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MoF: Revised allocation formula for input VAT deduction of financial institutions

Towards the end of 2024 the Federal Ministry of Finance (MoF) commented in some detail on the input VAT deduction for credit institutions. The ministerial pronouncement focuses on the attribution of input transactions to output transactions and the relevant input VAT allocation in accordance with Section 15 (4) VAT Act. Another focus of the MoF circular is on cross-border structures and specifically the services between local branches and their foreign head office and vice versa.

The core of the MoF circular - but by no means its only subject - is an extensive revision of an almost twenty-year-old circular on a specific VAT allocation formula devised especially for banks. Although the current circular refers explicitly to credit institutions it could also be relevant for other financial service providers.

The MoF points out first, that the right to deduct the VAT on input supplies and services generally requires that the expenses incurred for the purchase of these supplies are part of the cost elements of the taxable output transactions for which the goods and services are used. An indirect connection between input transactions and output transactions is generally secondary to an existing direct and immediate connection. The entitlement for input VAT deduction is based on the intended first use of the particular input transaction.

Banks often use a (single) apportionment method to determine the deductible input VAT for their mixed input supplies. Instead, the MoF wants credit institutions to carry out an extended allocation of their input supplies or input VAT amounts. It thus appears, that credit institutions are likely to face considerable additional administrative work in the future.

In its letter, the MoF – along with other allocation methods - explores segmentation as a method for allocation for attribution to output transactions. Thereby an additional stage for the attribution of input to output supplies is envisaged in addition to the direct attribution of input VAT amounts and the use of a (residual) key for (all) mixed input services. In the opinion of the MoF, a separate view and analysis of individual and separate parts of the company for the purposes of input VAT deduction (segmentation) takes adequate account of the requirements as outline and described in the circular.

The MoF also indicates examples of possible segments, such as: Controlled companies, foreign permanent establishments, branches, business divisions (e.g. investment banking, private client business, corporate client business), departments (e.g. insurance brokerage, real estate management), product groups (e.g. credit business, custody business, real estate trading, wind power plants, certificate trading).

Cross-border structures

If input services of a domestic permanent establishment are connected to output services of the foreign head office an input VAT deduction is only possible if the output services are taxable both abroad and (locally) in Germany. The MoF thus applies the so-called double test, which is based on the ECJ decision in the “Morgan Stanley” case (judgment of 24 January 2019 **C-165/17** *Morgan Stanley & Co International*; see our **[blog post of 8 February 2019](#)**).

According to the MoF letter, the same should apply in the reverse case, i.e. for the receipt of services from a foreign permanent establishment in the case of a domestic parent company.

Application

The principles of this circular are to be applied in all open cases. The tax authorities will not object if an entrepreneur for the period up to 31 December 2025 relies to the principles laid down in the MoF letter of 12 April 2005* to the banking associations provided that its requirements are met, and this does not conflict

with MoF guidelines which have been published in the meantime.

*) With this letter the MoF had introduced a new method based on Section 15 (4) VAT Act to be applied as an alternative to the officially prescribed allocation at the time. In essence, this alternative method called for a „reasonable estimate“ of the deductible proportion from input VAT which is not directly attributable either to taxable or non-taxable transactions.

Source

Federal Ministry of Finance, circular of 9 November 2024 (GZ III C 2 - S 7306/19/10003 :004).

Keywords

banking service, input VAT deduction