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VAT NEWSLETTER

Provision of operating equipment in the case of leasing: single supply or separate supplies?

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1 Introduction

With its submission to the ECJ (cf. decision of 26 May 2021, V R 22/20), the German Federal Fiscal Court is addressing one of the most difficult issues in VAT law. This is because almost every rental of premises raises the question of how to deal with additionally provided operating equipment. Is it a separate supply that must be treated as subject to VAT under section 4 number 12 sentence 2 of the German VAT Act, or does the provision of the operating equipment share the fate of the main supply "rental", which always remains VAT-exempt under section 4 number 12 sentence 1 of the German VAT Act? For taxpayers, the answer to this question is of great relevance: They need to know whether they can claim the VAT exemption or whether they are required to treat the rental as (partly) subject to VAT and thus (partly) benefit from the input VAT deduction.

2 Facts

The plaintiff leased a building for turkey breeding on a long-term basis. Equipment and machines were permanently installed in the barn building. These were equipment features that were specially adapted to the contractual use of the premises as a turkey breeding facility. The plaintiff assumed that the lease, as a whole, was exempt from VAT. In contrast, the tax office was of the opinion that 20% of the uniformly agreed lease payment was attributable to the equipment in accordance with the costs incurred by the plaintiff and was therefore subject to VAT. The plaintiff was not satisfied with this and took the matter to the Tax Court. The Lower Saxony Fiscal Court ultimately upheld the claim. It was of the opinion that there was an overall VAT-exempt service, which therefore also included the leasing of the installed equipment and machinery. The Fiscal Court referred to ECJ case law (cf. ECJ, judgment of 16.04.2015, C-42/14 – *Wojskowa*), according to which there is a single

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supply if a building offered for rent, with accompanying services, objectively forms “a whole” in economic terms. The Tax Court also referred to German Federal Fiscal Court case law from 2015, according to which the provision of the inventory was judged to be an auxiliary service to the VAT-exempt lease of a senior citizens' residential home (German Federal Fiscal Court, judgment dated 11 November 2015, V R 37/14).

3 German Federal Fiscal Court decision

In its request for a preliminary ruling, the German Federal Fiscal Court deals intensively with Art. 135 of the VAT Directive: according to its para. 1 lit. l), *the renting and leasing of real estate* is VAT-exempt. Para. 2 lit. c) makes an exception to this rule and excludes the *rental of permanently installed equipment and machinery* from the VAT exemption. At first glance, German law has a similar structure in section 4 number 12 sentence 2 of the German VAT Act, albeit with different wording. For the German Federal Fiscal Court, however, it was less a matter of the wording of the regulations, but rather of the question of whether EU law prescribes an apportionment requirement in the case of mixed rentals.

It is clear to the German Federal Fiscal Court that the building constituted a lease of real estate. It is also clear that the co-leased items are "business equipment" within the meaning of section 4 number 12 sentence 2 of the German VAT Act or "permanently installed equipment and machinery" pursuant to Art. 135 para. 2 lit. c) of the VAT Directive. What remains unclear to the German Federal Fiscal Court is whether this is a single supply or two separate supplies.

In this context, the German Federal Fiscal Court summarizes the ECJ’s previous case law: According to this, a supply may not be artificially split. Unity is always to be assumed if several individual services or actions provided by the taxpayer to the customer are so closely connected that they objectively form a single inseparable service, the splitting of which would be unrealistic. In this case, the auxiliary services share the fate of the main service. The decisive factor is the view of the average consumer and also the respective value of the services.

In the present case, the German Federal Fiscal Court tends to assume a single supply. It cannot be concluded, from the fact that the rental of equipment and machinery is specifically taxable under Art. 135 para. 2 lit. c) of the VAT Directive, that the principles for the determination of a single transaction are to be thrown overboard. In other words, it must first be determined whether the supply in question constitutes one supply or several supplies, and only as a second step must it be clarified whether the individual supply is VAT-exempt or subject to VAT. The German Federal Fiscal Court thus postulates a precedence of the single supply over Art. 135 para. 2 lit. c) of the VAT Directive and rejects the general requirement of apportionment.

4 Consequences for the practice

In practice, the correct assessment of the (co-)provision of operating equipment is like playing the lottery. Although there is a great deal of case law and the statements of the tax authorities in sections 4.12.10 and 4.12.11 of the German VAT circular are very extensive, it is often not possible to assess the specific individual case with any great degree of legal certainty. It always depends on the specific circumstances of the case in question. The difficulty in practice arises from the fact that every situation is different. For taxpayers, therefore, determining the scope of the VAT exemption is very laborious. Insofar as the ECJ follows the path preferred by the German Federal Fiscal Court of the priority of the unity of the supply, this means that the provision of equipment and machinery can only be subject to VAT as a separate supply if there is no connection with a more extensive provision of buildings or land.

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