KMLZ

VAT'S UP

VAT NEWSLETTER

Federal Fiscal Court: VAT on copyright warnings

24 I 2019

1 Facts

The Plaintiff is a phonogram producer and the owner of copyright protected exploitation rights to sound recordings. It commissioned a law firm to take action against the illegal distribution of protected sound recordings on the internet. The law firm warned the infringers on behalf of the Plaintiff and claims for injunctive relief and compensation were threatened. Ultimately, an out of court settlement was agreed. The law firm offered the infringers the opportunity to avoid formal court proceedings in return for payment to the Plaintiff of a lump sum of EUR 450 (net). For its supplies of services, the law firm invoiced the Plaintiff for a revenue based fee plus VAT.

In the Defendant's view, the warning was a supply by the Plaintiff to the respective rights infringer against payment. However, the Tax Court Berlin-Brandenburg ruled, that the warnings issued to the infringers by the Plaintiff were not taxable. Therefore, the Plaintiff could not claim input VAT from the supplies rendered by the law firm. Both the Plaintiff and the Defendant appealed the tax court's decision.

2 Reasons for the decision

The Federal Fiscal Court agreed with the Defendant and set aside the tax court's decision. The court found that a relationship existed between the Plaintiff, as the party issuing the warnings, and the warned infringer, namely a form of an agency without authority. By issuing the warning, the Plaintiff rendered a supply to the infringer within the scope of this legal relationship. The payment made by the infringers constituted remuneration for this supply. From the Federal Fiscal Court's point of view, the warning's purpose was to warn, settle the dispute and avoid costs. The warning served the

Dr. Thomas Streit, LL.M. EUR.
Lawyer

+49 (0) 89 217 50 12-75
thomas.streit@kmlz.de

objective and presumed interest of the infringer. The infringer benefited from the possibility of avoiding a legal dispute in a cost-effective manner by submitting to a covenant to cease-and-desist, subject to penalty. Both a consumable advantage and a taxable supply would exist.

According to the Federal Fiscal Court, all payments received for the supply of warning services are part of the taxable remuneration. The remuneration also includes the costs associated with identifying an infringer, as well as the cost of obtaining information from an internet provider. Compensation payments, on the other hand, would not be subject to VAT.

The Federal Fiscal Court considers it to be irrelevant that the taxable person issuing a warning cannot know whether it is warning the actual rights infringer. Beyond the scope of competitions, the uncertainty of any eventual payment is not sufficient to break the direct link between a supply and a possible payment. In the present case, it was also irrelevant that the costs associated with the issuing of a reminder are not taxable. The difference is that, in the case of a reminder, the debtor is already aware of the basis of the claim against him.

Finally, the Federal Fiscal Court did not see any significant difference between warnings issued for infringements of competition and those issued for infringements of copyright. The Federal Fiscal Court therefore obviously considered itself bound by its decision on the treatment of warnings in accordance with competition law (Federal Fiscal Court, decision of 21.12.2016 - XI R 27/14).

Since, in the view of the Federal Fiscal Court, a warning is a taxable supply, the Court went on to grant an input VAT deduction for the procured legal services.

3 Consequences for the practice

In the present constellation, the Federal Fiscal Court does not consider the position it has taken to conflict with Union law and has therefore found it unnecessary to refer the matter to the ECJ. The fact that the average consumer who illegally uploads music to the internet generally regards a warning as a burden, rather than an economic advantage, is not decisive for the Federal Fiscal Court. Also, the lack of will by the holder of the rights to give the infringer an advantage, but rather to reduce its own cost risk in the event of a complaint without warning is irrelevant in the Federal Fiscal Court's opinion.

The decision raises a number of follow-up questions: Among other things, the time of taxation is questionable. According to the Federal Fiscal Court, the warning notice constitutes the supply. At the time of the warning, however, the party issuing the warning does not yet know whether the person warned is actually the infringer. As a rule, it will not know this until a warned party has paid. Since the Federal Fiscal Court equates a warning party with an intermediary, for which only successful actions are subject to VAT, it is likely that the occurrence of success, i.e. the payment by the warning person, will be deemed to be the decisive factor.

The fiscal authorities would do well to establish a transitional regime. The warning parties are likely to face considerable practical and legal difficulties if they want to claim VAT for the past from warned infringers. The number of private individuals being warned for infringement of this kind is considerable.

The decision is also important for other areas of intellectual property, e.g. trademark law.