

April 2009

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## Editorial

The so-called "sphere theory" in VAT law is currently the subject of much discussion. Under what circumstances might a shareholding fall within the sphere of business activity? On the other hand, when will it fall to be a non-business activity? When does an economic asset or other service support the business, so that the deduction of input tax is permitted? While the public sector acts both commercially and as an authority, it is to be assumed that natural persons also have a private sphere, quite separate from their

business activities, within which the taxation principles of VAT law do not apply. According to the ruling by the European Court of Justice (ECJ) in the "Securita" case (13 March 2008, C-437/06), this principle does in fact also apply to legal persons under private law.

In its ruling on 8 May 2002 in the "Seeling" case (C-269/00), the ECJ confirmed that assets used only partially for business purposes initially qualify for full deduction of input VAT if they are allocated to the business sphere. Private usage is then captured via taxation. A proposed amendment to the VAT Directive (MwStSystRL) – the new Art 168a – is intended to limit input tax deduction to the extent of actual business use and thereby to curb cash flow advantages. According to the ruling of the German Federal Tax Court (BFH) on 8 October 2008 (XI R 58/07), a deduction of input tax is completely ruled out if, aside from its non-business usage, the asset is used only to generate VAT exempt revenues excluded from input tax deduction (e.g. certain medical care activities, insurance and banking activities).

Further debate around business and non-business activity arose from the ECJ ruling in the "VNLTO" case (ruling of 12 February 2009, case C-515/07), details of which are discussed in this newsletter. Although allocation rights exist for capital goods, no such rights exist for other goods and services, necessitating apportionment for the purposes of input tax deduction. The influence that this ruling will have on the discussion of the allocation of capital goods remains to be seen.

Yours

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# Compromise reached on optional and permanent introduction of reduced VAT rates

In its meeting held on 10 March 2009, the ECOFIN Council decided to grant Member States the option to introduce a reduced rate of taxation for the following labour-intensive services for an unlimited period of time:

- Minor repairs of bicycles, shoes and leather goods, clothing and household linen (including mending and alteration)
- Renovation and repairs of private dwellings, excluding materials which account for a significant part of the value of the service supplied
- Window-cleaning and cleaning in private households
- Domestic care services (such as home help and care of young, elderly, sick, or disabled people)
- Hairdressing services
- Restaurant services
- Books on all physical means of support (according to the Federal Ministry of Finance (BMF) website, these shall be audio books).

The decision aims to encourage consumers to purchase more services and to cut down on illegal labour. Widening the categories for reduced VAT rates is intended - especially in the labour-intensive service sector - to increase the numbers of unskilled workers in permanent employment.

The reduced VAT rate must not fall below 5%. At the same time the ECOFIN Council rejected the Commission's other proposals to introduce further reduced VAT rates (see proposal for a Directive put forward on 7 July 2008). Included in this proposal were, for instance, child safety seats for motor vehicles, CDs, and gardening and landscaping services. However, the Commission has already announced that it will present a further proposal in April 2009 for extending the reduced VAT rate to cover the supply of energy efficient products and services.

## Note:

The reduced VAT rate for the services mentioned above will be introduced only if the Member State avails itself of the option to do so. The German Finance Minister has, following the line taken by four other Member States, said on record that he will not make use of this possibility, as reduced VAT rates place a burden on the public budget, increase bureaucracy costs and do not have a positive influence on employment rates.



# German Federal Tax Court: party services generate turnover from restaurant services

## The case

The BFH has again stated its position on the issue of which conditions are necessary for services provided by a party service to be taxed as restaurant services using the standard tax rate of 19%. This case involved a party service which, in addition to supplying the food, offered the loan of tableware and cutlery as part of its range of services, and also cleaned the tableware and cutlery after collecting it from the customer. The claimant (the party service) and subsequently the Lower Tax Court (FG) classified the service as a supply of food ready for consumption with the "loan and cleaning of tableware and cutlery" as a dependent ancillary service described, together subject to a reduced rate of taxation.

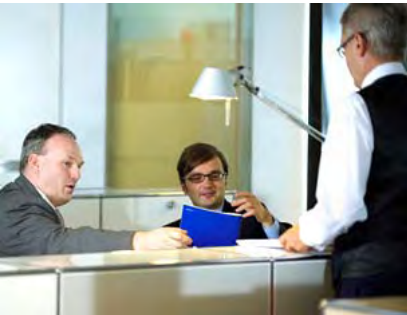
## Ruling by the BFH on 18 December 2008 (ref. no. V R 55/06)

The BFH did not concur. The Court confirmed the standpoint taken by the tax authorities and classified the services as restaurant services altogether subject to the 19% rate of taxation. Reiterating the legal view it had previously expressed, the BFH - considering the overall situation - based its argument on the point of view of the average consumer and the assumption that, from a qualitative perspective, the service elements of the supply elements provided by the claimant outweighed the other aspects. The result of the ruling is not surprising, as loan and cleaning of tableware and cutlery alongside the supply of food have always been rated as important services which altogether constitute restaurant services (cf. BFH, decision of 8 March 2006 – V B 156/05; BFH, ruling of 10 August 2006, V R 38/05).

