



KMLZ VAT NEWSLETTER

Reform of VAT taxation of public bodies

1. New legal regulation

Legal entities under public law (“legal entities”) are not acting as entrepreneurs, despite economic activity in accordance with sec. 2b para. 1 German VAT Act, if they engage as **public authorities** and if there is no risk of **significant distortion of competition** when treating them as non-entrepreneurs. When these two conditions are met, legal entities are not acting as entrepreneurs and their supplies are not subject to VAT. Sec. 2b para. 2 and para. 3 German VAT Act identify cases in which there are no significant distortions of competition.

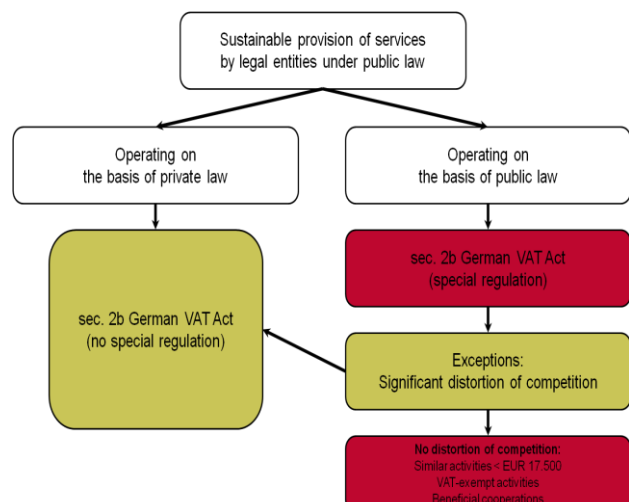
2. Criterion public authorities

According to the still applicable previous case law, legal entities do not exercise public authority if operating on the **basis of private law** (i.e. civil law contract). However, if these entities operate on the **basis of public law**, they do exercise public authority. Public actions include administrative acts, public law contracts or statutes. This means: As soon as legal entities supply services on the basis of private law, they operate as entrepreneurs. Only if legal entities operate on the basis of public law may the exceptional

Harder times for public bodies

The tax reform law 2015 introduced sec. 2b German VAT Act. This change has allowed the legislator to harmonize the legal situation for the taxation of legal entities under public law with the legal case law of the Federal Fiscal Court. There is now a special regulation for assistance services. Legal entities under public law will now act as entrepreneurs in the case of supplies worth less than EUR 30.678 and within the framework of asset management. It is to be expected that the Federal Ministry of Finance will issue an administrative circular regarding sec. 2b German VAT Act during the course of this year.

regulation of sec. 2b German VAT Act be applicable (as long as the legal entity does not compete with private third parties). According to the new regulation, the basis of action of legal entities is crucial. The connection to the Corporate Income Tax is passé.





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3. No significant distortion of competition

Generally, there is no significant distortion of competition with private economic operators if no private economic operator may provide services, which are comparable to the services of legal entities under public law. Sec. 2b para. 2 German VAT Act states that there is no competition if legal entities generate revenues of less than EUR 17.500 for similar activities in the calendar year or if comparable services, on the basis of private law, are subject to VAT exemption in accordance with sec. 9 German VAT Act, without any right of waiver.

In sec. 2b para. 3 German VAT Act, the legislator is still attempting to exclude the supplies between two legal entities (i.e. cooperation between local authorities or cooperation of two clerical legal entities) from taxation. There has not been a commercial entity in the case of so-called assistance services until now. The supplies were treated as non-taxable supplies. In future, an exception is to be applicable, however this will only be the case if certain requirements are met. According to the new law, there is no competition if supplies are: carried out based on a long-term public agreement, serve to preserve public infrastructure, fulfill a task in the general public interest, are rendered exclusively against reimbursement and the legal entity only renders similar services to other legal entities.

4. Transitional regulation

According to sec. 27 para 22 German VAT Act, this new regulation is to be applied to all services as of 1 January 2017. However until **31 December 2016**, a legal entity may declare to the tax office that it intends to apply

this new regulation only for services supplied as of 1 January 2021. This declaration is then consistently applicable to the whole range of entrepreneurial activity of the legal entity. Legal entities may revoke this declaration at the beginning of the following calendar year.

5. Practical tips

The decisive criterion for the application of sec. 2b German VAT will be whether a legal entity engages as a public authority. It is often difficult to determine whether a contract is public in nature, which often leads to legal uncertainties. Therefore, a situation like this should be avoided if possible. Legal entities may define their relationship to the citizen by statutes. It is recommended, for the purpose of cooperation between local authorities, that negotiated arrangements in accordance with the respective state law be concluded. According to the legislative provisions, these arrangements are considered to be public contracts. In order to prevent distortions of competition, legal entities must attempt to satisfy the conditions of sec. 2b para. 2 or 3 by acting accordingly. Every legal entity should examine all of its output transactions in 2016 to determine whether their VAT-treatment may change based on sec. 2b German VAT Act. If there are disadvantages for the legal entity, a declaration in accordance with sec. 27 para. 22 German VAT Act should be submitted to the tax office by 31 December 2016. Even if there are no apparent disadvantages, this examination of output transactions is necessary. Regardless of which regulation the legal entity may apply as of 2017, the application must meet the requirements of the latest legal situation. In order to ensure this, legal entities need to examine their output transactions.