



VAT NEWSLETTER

## Input VAT deduction for infrastructure construction works free of charge – rethink by the Federal Fiscal Court

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### 1 Background

According to sec. 15 of the German VAT Act, a taxable person is only permitted to deduct input VAT for input supplies for its company. Article 168 of the VAT Directive also requires the taxable person to use the purchased goods or services "for the purposes" of its supplies within the scope of VAT. The prerequisite is therefore a direct purchase of the input services for the company. Input VAT deduction generally requires a direct and immediate link between input supplies and taxable output supplies. In the absence of such a link, input VAT deduction can be claimed in cases where the input supplies constitute general costs associated with the economic activity of the taxable person. However, according to previous national case law, a taxable person is not entitled to deduct input VAT if there is a direct and immediate link to a non-economic activity, such as a supply without payment.

### 2 Decision of the German Federal Fiscal Court

It was up to the Federal Fiscal Court to decide whether the Plaintiff was entitled to claim input VAT deduction from supplies it purchased to carry out construction work on a municipal road. The Plaintiff undertook the road construction, free of charge, on behalf of a city. The Plaintiff additionally operated a limestone quarry. The competent authority issued an approval for the operation of the quarry on the condition that the Plaintiff makes use of and develops municipal road D, which was owned by city X. The approval would have expired if the road expansion had not been carried-out by the Plaintiff by a specific date. In order to ensure that the limestone was transported via D, the municipal road had to be extended. The Plaintiff had contractually agreed with the city to bear the costs of the extension. The Plaintiff claimed input VAT deduction for its input supplies in this regard. The Federal Fiscal Court denied the right to deduct input VAT on the basis of national law, but nevertheless referred these and other questions to the ECJ.



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### 3 Consequences for the practice

For some, the facts associated with the questions referred by the Federal Fiscal Court to the ECJ will trigger a feeling of déjà-vu and they will ask themselves whether there is a so-called acte éclairé ("clarified case") at hand, which makes the loop over Luxembourg unnecessary. This is due to the ECJ's decision in the case *Iberdrola* (C-132/16), where the ECJ was already asked to consider questions similar to those raised here. This being the case, the relevant legal questions might already have previously been answered.

The *Iberdrola* proceedings also concerned the improvement of a property owned by a third party. *Iberdrola* renovated a municipal pumping station at its own expense in order to be in a position to subsequently rent out a holiday complex for consideration and subject to VAT. *Iberdrola* claimed input VAT deduction from the construction company's invoices. The ECJ ruled that there was a direct and immediate link between the pumping station repairs and *Iberdrola*'s taxed output supplies, since the repairs were clearly intended to enable *Iberdrola* to carry out its economic activity. The fact that the municipality also benefited from the pumping station repairs, would not prevent the deduction of input VAT, provided that the direct and immediate link with the taxed output supplies could be proven. Here, the ECJ identified two criteria that can be used for the examination of the context:

- 1) Is the relevant input supply a price-setting factor of a taxed output supply?
- 2) Is the input supply limited to what was necessary to enable the economic activity to be carried out or does it go beyond that?

In *Iberdrola*, the ECJ therefore, once again (see the previous case *Sveda* (C-126/14)), interpreted the direct link between input supplies and taxable output supplies very broadly. The direct use of free of charge investment goods would not necessarily break the direct link to subsequent taxed activities.

The parallels with the present case are unmistakable: The plaintiff in the proceedings referred to the ECJ also required the input supplies in order to be able to develop its economic activity. Without the construction measures to extend road D, the plaintiff would not have received the permit to operate the limestone quarry, since the removal of the limestone would not have been possible without the extension of the road. It is therefore clear that the direct and immediate link required for the deduction of input VAT is established due to the taxable person's entire economic activity. The Federal Fiscal Court was not entirely convinced of the correctness of this positive result for the taxpayer and therefore referred one further, highly interesting, question to the ECJ, namely whether the official permit to operate the quarry was to be regarded as a "remuneration" and therefore a taxable supply would have to be assumed. And even if the ECJ also negates this question, in the opinion of the Federal Fiscal Court, it might possibly still result in a taxable output supply in the form of a taxable disposal of goods free of charge. This finding could, in the opinion of the Federal Fiscal Court, be necessary in order to avoid an untaxed final consumption.

The procedure very clearly shows how difficult it is for the Federal Fiscal Court to deal with the question of the existence of a direct and immediate link. The Federal Ministry of Finance may have to change its view and abandon its tough stance with regard to the refusal of input VAT deduction for infrastructure construction works (see Federal Ministry of Finance letter of 07.06.2012).