



VAT NEWSLETTER

Construction works in terms of VAT and construction withholding tax according to the Ministry of Finance

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1 Background

For a long time, it was assumed that the concept of immovable property in VAT and income tax was to be understood as being broadly congruent. In 2020, the German Federal Fiscal Court (BFH) published its ruling of 07.11.2019 - I R 46/17, wherein the court had to decide whether a photovoltaic system can constitute a construction, requiring the service recipient to withhold construction withholding tax. The court ruled that the term "construction" is to be understood much more broadly for the purposes of construction withholding tax than it is for VAT purposes. The German Ministry of Finance (BMF) included this in a revised letter dated 19.07.2022, which replaces, with immediate effect, the BMF letter of 27.12.2002. Companies must now differentiate more precisely between the various types of tax, when immovable property is involved.

2 Construction works in terms of construction withholding tax

When providing construction works for a building or structure, the customer is generally obliged to withhold 15% of the remuneration and pay it to the tax authorities on behalf of the supplier, unless the customer is presented with an exemption certificate from the supplier prior to payment of the remuneration.

According to the current BMF letter, all services carried out for the purposes of the production, repair, maintenance, modification or removal of buildings qualify as construction work pursuant to Sec. 48b (1) sentence 3 of the German Income Tax Act. The assumption of construction work requires that it has a direct effect on the substance of the building. However, the term "construction" includes not only buildings and other immovable assets but extends to all assets that are, in some way, connected with the building or, as a result of their own gravity, resting upon it and take the form of ("movable") installations made of building materials or components with structural equipment, including photovoltaic installations.



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3 Construction works in terms of VAT

For VAT purposes, a construction work is deemed to exist if the service affects the substance of an immovable property. This means that the substance of an immovable property must be expanded, improved, removed or maintained (cf. Sec. 13b.2 (1) VAT Circular). The concept of immovable property under VAT law is an independent concept under Union law and is not based on the national concept of immovable property. According to Art. 13b of the Council Implementing Regulation (CIR), immovable property includes, in addition to any building or structure also movable property, fixtures and fittings and machinery/plant. However, these must become integral parts of the land or be permanently installed there, such that they cannot be moved without destroying or altering it.

Without immovable property, therefore, there can be no construction work for VAT purposes. Difficulties in qualifying a construction work in practice are therefore initially caused, above all else, by movable objects, such as the photovoltaic systems assessed in the BFH ruling of 07.11.2019. These systems do not themselves constitute a building. They are also generally not to be qualified as a construction for VAT purposes. So, a connection of the objects with an immovable property is required. Otherwise, there can be no construction work. According to the VAT Circular, only the supply and installation of photovoltaic systems constitutes construction work (Sec. 13b.2 (5) no. 11 VAT Circular). However, such a work supply requires that an object (e.g., a part of immovable property) is provided, which is processed. If the equipment is set up ready for operation and can be removed without resulting in any damage, this is likely to be a supply of goods, including their assembly. This is of particular importance regarding the identity of the person liable for VAT. The VAT liability is shifted to the customer in the case of work supplies and construction services, but not in the case of a supply of goods, including their assembly.

4 Consequences for the practice

From an income tax point of view, a construction service can therefore be deemed to exist even if the item does not constitute immovable property for VAT purposes. This will have an impact on VAT, particularly with regard to the question of the taxable person liable for VAT. For example, the regulation which states that the VAT liability is shifted to the customer is based solely on the definition of immovable property in the CIR which is directly applicable throughout the EU. The BMF letter states that the term "construction", in connection with construction withholding tax, is to be interpreted in a norm specific manner. Hence, despite the withholding of construction withholding tax, an invoice showing VAT can be correct.

In the construction industry, the use of subcontractors is common practice. Now, both the supplier and the customer must take a differentiated view of the supplies provided. From a VAT point of view, the question must be asked as to who is liable for tax and whether the customer has to withhold tax from an income tax perspective.

These questions become particularly interesting when foreign subcontractors are involved. On the one hand, they also may have to account for VAT if a supply of goods, including their assembly (and no work supply), is taxable in Germany and therefore require registration. On the other hand, they may not be aware of the withholding tax regulation and therefore cannot present an exemption certificate. Even if it were possible to "save" one or the other case under VAT law via the non-objection provisions in the VAT Circular, the construction withholding tax always hovers over the customer like a sword of Damocles.

Above all, this should be viewed critically because every object rests upon the ground due to gravity, which, however, contradicts the purpose of the regulation, namely, to avoid possible abuse in the construction industry.