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KMLZ VAT NEWSLETTER

No input VAT deduction in the case of asymmetric charges

1. Background

If a supply is offered at a cost price, it is often the case that there is an excess of input VAT. As a result, the tax authorities often feel compelled to consider the plausibility of this result leading them to quickly search for possible corrections based on the VAT law. The minimum assessment basis, pursuant to sec. 10 para. 5 German VAT Act, is excluded if it is not a matter of supplies to related parties or their own staff. Attempts to disregard symbolic charges as remuneration have been rejected by the ECJ in its decision in the case *Skandia*. The amount of the remuneration cannot play a role in the qualification as a supply against remuneration. The hurdles for the assumption of an abuse of law, pursuant to sec. 42 of the German General Fiscal Code, are very high in VAT. This leaves only the question whether an status as a taxable person, in accordance with sec. 2 German VAT Act, may be assumed at all.

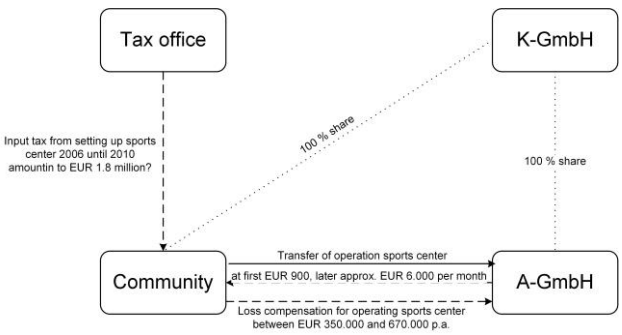
2. Facts

A community set up a sports center for approx. EUR 10 million and rented this facility to its own subsidiary, A-GmbH, for a monthly rent of only EUR 900. The community subsequently increased the monthly rent to EUR 6.000.

Asymmetric charges in VAT

Taxable persons are only those who carry out an economic activity in the sense of a sustainable activity for the purpose of generating revenue pursuant to sec. 2 para. 1 German VAT Act. By judgment of 15 December 2016, V R 44/15, the German Federal Fiscal Court found that the status as a taxable person is not present where an asymmetry between the operating costs and the revenue exists. In this case, according to ECJ case law *Borsele*, there is no remuneration and therefore no economic activity. This judgment has implications not only for the public sector but also for private economy entrepreneurs.

Since the operation of the A–GmbH was deficient, the community ultimately paid high loss compensation as a non-taxable subsidy. It was obvious that the tax office would not want to pay the excess of input VAT. However, the Fiscal Court in Saxony saw this differently. A-GmbH was entitled to the deduction of VAT in accordance with sec. 15 German VAT Act since the applicant ran an industrial business with the leasing of the sports center and the loss compensation had not resulted in either the elimination of the intention to make a profit or to non-remuneration.



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3. Decision of the German Federal Fiscal Court

The German Federal Fiscal Court decided in favor of the tax office. In the meantime, the ECJ had decided the case of *Borsele*. Against this background, the German Federal Fiscal Court questioned the status of the community as a taxable person and referred the case back to the Fiscal Court to clarify the facts.The German Federal Fiscal Court did not (properly) examine the status of the community as a taxable person according to the sec. 2 para. 3 German VAT Act (new sec. 2b German VAT Act). Instead it jumped a step ahead and asked the question whether there was actually any economic activity within the meaning of sec. 2 para. 1 German VAT Act. This is the basic prerequisite for the acceptance of an entrepreneurial activity and therefore the right to deduct input VAT. The ECJ had stated the idea, in the case *Borsele*, that an entrepreneurial (economic) activity would not exist if a community covered only a small part of its costs. If the costs were financed by only 3% from the revenues and otherwise by public funds, this asymmetry between the operating costs and the amounts received in return would indicate no remuneration and thus no economic activity. The Fiscal Court in Saxony should, in particular, examine the following aspects:

Is there an asymmetry within the meaning of the ECJ case law?

In my opinion, this question cannot be answered easily. The "asymmetry" of the amount of the remuneration to the expenses does not necessarily lead to the negation of the entrepreneurial activity. In individual cases, all aspects of the concrete situation must be taken into account. This also includes the ECJ's important question of whether the community itself has acted more as a final consumer than as an entrepreneur. If the community is entitled to the deduction of input VAT in the case of its own operation, there is much evidence to suggest that it cannot be regarded as a final consumer when the supplies are purchased.

Are leasing and loss compensation to be balanced?

The German Federal Fiscal Court places emphasis on this balancing where the lease and loss compensation are based on a uniform contractual basis. In this case, the community would have no taxable output transactions due to the lack of remuneration. The community would not be a taxable person and therefore not entitled to deduct input VAT. The German Federal Fiscal Court is apparently taking up the corporate tax jurisdiction of public owned commercial operations (see R 4.3. Administrative Corporate Tax Guidelines).

4. Impact on the practice

With this ruling, the German Federal Fiscal Court states that it would like to have the ECJ case law of *Borsele* applied. However, many questions remain unanswered. In the future, public authorities will have to consider exactly how they go about the leasing of permanent deficit facilities. Most public law legal entities want to avoid tax liability. In the future, this will be more difficult under the regulatory regime of sec. 2b German VAT Act. Therefore, the new jurisprudence is interesting because it calls into question the basic requirement of "economic" activity at very low charges. However, the judgment is of equal importance for private-sector companies (see ECJ judgment *Lajver*). It must be blatantly obvious that the company has acted more as a final consumer than as an entrepreneur. The fiscal authorities will rarely succeed in producing such evidence.