



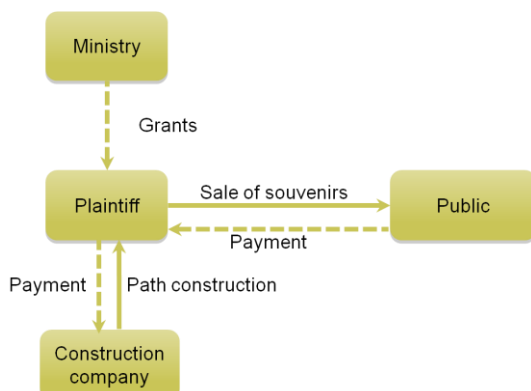
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# KMLZ VAT NEWSLETTER

## Full VAT deduction in the case of grants

### 1. Problem

According to the VAT Directive, VAT deduction is to be granted if there is a direct link between incoming transactions and output transactions, which allow for the right to deduct VAT. However what happens when capital goods are directly provided to the public free of charge? It is essential to know how the grants received restrict the right to deduct VAT.



### ECJ defines direct link

The ECJ softens the right to deduct VAT in the case *Sveda*. Taxable persons may now even deduct VAT in the case of the free use of capital goods. The judgment also comments on the question of whether and how taxable persons are entitled to deduct VAT in the case of grants. It is not only non-profit organizations that will benefit from this case law. The decision may also have an impact on the input VAT deduction of holding companies.

### 2. Facts

The plaintiff entered into a contract with a ministry to construct a so-called “discovery path to the Baltic mythology“, within the framework of a project. Following its construction, this path was to be offered for use by the public, free of charge. The ministry granted 90% of the costs for this path. The other 10% was paid by the plaintiff himself. The plaintiff planned to attract visitors by selling souvenirs and offering catering services onsite.

The tax office denied VAT deduction from the investment costs for the path, as it considered that there was no direct link between the construction of the path and the carrying out of taxable output transactions.

### 3. ECJ, judgment of 22 October 2015, C-126/14 *Sveda*

The ECJ, however, considered the VAT deduction to be legitimate. In the ECJ's opinion, the direct link was not suspended by the offering of the use of the path free of charge.



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It was more essential that the expenditures paid were attributable to the taxed output transactions, which also allow for VAT deduction.

Therefore, the ECJ was of the opinion that the direct and free use of capital goods does not call into question the direct link which exists between the incoming transactions and the output transactions allowing for VAT deduction or the economic activities of the taxable person. For this reason, the free use of the path did not restrict the right to deduct VAT. The ECJ found that the overriding element was whether the taxable person intended to subsequently carry out taxable supplies. As this was clear from the outset in this particular case, the ECJ granted full VAT deduction.

Therefore, the ECJ assumes that the direct and free use of capital goods does not question the direct link which exists between the incoming transactions and the output transactions allowing for VAT deduction or the economic activities of the taxable person. For this reason, this concrete and free use of the path does not restrict the right to deduct VAT. The ECJ finds it more essential whether the taxable person intends to carry out taxable supplies later on. As this was clear from the beginning in this case, the ECJ granted full VAT deduction.

#### 4. Practical tips

This case is interesting, not only because the ECJ decided that VAT may be deducted even in cases where a taxable person offers capital goods to third parties free of charge. It

is also interesting because the direct link is not regarded to be the free use of the path but rather the taxable sale of onsite souvenirs. It remains to be seen whether the German tax authorities and national tax courts will ultimately regard such a link as a direct or an "indirect" link. The new interpretation of the ECJ regarding the direct link may also have an impact on the input VAT deduction of holding companies.

It is also interesting that the ECJ has not deemed grants to be harmful for VAT deduction.

National case law has recently proffered a different view on this issue. That is to say, grants have often been deemed as being harmful to VAT deduction. Often, the taxable person has been faced with the question of whether the grants should be seen as remuneration of third parties and therefore as a taxable supply.

The ECJ's judgment naturally provides hope to grant funded companies that they may now be granted VAT deductions. The ECJ's following comments will be sure to attract the attention of most of these organizations:

*„The tax authorities and national courts should consider all the circumstances surrounding the transactions concerned and take account only of the transactions which are objectively linked to the taxable person's taxable activity.“*