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KMLZ VAT NEWSLETTER

Posting to a capital account II: transfer against consideration or free of charge?

If an asset is transferred to a partnership, from a VAT perspective, this can be considered to be a transaction against remuneration or free of charge. The latter may lead to a definite VAT burden if the original purchase of the asset entitled to input VAT deduction. What is decisive is how the contribution is posted. The fiscal authority has now changed its view based on Federal Fiscal Court case law. Although the case law concerned the income tax treatment, the same is likely to apply to VAT. How capital accounts are defined and on which account the transfer is to be posted should always be examined.

Transfer of an asset to a partnership

1. Background

Assets can be transferred to a partnership against remuneration or free of charge. In addition to resulting income tax consequences (e.g. continuance of book values in accordance with sec 6 para 5 of the Income Tax Act / hidden contribution), there are also VAT consequences to be taken into consideration. However, different overlaps apply to income tax and VAT. According to sec 6 para 5 of the Income Tax Act, a transfer, which is free of charge or a transfer against the grant of company rights, is privileged. From a VAT perspective, the allocation of company rights is deemed to be remuneration. Therefore, it must be handled differently from a transfer free of charge.

A transfer against remuneration is deemed to be a supply in terms of sec 3 para 1 of the German VAT Act, which generally is subject to VAT. If the shareholder is a taxable person, he would be required to issue an invoice showing VAT. The partnership would generally be entitled to deduct the input VAT.

According to sec 3 para 1b of the German VAT Act, a transfer free of charge would be considered to be a supply against remuneration and would also be subject to VAT if input VAT was deducted in full or partially when the asset was originally purchased. However, the shareholder is not entitled to issue an invoice for this and therefore, the partnership cannot deduct input VAT. The VAT amount would then become a definite cost.

This principle is also contained in sec 1.6 para 3 of the German VAT Circular. The VAT treatment of a supply by the shareholder depends on whether the supply is compensated through participation in the profit or losses or whether it is carried out against a special remuneration and aims to be a supply against consideration.

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2. Federal Fiscal Court case law

As far as VAT is concerned, the Federal Fiscal Court has already decided, that a supply against consideration exists where the contributions are posted to the shareholder's capital account and any shareholder payment claims result therefrom (judgment of 18.12.2008, V R 73/07 and judgment of 16.03.1993, XI R 52/90).

To date, there has been a similar approach as regards income tax. The Federal Ministry of Finance held this view in its Circular of 11.07.2011. According to this, a transaction against remuneration is to be assumed where merely a book entry on the capital account II is conducted and no shareholder direct payment claims result from it.

In its judgments of 29.07.2015 (IV R 15/14) and 04.02.2015 (IV R 46/12), the Federal Fiscal Court expressly objected to this legal opinion. According to the Federal Fiscal Court, transfers to the partnership against posting to a shareholder's account are only deemed to be taxable supplies, resulting in a grant of company rights, where a capital account is used on which the decisive corporate rights, particularly the profit sharing rights, depend. As a rule, this would be the capital account I. Thus, exclusive posting to capital account II would not result in a transaction against remuneration.

3. Federal Ministry of Finance of 26.07.2016

In its Circular of 26.07.2016, the Federal Ministry of Finance follows the recent Federal Fiscal Court case law. Postings to capital account II are no longer deemed to be transactions against remuneration – apart from during the transitional period up until 31.12.2016. They should then be considered hidden contributions and thus transactions free of charge.

4. VAT Consequences

The Federal Ministry of Finance Circular of 26.07.2016 was issued by the department IV C 6, which is responsible for income tax. The case law was published by the IV. Senate of the Federal Fiscal Court, which is responsible for income tax. However, the question rises, whether the general statements as regards consideration must / can also be transferred to VAT. In this regard, the question has to be dealt with as to how the account, on which the posting is conducted, is defined. If the capital account, corresponding to the facts set out in the Federal Fiscal Court judgments, is defined in such a way that only the profit or loss shares, as well as contributions and withdrawals are recorded, and possibly also non-withdrawable reserves are posted, remuneration cannot be assumed as regards VAT.

This requires, that a posting to capital account I is conducted, which, as a rule, determines the share of the shareholder to the joint property (Gesamthandsvermögen). The remuneration would then be the granting of company rights. A partial posting to capital account I would be sufficient – even if the amount was rather small. The same applies if a private account was addressed, to which accessible profit shares and other payment transactions between the shareholders and the company are posted.

What is important is which contractual agreements exist with regard to the capital accounts. If capital account II is kept as a loan account and is not bound in joint property, posting the transfer of the asset on it would be considered to be a supply against remuneration.