KMLZ

VAT'S UP

VAT NEWSLETTER

Status as taxable person at stake in the case of loss-making activities

18 I 2023

1 Background

Is a legal entity under public law considered a taxable person in the case of a loss-making activity? This question is relevant not only when it comes to the taxation of the supplies rendered but also to the question of input VAT deduction from the procured goods and services. The ECJ commented on this issue in two recent decisions. After all, the right to input VAT deduction only exists if the status as taxable person is affirmed.

Deficit activities can result from the fact that grants are paid by third parties and/or consideration below the market price is to be paid. This phenomenon occurs very often among legal entities under public law as they receive grants in many sectors. In addition, for socio-political reasons, cost-covering consideration is often not charged. In local self-government, the principle of cost covering generally applies. However, it is possible to deviate from this if the measure serves the welfare of all citizens. It is therefore not surprising that municipalities, especially in the sectors of culture, transport and sport, sometimes operate with cost covering rates of less than 10%.

2 Decision of the ECJ in the case *Gmina O.* (judgment of 30.03.2023, C-612/21)

In this dispute, a Polish municipality wanted to ensure that it was not considered a taxable person and that its supplies were therefore not subject to VAT. The municipality had provided photovoltaic systems to property owners and only charged 25% of the eligible costs. This was possible given that the municipality had received 75% of these costs through a grant from a third party and had borne the rest of the costs (in the form of non-eligible costs) itself.

Prof. Dr. Thomas Küffner
Lawyer, Certified Tax Consultant, Certified Public Accountant

+49 (0) 89 217 50 12-30
thomas.kueffner@kmlz.de

In conclusion, the ECJ affirmed that the municipality provided a supply for consideration, as the amount of the price is not decisive in this respect. However, the ECJ was uncertain as to whether the municipality had carried out an economic activity so that it could be considered as taxable person. After an overall assessment of the circumstances of the individual case, the ECJ reached the conclusion that the municipality did not act in a sustainable manner (one-off supply to landowners) and also sold its supplies far below the market price (at only 25% of the eligible cost price). In the context of an arm's length comparison, the ECJ finally concluded that a private third party would not have acted in this way. In the final analysis, the status as taxable person was consequently denied.

3 Decision of the ECJ in the case *Gmina L.* (judgment of 30.03.2023, C-616/21)

The second case was similar: The relevant question here was whether a Polish municipality had acted as a taxable person. The ECJ responded in the negative, pointing out that the municipality provided its supplies of asbestos removal to the property owners free of charge. This was possible because the municipality subsequently expected to receive grants from an environmental fund amounting to between 40% and 100% of the cost of the performed service.

Again, the ECJ tends towards a supply for consideration since the grants could also be regarded as consideration. However, there was no economic activity and thus no acting as a taxable person. The municipality failed to act in a sustainable manner. It made no endeavor to cover its costs through its prices and to achieve a profit margin. Rather, it had hoped to be compensated for the structural deficit by means of subsequent grants.

4 Consequences for the practice

Loss-making activities carried out by the public sector can lead to the denial of the status as taxable person. As a result, taxation of supplies rendered can be omitted. On the other side, however, input VAT deduction is no longer possible. “Cross-subsidization" via input VAT surpluses would thus not be possible. The municipalities would therefore be required to finance previous input VAT surpluses from their own budgets or seek compensation from the federal or state governments.

The Federal Fiscal Court has so far affirmed the marketability and thus an economic activity in the case of loss-making activities (judgment of 28.06.2017 – XI R 12/15: permanently loss-making use of sports facilities). The only exception is in the case of symbolic considerations (Federal Fiscal Court, judgement of 22.06.2022 – XI R 35/19: no supply for consideration in the case of a rental fee of EUR 1,00, see KMLZ VAT Newsletter 45 | 2022) or if there is an asymmetry between the operating costs and the income (Federal Fiscal Court, judgement of 15.12.2016 – V R 44/15: renting of a sports center, see KMLZ VAT Newsletter 08 | 2017). There are concerns that, in the next case, the Federal Fiscal Court will correct this jurisprudence, which has so far tended to be generous.

Nevertheless, both ECJ decisions are based on an overall assessment of the circumstances of the individual case. In both cases, there were no recurring activities undertaken by the municipalities, a point which the ECJ emphasized in each case. In addition, it was uncertain at the time of the initial supplies whether or to what extent grants would flow. It will therefore depend very much on how the specific facts are presented, in their entirety.

The tax authorities have, to date, been generous. Municipalities and other public corporations are therefore well advised not to go too far as regards involving the tax authorities in financing in the form of input VAT refund. Legal proceedings are not an option in this respect. Instead, the precept is to ensure legal certainty at an early stage by obtaining binding rulings.

KMLZ Rechtsanwaltsgesellschaft mbH | www.kmlz.de | office@kmlz.de
D-80331 München | Unterer Anger 3 | Tel.: +49 89 217501220 | Fax: +49 89 217501299
D-40221 Düsseldorf | Speditionstraße 21 | Tel.: +49 211 54095320 | Fax: +49 211 54095399