying a real-use method instead of one standard turnover-pro-rata method. Due to the strict interpretation in Dutch case law of actual use, as well as the interpretation of the Tax Authorities based on this, this space could in fact not be used. The basic principle of VAT deduction should, however, be that it is as realistic as possible, matches the use as much as possible and thus does justice to tax neutrality.

Hof Den Bosch considers the method used to be based on (sufficiently) objective and accurately determined data, which - compared to the standard turnover-pro-rata method - leads to a more precise determination of actual use and thus of the VAT deduction. The court explicitly considers that within a real-use approach there is room for applying flat rates, since it is inherent in mixed-use costs that they cannot be directly related to taxed or exempt turnover. Cost accounting based methods similar to those used by interested parties should also be acceptable. The Court of Appeal rightly ruled that the Morgan Stanley judgment also supports a more specific approach to costs with regard to the VAT deduction.

The Netherlands has not made use of the option provided in the VAT Directive to specifically allow a VAT deduction method based on sectors. A number of other Member States do have this option and in practice many foreign taxpayers use it. It appears that the court's ruling through the route of actual use leaves room to allow a sector-based method, provided that it is based on objectively and accurately determined data and leads to a more accurate result.

## 4. What can you do now?

This judgment is of great importance for the application of the actual use method to mixed costs by taxable persons who perform both VAT-taxed and VAT-exempt services. Although it is not inconceivable that cassation can be lodged against the ruling, this ruling gives rise to financial, public, educational and healthcare institutions, among others, to look more closely at their VAT deduction on mixed costs.

It is recommended to further investigate whether, and if so to what extent it is interesting to investigate further whether an actual use method can be identified that leads to a more accurate determination of the actual use of mixed costs than the standard turnover-pro-rata method. This could include existing cost accounting methods within your organization. From the judgment we conclude that the bar of objective and accurately determined data is lower than Dutch judges and that the Tax Authorities had previously envisaged. In that context, it is advisable to look at robust starting points, such as international accounting standards and the way in which supervisors and the external auditor deal with the allocation of mixed costs.

If you would like to discuss this ruling, please do not hesitate to contact the advisers of the Indirect Tax Financial Services Group of Meijburg & Co or your usual adviser.

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