



Federal Fiscal Court: indirect link sufficient for input VAT deduction

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1 Background

After ten years it is finally official: the German Federal Fiscal Court has, once again, changed its jurisprudence. This change follows a revision of its former legal opinion as contained in its judgment of 13 January 2011. At that time, the Court held that a taxable person is not entitled to input VAT deduction from the construction of a road, in the instance where the road is later given to a municipality, free of charge. Today it is clear: in 2011 the Federal Fiscal Court misunderstood the opinion of the ECJ in this regard. The ECJ's latest judgment of 16 September 2020, in the case *Mitteldeutsche Hartstein-Industrie AG* (C-528/19), made it clear that the Federal Fiscal Court was too restrictive in its view concerning input VAT deduction (see KMLZ VAT Newsletter 52 | 2020). In its judgment of 16 December 2020, XI R 26/20 (XI R 28/17) the Federal Fiscal Court implemented the ECJ decision and granted the plaintiff full input VAT deduction.

2 Facts

The plaintiff wanted to commence operating a limestone quarry and therefore submitted an application for approval to the regional council. The council approved the operation on the condition that a new public road to the quarry be built. The plaintiff agreed with the municipality, on whose premises the quarry was located, to develop the public road and to subsequently transfer it to the municipality, free of charge. The plaintiff claimed the deduction of input VAT from the construction costs. The tax authority initially granted input VAT deduction but intended to additionally assess a taxable supply carried out free of charge. The Fiscal Court, however, rejected a taxable supply carried out free of charge but and, at the same time, denied the input VAT deduction. The subsequent decision of the Federal Fiscal Court in this case seemed to be clear, as it had only decided in 2011 that the input VAT deduction was, in principle, to be denied if the procured goods



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or services were used to render supplies carried out free of charge. However, the Federal Fiscal Court had doubts as to whether its previous line of reasoning was still compatible with Union law due to the more recent ECJ judgments in the cases *Sveda* and *Iberdrola*. Finally, the Federal Fiscal Court referred the case to the ECJ. In its judgment of 16 September 2020 in the case *Mitteldeutsche Hartstein-Industrie AG*, the ECJ ruled that the plaintiff was entitled to input VAT deduction and rejected the taxation of a supply carried out free of charge.

3 Federal Fiscal Court decision

Two statements in the Federal Fiscal Court judgement are important. An indirect link is sufficient for the deduction of input VAT and a supply carried out free of charge is not taxable if there is no threat of an untaxed final consumption.

It is to be welcomed that an *indirect* cause is now “officially” sufficient for the deduction of input VAT. It remains to be seen whether this change in jurisprudence will, apart from the construction of a municipal road, also apply to other sectors. This change in jurisprudence has been predicted for years, although the ECJ has, so far, always differentiated according to whether there was a direct and immediate link between goods or services procured and a taxable output supply. If this link is ultimately denied, input VAT deduction can nevertheless be granted if the costs for the supplies in question are part of the taxable person’s general expenses and thus cost elements of the goods and services supplied by it. For taxable persons, this wording has often proved difficult to understand. Both the Federal Fiscal Court and the ECJ have always avoided the concept of an “indirect” link. Now the Federal Fiscal Court has clarified that such an indirect link is sufficient. In doing so, the wording of its judgment goes even beyond that of the ECJ judgment. In any case, this applies if the procured goods and services (as in the case at hand) do not exceed the extent of what is required. This result is appropriate. The plaintiff did not build the municipal road in order to do something beneficial for the municipality, but rather in pursuit of its own economic interests, namely, to exploit the quarry.

It is also to be welcomed that there is no (taxable) supply carried out free of charge within the meaning of sec. 3 para. 1b or sec. 3 para. 9a of the German VAT Act. The wording of the provisions suggests a supply carried out free of charge. However, against the background of the ECJ judgment, the Federal Fiscal Court has now restricted the German provisions, in conformity with EU law. If there is no threat of untaxed final consumption, VAT cannot be charged. Thus, if the procured goods and services are necessary for the company and the costs are (calculated) included in the price of the output supply, taxation in the form of a supply carried out free of charge may be omitted. Any benefits for the public are then incidental effects that do not lead to any VAT liability.

4 Consequences for the practice

It must be noted: It is always worth fighting for something you believe in! It is a great credit to the plaintiff in this case that it refused to accept the change made by the jurisprudence 10 years ago. Both the jurisprudence and the tax authorities have now had to add another facet to the right to input VAT deduction. Indirect links can be sufficient for input VAT deduction. Furthermore, the issue of supplies carried out free of charge must now be viewed in a new light. Sec. 3 para. 1b and para. 9a of the German VAT Act must be restricted in conformity with the Directive to the effect that taxation can be omitted if there is no threat of untaxed final consumption. The latter is the case if e.g. taxable persons give something to third parties free of charge in order to generate supplies (e.g. giving blood glucose meters free of charge to diabetics for the purpose of promoting the sale of test strips to be purchased later). The tax authorities will have to amend the Federal Ministry of Finance's letter of 2 January 2012 in the near future - this time in favour of taxable persons.