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VAT'S UP

VAT NEWSLETTER

ECJ on letting of a building including operating equipment: Precedence of single supply over splitting requirement

23 I 2023

1 Background

In accordance with the requirements of EU law (Art. 135 EU VAT Directive), German law provides that the letting and leasing of immovable property and buildings is, in principle, exempt from VAT (sec. 4 no. 12 sentence 1 letter a. German VAT Act). However, in certain circumstances, the national legislator subjects the letting and leasing of so-called operating equipment to VAT (sec. 4 no. 12 sentence 2 German VAT Act). If a building is rented out together with operating equipment, the relevant question which arises is: Is there a single VAT-exempt supply of rental services in which the letting of operating equipment is an ancillary supply, which shares the same VAT treatment as the VAT-exempt main supply or should the supply of rental services be divided into a part subject to VAT and a VAT-exempt part? In other words: Does a splitting requirement also result from sec. 4 no. 12 sentence 2 of the German VAT Act for uniform supplies? The ECJ explicitly commented on this issue in its decision of 4 May 2023 in case C-516/21 (*Finanzamt X*).

2 Facts

The plaintiff leased out a building, on a long-term basis, for the purpose of turkey rearing. Special equipment and machinery had been permanently installed in the building in order to ensure its optimal contractual use as a turkey rearing facility. According to the provisions of the lease, the plaintiff received a single payment for the provision of the rearing shed, equipment and machinery. The plaintiff assumed that his leasing service was wholly exempt from VAT. In contrast, the tax office took the view that 20% of the agreed one-off remuneration corresponded to the leasing of machinery and equipment and was therefore subject to VAT. For the years in dispute, it issued corresponding notices of amendment. The court of first instance believed there was an overall VAT-exempt service, which therefore also included the leasing of the

Dr. Jochen Tillmanns
Lawyer
Dipl.-Finanzwirt (FH)

+49 (0) 211 54 095-381
jochen.tillmanns@kmlz.de

installed equipment and machinery. The tax office appealed against this ruling. The Federal Fiscal Court suspended the proceedings and referred the matter to the ECJ for a preliminary ruling (Federal Fiscal Court decision of 26 May 2021 – V R 22/20). Essentially, the Federal Fiscal Court wanted to know whether, in the case of mixed lettings, a VAT liability can be assumed for the purposes of implementing the apportionment requirement, even if there is a single economic supply. In particular, clarification was required as to whether the ECJ principles on the determination of a single supply take precedence over the apportionment rule.

3 Judgment of the ECJ

According to the ECJ, where a transaction consists of several separate supplies or acts, it is necessary, for VAT purposes, to take an overall view in order to determine the existence of either separate supplies or a single supply. The latter is the case when several separate supplies or acts, performed by the taxable person for the customer, are so closely connected that, objectively speaking, they constitute a single, inseparable economic supply, the separation of which would be artificial. This is particularly the case when there is a principal supply and ancillary supplies. A supply of ancillary nature is typically characterised by the fact that it does not represent a separate purpose for the customer, but rather serves to utilise the main supply under optimal conditions. The ancillary supply shares the VAT treatment of the main supply for VAT purposes. If there is a transaction that represents a single economic supply, it must not be artificially split in order to maintain a functioning VAT system - not even through legal action by Member States. Article 135 (2) of the EU VAT Directive does not preclude this. The regulation does not require a uniform economic transaction to be divided into independent supplies. The Federal Fiscal Court had to examine whether the case in question involved main and ancillary supplies that formed a single supply. For the ECJ, “it appears to suggest”, that these services constitute a single economic supply.

4 Consequences for the practice

The ECJ's clear statements on the priority of the single supply over a statutory splitting requirement are to be welcomed. This fundamentally weakens the splitting requirement, which is mandatory according to administrative practice. In parallel cases (e.g. canteens and industrial properties), a (renewed) examination would be necessary in each individual case to determine whether the provision of operating equipment is an ancillary supply to the VAT-exempt rental service as a main supply. The assumption of a single VAT-exempt supply would have consequences for the customer. The previously possible input VAT deduction, regarding the taxable provision of operating equipment, would cease to apply. In this respect, a waiver of the VAT exemption pursuant to sec. 9 para. 1 German VAT Act – for the entire rental service – would be necessary, whereby the restrictions of sec. 9 para. 2 German VAT Act must be taken into account. However, the risk of an unrecognized taxable rental of operating equipment and the consequent threat of a VAT claim by the tax office would be eliminated.

In any case, the decision confirms the VAT treatment of the provision of parking spaces in connection with rental services (see KMLZ VAT Newsletter 24│2021). It will be interesting to see how this decision will affect the cases pending before the German Federal Fiscal Court (Ref. V R 15/21 and XI R 8/21). In particular, on the issue of ancillary rental costs (heating and electricity) as mere ancillary supplies and on the legality of the splitting requirement for accommodation supplies (see KMLZ VAT Newsletter 23│2022). The Federal Fiscal Court's follow-up decision may thus have a far-reaching effect.

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