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VAT NEWSLETTER

Federal Fiscal Court: No input VAT deduction from heating system installation costs for residential letting

09 I 2024

1 Problem outline

Landlords regularly provide additional supplies, e.g. heating and hot water, to their tenants alongside the actual rental service. To date, energy supplies have been classified as ancillary supplies to the letting service (sec. 4.12.1 para. 5 of the German Administrative VAT Guidelines) and therefore, for VAT purposes, share the fate of the letting service. In its decision of 16 April 2015 – C-42/14 – *Wojskowa Agencja Mieszkaniowa w Warszawie*, the ECJ decided differently, stating that the supply of energy by a landlord should, in principle, be assessed independently (see KMLZ VAT Newsletter 14 I 2015). Based on the ECJ's opinion, it must be clarified to which supply the purchase of a heating system by a landlord is to be directly linked: the VAT exempt letting service or the taxable supply of heating and hot water. If the expense is linked to the supply of heating and hot water, the landlord could claim the input VAT deduction from the purchase of the energy system.

2 Facts

The plaintiff rented out two flats in a house VAT exempt. The rental agreement specified the payment of a basic rent, "cold" operating costs and heating operating costs. The tenants settled these operating costs in advance, annually. In 2016, the plaintiff installed a new boiler system and heating, as well as a new hot water tank. The tenants could regulate the water temperature individually and the quantity was recorded by individual meters for each apartment unit. The plaintiff opted to be liable to VAT on its supplies of heating and hot water and deducted the input VAT from the purchase and installation of the heating system. The tax office considered the supply of heating and hot water to the tenants to be typical ancillary supplies for letting. An input VAT deduction was therefore not permitted. The Fiscal Court Münster followed the ECJ and ruled that the energy supplies provided by the landlord were not ancillary to the VAT exempt letting of the flat, but rather

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were separate supplies. The supplies received for the installation of a boiler system and heating are directly and immediately related to the supplies of energy that are subject to VAT. The Fiscal Court Münster therefore allowed the input VAT deduction. The German Federal Fiscal Court does not follow this opinion – and leaves open the question as to how the energy supply is to be classified, whether as an ancillary supply of the letting or as a separate supply.

3 German Federal Fiscal Court decision

In its decision of 7 December 2023, the German Federal Fiscal Court dismissed the lawsuit. According to the German Federal Fiscal Court, the costs of purchasing and installing a heating system are directly and immediately linked to the VAT exempt letting service. In accordance with the tenancy law regulations, a landlord may not allocate the installation costs of a heating system to his tenants through the operating costs – but only through the basic rent. The provision of an intact heating system for the contractual use of a rented flat is part of the letting service. The installation costs of a heating system are therefore exclusively linked to the supplies of the VAT exempt letting of residential space and any input VAT arising from such is not deductible. Consequently, the German Federal Fiscal Court left open whether the supplies of heating and hot water constitute separate supplies as assumed by the ECJ or – as the tax authorities believe – the supplies are to be regarded as ancillary supplies to the (VAT exempt) letting service. The answer to this question was not relevant here.

4 Consequences

The German Federal Fiscal Court derives the allocation of supplies in relation to costs based on national rental law provisions. This is not to be criticized. Consequently, input VAT deduction is generally ruled out for certain "infrastructure costs" – which must be included in the rent under tenancy law. The ECJ ruling of 16 April 2015 – C-42/14 loses practical relevance in this context. A direct allocation of such procured goods and services to heating and hot water supplies for which the supplier may waive the VAT exemption is blocked. The input VAT deduction then depends on whether the basic rent is subject to VAT or VAT exempt.

However, the decision of the German Federal Fiscal Court does not contradict the decision of the ECJ. An input VAT deduction remains imaginable with recourse to the ECJ decision if – in contrast to the case in question – a supply is not directly related to the VAT exempt rental supply, but to a different, separate supply subject to VAT (e.g. in the form of electricity, heating or hot water supplies). This gives rise to certain structuring options. Within the limits permitted under civil law and as an expression of the parties' autonomy, it can be contractually determined which cost elements are included in the basic rent and which are included in operating costs for which the VAT exemption may be waived or are included in separately assessable other supplies. Of course, there is less leeway in residential lettings than in commercial lettings.

With this in mind, a more detailed clarification of the German Federal Fiscal Court's understanding, with regard to the ECJ decision in connection with another pending case (XI R 8/21), is still to be expected. In this case, the question is whether the purchase of a photo-voltaic system by the landlord for the supply of the generated electricity to the tenants is directly related to the VAT exempt rental service.

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