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VAT NEWSLETTER

Federal Ministry of Finance: TOGC for letting activity – particularly for property developers and chain transfers

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1 Background

The transfer of a going concern (TOGC) is a somewhat dangerous provision in VAT law. Although such a transaction is not taxable, problems can quickly arise if the associated VAT issues are misjudged. For instance, if the parties erroneously assume the existence of a TOGC or mistakenly do not recognize such, VAT may have to be paid with interest on the proceeds of sale. And that's not all. With the TOGC, the so-called "footprint theory" applies, according to which the purchaser assumes the risk of adjustments of deductions (sec. 15a of the German VAT Act / Art. 184 EU VAT Directive).

2 German Federal Fiscal Court's opinion on the continuation of a letting activity

A TOGC requires the continuation of the seller's business activities by the purchaser. If leased land is transferred, a TOGC is, in principle, only applicable if the purchaser enters into the lease agreements and takes over a leasing company. In this case, no property is delivered for VAT purposes, but rather a leasing company is transferred. No precise answer can be inferred from the German Federal Fiscal Court's case law on the question of when such valid letting business is given. For example, no TOGC is given if a property developer develops a property, concludes rental agreements and sells the property in a timely manner. The reason for this is that the purchaser does not take over the building activity in this case (ref. V R 45/02). A different situation applies, however, if a developer sells a property after several years of leasing (ref. XI R 16/14). The continuity of the letting required for a TOGC is given in any case after letting for a period in excess of 17 months (ref. V R 66/14).

The continuation of the enterprise activity in a chain transfer must be given only principally, not in person, regarding every single respective purchaser (ref.: V R 66/14). In the case decided, two shareholders acquired a piece of land in fractional

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ownership. Within the framework of a GbR (civil partnership under the German Civil Code) founded in parallel, they developed the property and rented out the building. The property was not transferred to the GbR. In the context of the sale of the land by the shareholders, the German Federal Fiscal Court assumed an intermediate supply of the land by the GbR to the shareholders. However, the fact that it was not the shareholders, in their capacity as acquiring entrepreneurs, who continued the leasing activity, but rather the final purchaser, did not prevent the application of a TOGC.

3 Content of the Federal Ministry of Finance's letter

The German Federal Fiscal Court's decisions ref. XI R 16/14 and ref. V R 66/14 dated 2015 are now scheduled for publication in the Federal Tax Gazette and will thus become binding on the tax authorities. In its letter dated 16.11.2020, the tax administration specifies the judgements' principles and adapts sec. 1.5 of the German VAT Circular.

According to the new paragraph 2 in sec. 1.5 German VAT Circular, even property developers and property dealers are considered as being rental companies if a continuous rental activity already exists at the time of sale. For the purposes of the TOGC, the entrepreneur is then no longer considered to be a property developer or land trader, but a leasing company. The typical intention of property developers and property dealers to resell property or land is not necessarily an obstacle to continuous leasing activities. According to a rebuttable presumption, a leasing company is to be assumed if the leasing period has been at least six months. The allocation of short-term or fixed assets in the balance sheet is therefore irrelevant.

However, there is no TOGC if the vendor constructs a building and only seeks tenants for the property in order to subsequently sell it in a leased condition at the highest possible price.

The Federal Ministry of Finance further recognizes that the continuation of a business activity, in the case of a multiple transfer in a close temporal and factual connection, must only be given principally, not in person, regarding every single respective purchaser. In principle, in the case of a chain transfer, only the last purchaser must continue the business of the first seller in the chain. However, the Federal Ministry of Finance restricts its statement on the continuation of the business activity in the chain: In the case of a multiple transfer, a TOGC at each stage is only given if the respective acquirer is an entrepreneur, within the meaning of § 2 German VAT Act, at each individual stage of the transfer.

4 Consequences

In principle, The Federal Ministry of Finance's letter is to be appreciated, since it makes clear statements as to when a letting enterprise is to be assumed and under which conditions a TOGC is given in the context of multiple transfers. In practice, however, caution is required: Every entrepreneur, if he leases for half a year, can be a leasing company for the purposes of a TOGC, regardless of his genuine business purpose. From now on, TOGCs are likely to be given more frequently, especially by property developers and real estate dealers. In the case of chain transfers, increased attention must be paid to the entrepreneurial status of each participant. Intermediate shareholders and fractional owners could, for example, unexpectedly prevent a TOGC from taking place.

The letter is to be applied to all open cases. Entrepreneurs should therefore examine whether the retroactive application of a TOGC offers advantages. If, for example, no TOGC has been assumed so far and the seller has opted for VAT liability, Sec. 13b para no. 3 German VAT Act (reverse charge) applies. If the purchaser was only able to deduct part of the input VAT due to a quota, he may apply for a refund with reference to the Federal Ministry of Finance's letter.

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