



KMLZ VAT NEWSLETTER

Federal Tax Court softens principle of taxation at the time of supply

According to a recent decision of the Federal Tax Court, correction of VAT can be taken into account if the entrepreneur is not fully entitled to payment of the invoice amount at the time the supply is carried out. This temporary uncollectibility exists if the contracting parties agree on retentions over a strict period, during which the customer is not obliged to pay the full amount of the invoice.

1. Background

A company supplied construction services, which were charged to the customer with VAT. The customer only paid part of the invoiced amount as the contracting parties had agreed on retention over a period of years in the case of poor workmanship.

The company declared the reduced amount, (reduced by the retention), in its VAT returns. However, the responsible tax office determined the VAT to be the full amount, as, in

No obligation for pre-financing of VAT

Entrepreneurs are not obliged to pre-finance VAT over a period of years. The Federal Tax Court expressed its position regarding uncollectibility. Correction of VAT may potentially be taken into account whenever agreements regarding retentions are made on the basis of which entrepreneurs are not fully entitled to the payment of remuneration at the time of the supply is carried out (temporary uncollectibility).

their opinion, there was no legal basis in these circumstances for the reduction of VAT.

2. The Federal Tax Court's decision

In its judgment of 24 October 2013 (V R 31/12), the Federal Tax Court affirms the reduction of VAT amounting to the retention due to uncollectibility where the company has not been granted a guarantee. Therefore, it depends whether a banking guarantee was possible or not. The tax court now needs to make further statements regarding the extent and conditions of retention.

The Federal Tax Court does not question the basic principle of taxation according to which VAT becomes chargeable when the goods or services are supplied. However, it does point out that entrepreneurs are entitled to correction according to sec. 17 of the German VAT Act.

The German VAT Act does not define what uncollectibility means. In the German Administrative Circular, the tax authorities only refer to the type of cases that lead to



uncollectibility. However, in its judgment, the Federal Tax Court makes it clear that uncollectibility might be found to exist much earlier than the tax authorities had assumed.

The Federal Tax Court based its findings on the indicators of art. 90 para 1 of the VAT Directive, according to which the taxable amount shall be corrected in cases of cancellation, refusal or total or partial nonpayment, or where the price is reduced after the supply takes place.

3. Practical consequences

From our point of view, the Federal Tax Court's definition of uncollectibility has far-reaching consequences for other contractual arrangements.

3.1 Payments by installment

If goods are sold by means of an agreement to pay by installments, VAT becomes chargeable when the goods are supplied. Due to the contractual agreement, however, the entrepreneur is unable to claim the total purchase price at an earlier date. Compliance with the judgment of the Federal Tax Court would mean that supplier to assume temporary uncollectibility, leading to the correction of VAT.

3.2 Capital leasing / Hire purchase

Capital leasing and hire purchase also involve payments by installment. These sorts of contracts would normally provide that VAT is due, with respect to the entire purchase price, at the time the first installment is due. Customers should reject

the immediate request for payment of the total amount of VAT as they are not entitled to deduct VAT.

4. Conclusion

According to the Federal Tax Court's opinion, it would be disproportionate for entrepreneurs to pre-finance VAT over a period of years. As long as there is a temporary uncollectibility, VAT needs to be paid to the tax authorities in accordance with the installments. VAT payments should proceed correspondingly on the customer's side. The customer is only entitled to deduct the corresponding input VAT.

Companies are now encouraged to check which payment agreements have been made in relation to which the claim to payment over a specified period of time cannot be enforced. The same applies for liabilities of entrepreneurs for which the liability to correct the input VAT applies.

Furthermore, from our point of view no differentiation should be made concerning the period of time over which the claim cannot be enforced. It is more decisive that the claim cannot be enforced.

In our view, due to the existing case law, there is a need for adaption concerning the issue of uncollectibility regarding the German Administrative Circular. We all now eagerly await the tax authorities' reaction.