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VAT'S UP

VAT NEWSLETTER

Federal Fiscal Court: No splitting requirement when letting immovable property with operating equipment

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1 Background

While the letting of immovable property and buildings is exempt from VAT under sec. 4 no. 12 sentence 1 lit. a) of the German VAT Act (UStG), this does not apply to so-called operating equipment under sec. 4 no. 12 sentence 2 UStG. In many cases, immovable property is rented out together with operating equipment (mixed letting). The German Federal Fiscal Court (BFH) ruled as early as 1998 (judgment of 28 May 1998 - V R 19/96) that such mixed lettings are to be divided into VAT-exempt letting of real property on the one hand and lettings of business equipment subject to VAT on the other. The BFH stipulated a so-called splitting requirement. The tax authorities concurred (sec. 14.12.10 of the German Administrative VAT Guidelines - UStAE).

The splitting requirement has always been in conflict with the VAT principle of the "unity of the supply", according to which a uniform economic transaction may not be divided into several supplies in a way that does not correspond to reality (sec. 3.10 para. 3 UStAE). Rather, the uniform supply consists of a main supply and one or more ancillary services. The latter are characterized by the fact that they have no purpose of their own for the recipient of the service, but rather serve to utilize the main service under optimal conditions. The supply of ancillary services shares the fate of the main service for VAT purposes (sec. 3.10. para. 5 UStAE). The BFH (judgement of 17 August 2023 - V R 7/23 [V R 20/22]) now had to clarify: Does the splitting requirement also apply in the case of mixed letting regarding permanently installed operating equipment if this is a mere supply of ancillary services to the leasing of a building?

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2 Facts of the case

The plaintiff leased a building for turkey breeding with permanently installed equipment elements specifically representing the contractual use of the premises as a turkey breeding facility. The operating equipment included special fixtures for feeding, an industrial conveyor spiral, heating and ventilation systems, and lighting systems. The plaintiff assumed that the letting was wholly exempt from VAT. In contrast, the tax office took the view that 20% of the agreed remuneration corresponded to the letting of machinery and equipment and was therefore subject to VAT. The court of first instance believed there was an overall VAT exempt supply, which therefore also included the letting of the installed equipment and machinery. The BFH suspended the proceedings and referred the matter to the ECJ for a preliminary ruling (decision of 26 May 2021 - V R 22/20). In its judgment of 4 May 2023 (C-516/21 - *Finanzamt* X), the ECJ generally gives priority to the principle of a uniform supply over the splitting requirement (see KMLZ VAT Newsletter 23│2023). However, the ECJ left it up to the BFH to assess whether the supplies in the case at hand were also main and ancillary services forming a single supply - but expressly noted that this " *appears to be obvious*".

3 (Follow-up) decision of the Federal Fiscal Court

With this decision, the BFH follows the ECJ's clear hint - and expressly abandons its previous jurisprudence. According to the BFH's changed legal interpretation, sec. 4 no. 12 sentence 2 UStG does not apply to the letting of permanently installed operating equipment if this is a supply of ancillary services to the letting of immovable property/building as a main supply that is VATx exempt under sec. 4 no. 12 sentence 1 lit. a) UStG, so that a single (VAT-exempt) supply is involved. In other words, the principle of the unity of the supplies takes precedence over any splitting requirement. Furthermore, the BFH clarifies that sec. 4 no. 12 sentence 2 UStG - also in view of the underlying Art. 135 (2) (a) of the EU VAT Directive - does not impose a mandatory splitting requirement. In general, the regulation does not serve to exercise the authorization granted by Art. 135 (2) of the EU VAT Directive to provide for further exclusions to the scope of the VAT exemption for the letting of immovable property. The BFH does not question the general possibility of the national legislator to regulate splitting requirements by law with explicit reference to sec. 12 para. 2 no. 11 sentence 2 UStG. The BFH continues to see the permissibility of national splitting requirements in compliance with the requirements of EU law.

4 Consequences for the practice

The BFH's change in case is positive. Meanwhile, the BFH consistently continues its previous line of case law in the context of sec. 4 no. 12 UStG (cf. BFH judgements of 11 November 2015 - V R 37/14; of 10 December 2020 - V R 41/19 - see KMLZ VAT Newsletter 24│2021). In cases of mixed letting, it should be examined whether there is a uniform and thus entirely VAT exempt letting or whether there are separate individual supplies to be assessed for VAT purposes. It should be noted, however, that the assumption of a uniform VAT exempt supply leads to the loss of the previously possible right to deduct input VAT regarding the operating equipment. A deduction of input VAT then requires an option pursuant to sec. 9 UStG regarding the entire letting.

It remains to be seen whether the development of the case law will be further confirmed by the pending proceedings on the question of the treatment of electricity supplies as ancillary services in the case of VAT exempt leasing (BFH, cases V R 15/21 and XI R 8/21). In any case, not only an amendment to sec. 14.12.10 UStAE, but also a more specific version of sec. 3.10 UStAE would be welcomed.

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