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VAT NEWSLETTER

No VAT liability for state grants to local public transport

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1 Background

In the case of grants, there are four considerations under VAT law: Is the grant a disguised payment (1) or even a payment from a third party (2) or is the grant to be categorised as a so-called genuine (non-taxable) grant (3). Even if the hurdle of non-taxability has been cleared, the recipient of the grant should not be lulled into a false sense of security. This is because the tax authorities will try to deny the input VAT deduction (4) due to the non-taxability of the grant. However, in practice, it need not come to this. The Federal Fiscal Court (XI R 13/21) has now ruled in a case involving public transport grants that the grant is not taxable and that the input VAT deduction must be granted, in full. A nice windfall for the plaintiff municipality.

2 Facts of the case

In dispute was the treatment of a state allocation to a municipality for the construction of a landing stage. Following its construction, the municipality then leased the landing stage (at a permanent loss) to an X-GmbH, which used it for public ferry transport as part of its local public transport services. To finance the landing stage, the municipality received grants from the district (district allocation) and also from the state (state allocation). The Fiscal Court Schleswig-Holstein came to the conclusion that the district grant was subject to VAT, as remuneration from a third party. The state allocation, on the other hand, was qualified by the Fiscal Court as a genuine, non-taxable grant. Furthermore, the Fiscal Court came to the conclusion that the municipality was to be categorised as a taxable person, in its entirety, and was therefore entitled to a full input VAT deduction. However, the tax office did not want to accept the decision of the Fiscal Court and argued before the Federal Fiscal Court that the state allocation should also be subject to VAT, as remuneration from a third party. This is because, without the state grant, the district would have had to pay considerably more to the municipality for the construction of the landing stage. The state grant would therefore have had the effect of topping up the price.

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3 Decision of the Federal Fiscal Court

The Federal Fiscal Court confirmed the judgement of the Fiscal Court. It found that the state allocation was not subject to VAT as it was paid for structural policy reasons to promote the transport infrastructure. Such a state allocation is not to be regarded as remuneration for a service provided by a municipality to the state as the grantor, as local public transport is not part of the state's remit. The state could therefore not have transferred any 'own' tasks to the municipality in return for payment. According to the Federal Fiscal Court, there is also no remuneration from a third party (for the leasing of the landing stage by the municipality to X-GmbH). The Fiscal Court had found, in a manner that could not be criticised on appeal, that the state allocation was made primarily for general funding for structural policy reasons. The payment served to improve the general transport infrastructure. A merely technical link to a specific subsidised project (in this case the construction of the landing stage) is not decisive. The tax office's objection that the district allocation would have been higher without the state allocation is also irrelevant. This does not correspond to the agreements between the parties and is therefore, from a factual point of view, incorrect.

It is pleasing that the Federal Fiscal Court also confirmed the full input VAT deduction from the construction costs of the landing stage. Even if the operation of the landing stage is permanently loss-making (four-figure income with seven-figure construction costs), the municipality has acted as taxable person. It is therefore clear that "hobby losses" under income tax law have no place in VAT (see also KMLZ VAT Newsletter 18/2023). The fact that citizens can access the landing stage free of charge is also not detrimental to the input VAT deduction. Such a possible advantage for the general public is, at best, incidental and is therefore irrelevant for the input VAT deduction. Finally, the clear and unambiguous statement by the Federal Fiscal Court that non-taxable grants do not affect the input VAT deduction rate is particularly pleasing. This is a very important message that the Federal Fiscal Court is sending out at this point. This is because, in the case of input supplies that are exclusively directly and immediately related to taxable output transactions, the type of financing (through income from the economic activity or through subsidies) is irrelevant for the right to deduct input VAT!

4 Consequences for the practice

This judgement is a milestone. The heavy storm clouds surrounding public grants are slowly clearing. While in the past, grants were often classified as subject to VAT or at least as input VAT-reducing, this judgement clearly shows that grants may very well be non-taxable as so-called "genuine grants". And it is not the case that grants necessarily have a negative impact on the pro rata input VAT deduction (see also KMLZ VAT Newsletter 12/2022). The German public transport sector will also breathe a sigh of relief: we now know that state grants to municipal public transport are not subject to VAT.

And for the community: all's well that ends well? Not quite. In the end, the tax office's appeal was nevertheless successful. The cause of this was the same negligence on the part of the tax office that had already concerned the Federal Fiscal Court in the spa community judgement (KMLZ VAT Newsletter 11/2024). The tax office's decision was addressed to the business of commercial nature of the municipality, not to the municipality itself. At this point, the Federal Fiscal Court does not tire of emphasising that this is incorrect. This is because the municipality is a uniform taxable person for VAT purposes.

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