



ECJ on development measures: full input VAT deduction and no taxation of a supply carried out free of charge

1 Background

In 2011, the Federal Fiscal Court changed its previous case law and ruled that a taxable person is not entitled to input VAT deduction from the construction of a road, in the instance where the road is later given to a municipality, free of charge. The Federal Fiscal Court will now, once again, have to revise this jurisprudence due to the new ECJ judgment of 16 September 2020 in the case *Mitteldeutsche Hartstein-Industrie AG (C-528/19)*. As the tax authorities had followed the Federal Fiscal Court's judgment of 2011, they must now also return to the original jurisprudence. Taxable persons can breathe a sigh of relief. They will once again be entitled to deduct input VAT from the construction of a public road. In addition, the ECJ ruled that this does not constitute a supply carried out free of charge.

2 Facts

The Plaintiff wanted to operate a limestone quarry and therefore submitted an application with the regional council (*Regierungspräsidium*) for approval. The regional council approved the operation of the quarry on condition that the access to it was developed by way of a public road, belonging to the municipality, on whose premises the quarry was located. The Plaintiff then agreed with the municipality, to develop the public road and to transfer it to the municipality, free of charge. The Plaintiff claimed the deduction of input VAT from the construction costs.

The competent tax authority initially granted the input VAT deduction, but intended to assess a taxable supply of goods carried out free of charge. The Fiscal Court, on the other hand, rejected a taxable supply of goods carried out free of charge and, at the same time, denied the input VAT deduction. The subsequent decision of the Federal Fiscal Court in



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this case seemed to be clear, as it had only decided in 2011 that the input VAT deduction was, in principle, to be denied if the procured goods or services were used to render supplies carried out free of charge. However, the Federal Fiscal Court had doubts as to whether its previous line of reasoning was still compatible with Union law due to the more recent ECJ judgments in the cases *Sveda* and *Iberdrola*.

3 ECJ decision

The Federal Fiscal Court's doubts were justified. The ECJ affirmed the deduction of input VAT and rejected the taxation of a supply carried out free of charge. With respect to the deduction of input VAT, the Court considered it decisive that, without the development of the municipal road, the operation of the limestone quarry would have been impossible in both practical and legal terms. This was due to the fact that the necessary heavy goods traffic could only reach the quarry via a developed road. In addition, the costs of the developed road were included in the price of the taxable output supplies. The fact that the public could use the road free of charge was, according to the ECJ, irrelevant. As regards the scope of the input VAT deduction, however, the ECJ made it clear that only those expenses that were indispensable for the operation of the limestone quarry could qualify for input VAT deduction. Expenses are indispensable if the Plaintiff, had they not been incurred, would not have been able to carry out its economic activity. The Federal Fiscal Court will now have to take another close look at this imperative necessity in future proceedings. The ECJ also rejected the assumption of a barter-like transaction. The approval to operate the quarry could not be regarded as remuneration for the development of the municipal road. The ECJ rightly pointed out that the approval was a unilateral sovereign act, which could not, in principle, justify a legal relationship leading to taxable supplies of goods and services. Moreover, the approval was granted by the district government, whereas the developed road was owned by the municipality.

Particularly interesting are the ECJ's comments on the taxation of a supply carried out free of charge. The ECJ denied both *consumption for private use* and *consumption for the contractor's personnel*. Lastly, the taxable person also did not pursue *any purposes other than those of the business*. It is true that the ECJ (like the German law) considers the disposal of goods for business purposes a supply of goods carried out free of charge. However, in the case at hand, there is no risk of an untaxed final consumption or a violation of the principle of equal treatment. The development of the road benefited the Plaintiff and was directly and immediately linked to its entire economic activities. The costs continued to be a part of the cost components of the Plaintiff's output supplies. The ECJ goes on to refer to the arguments previously used to justify the deduction of input VAT in order to deny the assumption of a taxable supply carried out free of charge. Ultimately, the ECJ thus restricts the concept of supplies of goods carried out free of charge: In general, also the disposal of goods for business purposes constitutes a taxable supply carried out free of charge. However, according to the current ECJ decision, this does not apply if there is no risk of an untaxed final consumption.

4 Consequences for the practice

The Federal Fiscal Court will be forced to abandon its previous restrictive line. The tax authorities will follow. The judgment is a blessing for any taxable person needing to build development facilities and later hand them over to the municipality, free of charge. The rejection of the right to deduct input VAT was unfair. After all, no taxable person wants to grant an economic advantage to a municipality for no consideration. The taxable person develops the necessary roads solely for the purpose of running his business and generating taxable supplies. Giving the road to the municipality, free of charge, is only a reflex, no more and no less.