Newsletter 6/2019

On 24 of January 2019, the European Court of Justice issued its judgement on the case of Morgan Stanley & Co International v Ministère de l'Économie et des Finances (Case C165/17) in relation to the input VAT recovery right of the Morgan Stanley branch in France.

In its decision the ECJ pointed towards multiple pro-rata recovery mechanisms for calculating the recoverable proportion of input VAT. It concluded that those mechanisms should take into account in addition to the activities of the branch, the activities of the head office situated in the other Member State.

Facts of the Case

Morgan Stanley's head office is established in the UK, while the company also operated through a branch in France. The French branch generated income from financial services supplied to third parties in France for which an option to tax was made by the branch, as well as from the recharging of expenses to the head office in the UK. The branch claimed deduction of input VAT incurred on its expenses in full, on account of having carried out exclusively transactions subject to tax, even though part of its costs were incurred in relation to transactions with its head office in the UK. The French authorities challenged the recovery of input VAT of expenses relating wholly or partially to the head office claiming that the head office itself did not have entitlement to full recovery.

Questions referred to the ECJ

The ECJ was asked whether and to what extent the French branch was entitled to deduct VAT and in particular, whether the branch in France was entitled to input VAT deduction and if it was required to calculate its input VAT deduction right by taking into account the input VAT deduction right of its head office in another jurisdiction.

Ruling of the ECJ

In summary, the ECJ hold that the method of calculating the VAT recovery depends on whether the costs incurred relate to a specific field of business of the head office or whether the expenses serve both the business activities of the branch and of the head office (mixed-use/general costs). In both scenarios the branch should (partly) take into account the turnover of the head office when calculating its input VAT recovery ratio for these costs. The judgement leaves room to exclude turnover of the head office from the calculations if the costs lack a direct and immediate link with that turnover.

(a) Expenditure used exclusively for the head office

The pro-rata mechanism proposed by the ECJ is as follows:

In the numerator: the turnover relating to the head offices' taxed transactions which would be eligible for deduction if those transactions had been carried out in the Member State in which the branch is registered
In the denominator: the total turnover of the head office

(b) General Expenditure

The pro-rata mechanism proposed by the ECJ is as follows:

In the numerator: the taxed transactions of the branch and the taxed transactions of the head office which would be eligible for deduction if those transactions had been carried out in the Member State in which the branch is registered
In the denominator: the total turnover of the branch and the head office

Significance of the case

This decision will affect businesses which are active in the European market with principal establishments and branches being situated in different Member States in relation with the approach of calculating the right to deduct input VAT. In practice, a branch may be required to apply different input VAT recovery ratios for expenses that are (also) used by its principal establishment in another Member State and/or general costs.

How can PwC help you

Our designated team of Indirect Tax Specialists is at your disposal to discuss the impact of this case in your business and assist in the correct application of the rules.

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