



KMLZ VAT NEWSLETTER

Significant adjustment effort for public-law corporations due to sec. 2b German VAT Act

1. Background

The German legislator has legally reformed the VAT taxation of public authorities by deleting sec. 2 para. 3 German VAT Act and creating sec. 2b German VAT Act. According to the coalition agreement, the inter-municipal cooperation was not to be harmed in any way. Now – almost three years later – we are facing a major turning point with regard to the taxation of public authorities. The goal of inter-municipal cooperation being generally favored was accomplished. However, it has been a long and difficult journey and there will be many losers, as only those who are active on a public law basis will benefit. Those who are active on a private law basis will not fall within the scope of sec. 2b German VAT Act. According to the German Ministry of Finance, the legal entity of public law does not act in the “*exercise of public authority*”. The new regulation means that, in particular, assistance services and services within the framework of asset management carried out by a legal entity of public law will now be taxable. In addition, the fiscal authorities’ previous ceiling of EUR 35.000 will no longer be applicable in the future.

Letter of the German Ministry of Finance of 16 December 2016 for sec. 2b German VAT Act

The fiscal authorities have worked on the application bulletin regarding the revision of sec. 2b German VAT Act for nearly one year. Although the German Ministry of Finance follows the previous case law of the German Federal Fiscal Court, the fiscal authorities are visibly attempting to lessen the significant effects of the resulting changes. This has culminated in the taxable person having to know what he does according to the “principles of administrative legality”. Even if the public sector still has five more years to adjust, it remains a lot of work. Corporations of public law are now in the main focus of taxation.

2. Main contents of the German Ministry of Finance’s letter

The letter explains what is to be understood as falling under public authority and also discusses the resulting greater distortions of competition. At the same time, the fiscal authorities have finally opened the long anticipated gate for input tax corrections in accordance with sec. 15a VAT Act.

2.1. Public authority

The legal entity of public law always carries out an act of public authority when the entity is acting within the framework of a public special regulation (recital 6). Unfortunately, this means that the German Ministry of Finance follows the case law of the German Federal Fiscal Court. Important examples of such special regulations, which are stated by the German Ministry of Finance, are the public statute (i.e. statute of a wastewater association, recital 8), the administrative agreement (recital 10) and the public agreement. If special norms allow for the completion of an agreement, they are known as public agreements (i.e. agreements on



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the basis of the state laws regarding municipal cooperation, recital 12). If an agreement is to be judged by matter and purpose, the “*principle of administrative legality*” applies (recital 17). The fiscal authorities believe that the public authorities will generally choose the right type of action. It is expected that public law legal entities will attempt to bring the public character of an agreement in to force by choice of words (i.e. naming the agreement as a public agreement) and references to the law.

2.2 No distortion of competition

In the opinion of the German Ministry of Finance, two supplies are in competition if, from the consumer's point of view, they meet the same needs. Such comparable supplies need to be capable of being carried out potentially (and not only hypothetically) by private persons. Generally, there is no restriction placed on the local market. Legal conditions are of importance for assessment if the consumer is able to distinguish between two supplies based on different conditions. The German Ministry of Finance follows the case law of the Federal Fiscal Court and the ECJ in this respect.

The German Ministry of Finance has commented extensively on the elements of offences against sec. 2b para. 2 and para. 3 German VAT Act. These two paragraphs identify cases where there is deemed to be no competition. Para. 2 excludes competition if the legal entity of public law does not receive more than EUR 17.500 per year for performing similar activities (recital 3). Para. 3 covers the vertical and horizontal cooperation of two legal entities of public law. Services falling under no. 1 are services, which are legally reserved for legal entities of public law or are legally barred from private economic operators, even if the legal entity of

public law may request the provision of a service from another legal entity of public law (recital 40 ff.).

2.3. VAT deduction

It is very positive that the German Ministry of Finance is now allowing input VAT corrections in accordance with sec. 15a German VAT Act if input VAT deduction was impossible for purchases in the first place, but now – after the new regulation of sec. 2b German VAT Act – output transactions are taxable. By doing so, the German Ministry of Finance is attempting to lessen the imminent significant effects.

3. Tips

Every legal entity of public law, for which the previous case law is more favorable, needs to submit a declaration to stay with it in accordance with sec. 27 para. 2 German VAT Act by 31 December 2016. If it does not, it will need to apply sec. 2b German VAT Act as of 1 January 2017. Based on the German Ministry of Finance's letter, all revenue of legal entities of public law need to be checked for the obligation to pay VAT. If this has not happened yet, it is recommended to exercise this option. The fiscal authorities have made it clear that the retroactive revocation of the option for 1 January 2017, is possible (recital 58 ff.). The legal entity of public law may have issued some taxable services without VAT. This might still be better than applying sec. 2b German VAT Act as of now (without any possibility to revert back to sec. 2 para. 3 German VAT Act new version) and not knowing which services are taxable. Furthermore, the option is also retroactively revoked in the case of financial advantages. In order to permanently meet its tax obligations, the legal entity of public law needs to establish a tax department as well as an internal tax control system.