



## Research institutions receive windfall from Berlin

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### 1 Background

There is no more exciting subject than that of the VAT taxation of research institutions. In this context, two particular questions always play a role: Is the research institution considered to be a taxable person and to what extent is it entitled to deduct input VAT. In answering both questions, the fact that research institutions are extensively funded by public grants, usually plays a significant role. Research institutions are often public bodies, such as universities or non-profit institutions in the legal form of a registered association or a non-profit limited liability company. What both legal forms have in common is that their different activities are separated when it comes to VAT law. A distinction is made between economic activities (taxable sphere) and non-economic activities in the narrow sense (sovereign or non-material sphere).

Research institutions have always endeavoured to acquire a variety of funding sources. In addition to institutional funding, project funding, in a wide variety of forms, is also a possibility. The success of a research institution is often determined by the so-called third-party funding quota. Universities and universities of applied sciences, as well as non-governmental research institutions, therefore, regularly attempt to "land" research projects in the sector of contract research or the application of proven findings. Consequently, a research institution can suddenly become a taxable person under VAT law and must therefore comply with European state aid law in the form of the separation calculation (cf. the recently amended research aid framework dated 19.10.2022). Given that research institutions, as taxable persons, are required to pay VAT, it seems obvious to take steps to tap another source of funding in the form of input VAT deduction. The problem is that input VAT deduction is actually only possible if a direct and immediate connection between the funding and the specific taxable research activity exists.



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However, research activities are often subdivided into basic research (non-taxable sector) and contract research or the application of proven findings (taxable sector). The input VAT incurred must therefore be allocated. It is obvious that many research institutions have developed a flourishing “imagination” in order to optimise their input VAT deduction rate.

The tax authorities have, in the past, reacted in very different ways, leading to the emergence of a patchwork quilt in Germany. While so-called non-university research institutions have tended to be treated very generously, the tax authorities have been rather stricter with universities. For the latter, basic research has often been regarded as being part of the non-taxable sector (no input VAT deduction) and for the non-universities, basic research has been counted “as a preliminary stage” to later taxable activity.

## 2 New Federal Ministry of Finance letter dated 27.01.2023

The German Federal Ministry of Finance is now aiming for equal treatment for all research institutions, nationwide. Since there should be no political favouritism, the Ministry intends to grant all research institutions more extensive input VAT deduction in the future. The following new principles apply:

- Extent of the taxable person: Insofar as the intention is to use research results to generate income on a sustainable basis, the entire research institution and its research sector is to be treated as a taxable person. Even basic research is now considered a part of taxable activity. The input VAT deduction is to be granted, in full. An exception will only apply if the basic research is carried out in a definable sector (e.g. own institute). Pure teaching and other activities unrelated to research are to be excluded as a matter of course. If there is no such intention to market the research results for consideration, the research institution is, in principle, a non-taxable person. If, contrary to expectations, taxable supplies are made, a proportional input VAT deduction is available.
- Contributions to a so-called expense pool may not be taxable: Insofar as the research institution is considered to be non-taxable person, “independent supplies, which are carried out pursuant to a partnership or an affiliation with research institutions” may be assessed as non-taxable supplies. The Ministry’s above principles serve to bless the legal concept of the so-called expense pool. As a result, cooperations between research institutions can, under certain conditions, be treated as non-taxable (cf. *Küffner/Claussen* in UR 2023, 93).
- Fiction regarding input VAT deduction: Since the scope of the taxable person is generally to be drawn broadly, the input VAT deduction is to be granted, in full. The Ministry works with a fiction: all preceding research activities are directly related to the later generation of income for consideration. Government grants do not reduce the input VAT deduction.
- Facilitation for practice: The practice will thank the Ministry for having created five examples. Any delimitation questions can thus be solved more easily. It is also good that the Ministry provides a simple calculation scheme for cases in which the input VAT deduction is to be granted on a pro rata basis

## 3 Recommendations for practice

The new principles should apply to all open cases. The Federal Ministry of Finance is thus providing some research institutions with a windfall. Universities, as well as non-university research institutions are encouraged to keep their VAT assessments open. Applications for retroactive input VAT deductions must now be submitted. Amicable solutions must be sought with the tax authorities. A dispute before the tax courts or the Federal Fiscal Court is not worthwhile, as the courts have different, stricter standards for input VAT deduction. As always, there is also a flip side to the coin: Funding agencies are also aware of the more generous view of input VAT deduction and they will only issue so-called net subsidies when granting subsidies.