



Significant simplifications for input VAT deduction – a bright spot for legal entities under public law

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1 Background

The new regulation on the taxation of legal entities under public law in sec. 2b of the German VAT Act (UStG) is increasingly becoming a bit of a “never-ending story”. We recently reported that the legislator intends to, once again, postpone the application of sec. 2b UStG by means of the Annual Tax Act 2024 (KMLZ VAT Newsletter 13 | 2024). This is because the new regulation is too demanding for many legal entities under public law. In many cases, it is not a matter of substantive legal issues relating to sec. 2b UStG, but rather organisational challenges resulting from, above all, the decentralised organisational structure of the public sector. This is why it is so important that tax compliance structures are created in the course of the transition in order to clearly define responsibilities and competences. The legislator recognises these problems. In the justification for the law, the legislator admits that legal entities under public law still face “administrative challenges”. At the same time, the legislator acknowledges that there are also “other fundamental questions regarding the application of the law”. With the German Federal Ministry of Finance’s (BMF) new letter dated 12 June 2024, the tax authorities have attempted to resolve one of these questions, namely whether and, if so, which simplifications may apply regarding input VAT deduction.

2 Challenges with input VAT deduction

Contrary to “normal” taxable persons, legal entities under public law must not only differentiate as to whether the procured goods and services are to be allocated to a supply subject to VAT or to a VAT exempt supply (excluding input VAT) when deducting VAT. For legal entities under public law, there is also the preliminary question as to whether the procured goods and services are to be allocated to the sovereign (non-taxable) sector or to the taxable sector. We recognized and pointed out that this was the real challenge of the new regulation in sec. 2b UStG for the practice 10 years ago, when the regulation



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was still in its “infancy”. One could now argue that the question of input VAT deduction is of secondary importance, since the input VAT deduction does not have to be claimed. However, this is too short-sighted: legal entities under public law are obliged to manage their budgets economically and, therefore, must claim input VAT deduction. Otherwise, an audit or even the attention of the Court of Auditors must be feared. In addition, when applying for funding, legal entities under public law are often required to disclose whether they are entitled to deduct input VAT, as this determines whether net or gross funding is applied for.

3 Content of the German Federal Ministry of Finance's letter dated 12 June 2024

With this recent letter, the tax authorities have attempted to achieve the best possible result – to the benefit of the many and very different legal entities under public law. Some may have hoped for more. However, the tax authorities can only act within the legal framework of the law. So, what is so good about the letter?

- No one has to, everyone can! The BMF offers simplifications for input VAT deduction. Larger entities may apply a revenue-based allocation key for supplies used partially for taxable activity; smaller entities with supplies subject to VAT of < EUR 45,000 will regularly make a flat-rate input VAT deduction. Special provisions apply to mixed-use immovable property. In this case, it must first be determined if an adequate allocation key can be found under the usual conditions.
- The BMF recognises that the breakdown of input VAT according to the principle of economic allocation requires a disproportionate amount of effort. For us, this means that it is legitimate to use the new simplifications – even if the input VAT deduction could be higher if it were to be determined precisely. The auditors will have to accept the simplified input VAT allocation keys because, alongside the financial implications, organisational effort for calculating and monitoring (sec. 15a UStG !!!) must be taken into account in the context of economic budget management.
- The BMF provides many examples of how the revenue-based allocation key is to be calculated, starting with the quota:

$$\frac{\text{Income from the taxable sector} \times 100}{\text{Income from the taxable and the non-taxable sector (total revenue)}}$$

At a ratio of < 10%, mixed-use items are not considered to be allocated to the taxable activity, with the result that input VAT deduction is excluded. However, this threshold is irrelevant for the procurement of auxiliary and operating materials (e.g. office supplies) and for supplies of services. At a ratio of > 10%, input VAT deduction must be adjusted in accordance with sec. 15a UStG (including the de minimis limits of sec. 44 of the German VAT Implementation Code). If the legal entity under public law also renders VAT exempt supplies, the input VAT ratio must be further refined at a second level. However, this is easy to handle, since the annual revenue-based allocation key is the basis for the application of sec. 15a UStG. If the goods are sold at a later date, only that part of the goods used for taxable activities is subject to VAT. This will lead to “strange” invoices, since only a partial amount is subject to VAT. If goods or services used partially for taxable activities are used exclusively by a definable part of the legal entity under public law (e.g. business of a commercial nature (BgA), owner-operated municipal undertaking (Eigenbetrieb)), the input VAT allocation key can be calculated for the individual part of the legal entity under public law. Furthermore, both monitoring and adjustment, according to sec. 15a UStG, can be disregarded, if the full sale or replacement price is subject to VAT at the end of use or upon sale or withdrawal.

Of course, it is up to the legal entity under public law to allocate the input VAT precisely according to the principle of economic allocation. However, this could prove difficult: In addition to complicated questions involving sec. 15a UStG, there will often simply be a lack of personnel to cope with this mammoth task.