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VAT'S UP

VAT NEWSLETTER

Input VAT deduction for development facilities: Federal Ministry of Finance reacts with non-application decree

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1 Background

If a taxable person wants to develop an area for a (taxable) activity, it is dependent on the local municipality's goodwill. The municipality often imposes the development of the construction area as a condition of its development approval. The developer must then hand over the development facilities (e.g. roads) to the local authority, free of charge. In this context, the question always arises: Does the taxable person benefit from input VAT deduction? The fact that he cannot otherwise develop his economic activity speaks in favour of this. The fact that he must ultimately provide the development facilities to the municipality, free of charge, speaks against it. It must also be clarified, in each case, whether a supply carried out free of charge is taxable in the case of input VAT deduction.

Against this background, the VAT treatment of development measures has long been controversial. The German Federal Fiscal Court ruled in 2011 that a taxable person is not entitled to input VAT deduction from the construction of a development facility if it is later transferred to a municipality free of charge. However, in 2020, thanks to a ruling by the ECJ dated 16 September 2020 (C-528/19), the German Federal Fiscal Court has reversed its restrictive jurisprudence regarding input VAT deduction for development measures.

In the case *Mitteldeutsche Hartstein-Industrie,* the ECJ ruled that the taxable person was entitled to input VAT deduction from the costs of developing a road for the operation of a limestone quarry. The taxation of a supply carried out free of charge can also be omitted. After the tax authorities had followed the German Federal Fiscal Court's restrictive jurisprudence

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from 2011 up until then, there was now an eager wait for a turnaround. The Federal Ministry of Finance's letter of 24 January 2024 arrived, but the turnaround failed to materialise.

2 Jurisprudence

Following the ECJ judgement in the case *Mitteldeutsche Hartstein-Industrie*, the German Federal Fiscal Court rowed back from its original rulings: While the German Federal Fiscal Court previously required the procured goods and services to be directly linked to supplies subject to VAT in order for input VAT to be deductible, it now also accepts an indirect connection. Furthermore, in accordance with the ECJ jurisprudence, a supply carried out free of charge is not to be taxed if there is no risk of untaxed final consumption. Against the background of the ECJ judgement, the German Federal Fiscal Court reduced the German regulation of supplies carried out free of charge within the meaning of sec. 3 para. 1b no. 3 of the German VAT Act, in line with Union law. As long as there is no threat of untaxed final consumption, there is no scope for VAT. Therefore, if the procured supplies are necessary for the taxable person's economic activity and the costs (imputed) are included in the price of the output transactions, taxation in the form of a supply carried out free of charge can be omitted. Any benefits for the general public then amount to an incidental result that does not require taxation. This also corresponds to the logic, as the procured goods and services are included in the taxed supplies.

3 Federal Ministry of Finance's letter of 24 January 2024

So far, so good. But now to the tax authorities: With the Federal Ministry of Finance's letter dated 24 January 2024, the tax authorities reacted to the new jurisprudence in an unexpected way. The Federal Ministry of Finance emphasises that it sees no need to change the old Federal Ministry of Finance's letter from 2012 on development facilities because, in the cases there, the supplies carried out free of charge would generally lead to untaxed final consumption. Ultimately, the crucial factor will be whether the procured supply is necessary for the taxable person's economic activity. This is the case, in particular, if the taxable person would not be able to carry out or continue his economic activity without this supply. In other words: The procured supply is not necessary, if there is a benefit to the general public, which is not only incidental. The consequence is that the input VAT deduction would have to be denied. The primary interests of a taxable person then recede into the background. According to the Federal Ministry of Finance, this even applies if the taxable person constructs the development facility due to a legal obligation (such as an official requirement). In view of this, the Federal Ministry of Finance's letter of 24 January 2024 is nothing more than a hidden non-application decree.

4 Evaluation

I consider the Federal Ministry of Finance's letter to be far too narrow. The fact that the general public (also) has an advantage says nothing about whether the construction of a development facility is necessary for the taxable person or not. If a construction company cannot build in a development area without the construction of development facilities, the construction of the development facilities is of course necessary. The last word has definitely not yet been spoken here. Relevant cases must be kept open and submitted for judicial clarification. The chances of a successful outcome are reasonable. This is also evidenced by current jurisprudence. In a recent case, the Münster tax court emphasised that the benefit to the general public resulting from the development facilities in question was, at best, secondary.

Therefore, the only possible conclusion is: We continue to fight for the neutrality of VAT. Taxable persons must not be burdened with VAT as long as they incur expenses for the purpose of their taxable activities. If the general public benefits later, this cannot and must not be to the disadvantage of the taxable person.

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