



VAT NEWSLETTER

## Annual Tax Act (Part 11):

## Cross-border price reductions within a supply chain

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### 1 Background

Where a supplier grants a price reduction to his customer, the taxable amount is reduced in accordance with sec. 17 para 1 sentence 1 of the German VAT Act. As a result, the supplier who grants the price reduction can reduce his output VAT. The customer must also reduce his input VAT deduction in the same amount. This issue becomes more complex in the instance where, within the context of a supply chain the supplier grants a rebate, not directly to his customer, but to another recipient in the supply chain. Already in 2002, the ECJ decided in the case *Elida Gibbs* that, as regards price reductions granted within a supply chain, it is only the recipient who commercially benefits from the price reduction (ECJ C-317/94), who is required to reduce his input VAT deduction. However, the commencement of an infringement procedure was necessary in order to force Germany to change the law and implement regulation sec. 17 para 1 sentence 4 and 5 into the German VAT Act (ECJ C-428/98). Recently the German Federal Fiscal Court had to again deal with price reductions within a supply chain, but in these cases cross-border transactions were given (Az. XI R 25/12; V R 6/13). In general, two different scenarios have to be distinguished from one another.

#### 1.1 Price reductions from abroad



In this scenario, the German Federal Fiscal Court has decided that the recipient 2, who benefits from the price reduction, must only reduce his input VAT deduction if the transaction, carried out by the supplier granting the price reduction, is



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subject to German VAT. If the supplier granting the price reduction carries out a VAT exempt intra-Community supply, the recipient 2 who benefits from the price reduction is not obliged to reduce its input VAT deduction due to the fact that the supplier does not perform a supply subject to German VAT. This follows from the wording of the German VAT Act. According to sec. 17 para 1 sentence 1 of the German VAT Act, a precondition for a correction of the input VAT deduction is that the taxable base of a supply, subject to German VAT, has been changed. In practice, it is very challenging for the recipient 2 to determine whether the transaction carried out by the supplier is subject to German VAT or not.

### 1.2 Price reductions from Germany to other countries



The reverse scenario – i.e. the instance where the supply carried out by the supplier granting the price reduction is subject to German VAT, whereas the supply to the recipient 2 who benefits from the price reduction is VAT exempt – has not yet been decided by the German Federal Fiscal Court. Although some regulations have been introduced into sec. 17.2 of the German VAT Circular in this respect, they have not yet been implemented into the German VAT Act and are thus not binding. Therefore, suppliers who grant price reductions and who carry out supplies, which are subject to German VAT, might be able to reduce their output VAT even though the recipient 2, who benefits from the price reduction, is not obliged to reduce its input VAT deduction accordingly.

## 2 Planned changes to sec. 17 of the German VAT Act

This loophole will now be closed by the implementation of sec. 17 para 1 sentence 6 into the German VAT Act. As a result, price reductions, which are not directly granted to a supplier's customer but rather to another recipient in the supply chain, will only result in a reduction of the taxable base when the supply to this recipient is subject to VAT in Germany. Thus, if a supplier grants a price reduction to a recipient in the supply chain and this supply to the recipient who benefits from the price reduction is VAT exempt, as e.g. in an intra-Community supply, he cannot reduce his output VAT. Based on the reasons for the law, the neutrality of VAT is to be preserved. The direct customer is not obliged to reduce his input VAT deduction as he does not benefit from the price reduction (sec. 17 para 1 sentence 3 of the German VAT Act). Hence, it is not justifiable to allow the supplier granting the price reduction to reduce his output VAT. These changes will come into effect as soon as the Annual VAT Act is published.

## 3 Notes for the practice

To date, taxable persons have been able to base their arguments, for the reduction of their output VAT, on the wording of sec. 17 para 1 of the German VAT Act. This has been the case even where they have granted price reductions to a recipient in the supply chain who is not the direct customer but benefits from the price reduction, and the supply to this recipient is VAT exempt. When the Annual VAT Act comes into force, this opportunity will cease to exist. Taxable persons who grant price reductions should evaluate what kind of scenarios are given and whether it is possible to reduce their output VAT.

All taxable persons who grant price reductions to a recipient in a supply chain, who is not their direct customer, should carefully evaluate the VAT treatment. They have to check whether the supply to the recipient in the supply chain is subject to German VAT. If not, they will not be permitted to reduce their output VAT.