



KMLZ VAT NEWSLETTER

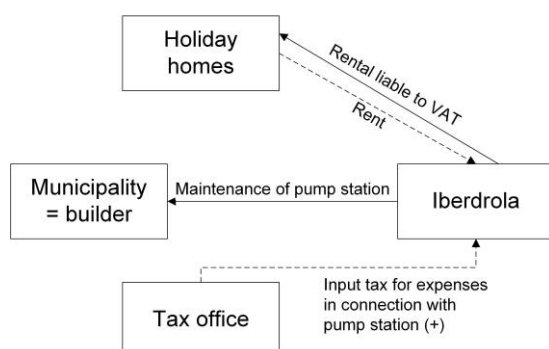
ECJ continues to soften "immediate link" between input and output transactions

The ECJ continues to soften the right to deduct VAT as seen in the legal case *Iberdrola* (C-132/16). This decision reignites the discussion about the question of the VAT treatment of development costs. The German Federal Fiscal Court's case law and administrative opinion are, once again, on trial. Moreover, the decision may also be of general importance concerning VAT deduction.

Full VAT deduction on development costs?

1. Facts

Iberdrola is a private investor who purchased several parcels of land in a municipal holiday village, for seasonal use. By signing the contract, *Iberdrola* undertook to repair the wastewater pump station serving the holiday village, free of charge. The pump station was essential for the use of the planned holiday village development. *Iberdrola* wanted to deduct VAT for the expenses related to the work on the pump station. The tax administration subsequently denied the VAT deduction.



2. Legal assessment by the ECJ

The ECJ states that, in accordance with settled case law, the existence of a direct and immediate link between a particular input transaction and a particular output transaction, giving rise to the right to deduct, is necessary. In principle, this link should be established before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement. The right to deduct VAT charged on the acquisition of goods or services presupposes that the expenditure incurred in acquiring them was a component of the cost of the output transactions that gave rise to the right to deduct. Furthermore, the right to deduct also exists even where there is no direct and immediate link between a particular input transaction and an output transaction or transactions giving rise to the right to deduct. This is the case where the costs of the services in question are part of the general costs and are, as such, components of the price of the goods or services supplied. Such costs are directly and immediately linked to the taxable person's economic activity, as a whole.

In the case at hand, such a direct and immediate link existed;



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since the connection of the new buildings to the water supply would have been impossible without the maintenance of the pump station. Therefore, maintenance was essential for the planned project.

Iberdrola would not have been able to carry out its economic activity in the absence of such reconstruction. These sorts of circumstances are likely to demonstrate the existence of a direct and immediate link between the reconstruction service, with respect to the pump station, and a taxed output transaction by *Iberdrola*. It appears that the service was supplied in order to allow *Iberdrola* to realize the real estate project. The fact that the municipality also benefited from this service could not justify *Iberdrola* being denied the right to deduct in relation to the service, where the existence of such a direct and immediate link was clearly established. The input reconstruction service in issue was a component of the cost of a taxed output transaction by *Iberdrola*. Where such a service is limited to what is necessary, VAT deduction is possible.

3. Effects on the practice

The VAT treatment of property development has always preoccupied the practice. The related issues also naturally concern more extensive construction projects and can have a significant impact on costs. Often, the municipality obligates the builder to construct development facilities in the municipal area where the project is to be built. Subsequently, the builder often makes these development facilities available for use, free of charge, to the municipality. With regard to the VAT

invoiced for the construction of such development facilities, the builder is naturally always keen to claim full VAT deduction. Both the German Federal Fiscal Court' case law (German Federal Fiscal Court, judgment of 13 January 2011 – V R 12/08, Federal Tax Gazette II 2012, 61) and the administrative opinion (section 15.2d para. 1 no. 13 German VAT Circular) are currently opposed to this deduction. The Federal Fiscal Court rejects the view that there is a direct and immediate link between the supply and the economic activity of the builder. According to this, "[...] *the (taxable person) is not entitled to deduct VAT if the taxable person intends to grant it to a municipality free of charge by consent to the public dedication.*" Even a mere indirect link, with the intention of taxing the developed land, is not sufficient. Rather, the Federal Fiscal Court denies the entrepreneur the right to deduct VAT from the costs of the development facilities, due to the fact that, at the time of construction of the said facilities, it was already intended to make them available to the municipality, free of charge. With its judgment in *Iberdrola*, the ECJ is emphasizing that its decision in the legal case *Sveda* (KMLZ Newsletter 25/2015) was no exception and that this area of the law is still evolving.

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