The remarks made by the BFH in relation to its earlier assertion in its ruling of 26 October 2006 (ref. no. V R 58, 59/04), according to which the "necessary precursor to marketing pre-prepared food ..." is "its preparation", are of particular importance. Therefore, in adherence to the ECJ ruling in the case of Hermann (ECJ, ruling of 10 March 2005 – case C-491/03), the preparation of food cannot qualitatively outweigh the other elements of the supply. The BFH has now established that this assertion only applies to food preparation from a customs tariff perspective. From a customs tariff perspective, the preparation of food only refers to the mixing and combining of individual components, but not to the preparation for consumption in the sense of cooking, frying, baking or similar processes.

### Note:

The BMF gave a comprehensive explanation of its stance on the distinction between supplies of goods and services concerning food and drink in its guidance of 16 October 2008. In its case examples, the preparation of food qualifies as a necessary part of marketing which is no service element. Therefore, in the overall situation in which all supply elements must be considered, the preparation of food is no restriction on the granting of a reduced VAT rate. The new ruling by the BFH could lead to a re-evaluation if the BMF is of the opinion that this ruling - beyond the concrete case - should be generally applicable.



# German Federal Tax Court rules on the necessity of indicating the date of supply on invoices

As stated in § 15 (1) sent. 1 (1) sent. 1 and 2 of the German VAT Act (UStG), input tax deduction is dependent mainly on whether the customer has invoices as defined by § 14 UStG at its disposal. In particular, the invoice must contain enough information to meet the legal requirements listed in § 14 (4) (1-9) UStG. The dispute up to now concerned the question of whether the date of supply required by § 14 (4) (6) UStG must always appear next to the invoice date, or whether it is legally acceptable to leave the date of supply to be inferred from the date the invoice was issued.



## The case

At issue was an invoice indicating 15 November 2005 as the order date and 30 November 2005 as the invoice date. The invoice did not contain a date of supply, nor did it mention any delivery slip. The delivery slip submitted later contained details that matched the invoice in terms of order date and order number, gave 28 November 2005 as the date of issue, but likewise did not contain a date of supply.

## Ruling by the BFH, 17 December 2008 (ref. no. XI R 62/07)

The BFH interprets the applicable version of § 14 (4) (6) UStG in line with the EC Directive to the effect that, as of 2004, invoices must always contain two separate dates indicating when the supply was rendered and when the invoice was issued. Regarding the legal situation from 2007 onwards, this ruling is based on a change to the German VAT Act which explicitly requires that the date the supply was rendered be stated on the invoice and only allows exceptions for cases involving partial or advance payments when the time of payments received is the same as the date the invoice was issued. Despite the law's unclear formulation, the BFH arrives at the same result for the legal situation from 1 January 2004 by interpreting in line with EC Directive. It stated that otherwise, i.e. if the date of supply is not indicated, there would always be an uncertainty for the tax authorities as to whether the date of supply is in fact the same as the invoice date or whether the former is instead missing for other reasons. This means that the date the supply was rendered absolutely must be shown, even if it is the same as the invoice date. The date of supply may likewise not be inferred from the date the delivery slip was issued, because the delivery slip is usually issued before the actual delivery of the goods or services.

### Note:

As was the case before the ruling, the stipulations in Article 185 (16) of the VAT Guidelines (UStR 2008) still apply; in particular, it is thus still permissible to use the phrase "delivery date same as invoice date" on the invoice.

Just as significant is the BFH's statement concerning the annotations to the "HE" rulings (ECJ ruling of 21 April 2005 – case C-25/03; BFH ruling of 6 October 2006, V R 40/01), which had relaxed the invoice requirements to a certain extent. The BFH explicitly states that these exceptions were only permissible under the law applicable prior to 1 January 2004. The requirements of the "Invoicing Directive" of 21 December 2001 were implemented by the German Annual Tax Act 2003, which, upon taking effect on 1 January 2004, eliminated such exceptions.

# European Court of Justice on the apportionment of input VAT instead of full input VAT deduction followed by the taxation of supplies made for no consideration

## Background

The ECJ ruling in the "Seeling" case (ECJ, ruling of 8 May 2002, case C-269/00) established the principle that, subject to any exemptions under § 15 (2) UStG, businesses can claim a full deduction of input VAT on property even if that property is used partly for private purposes, providing such supplies offered privately are also taxable as supplies other than for consideration. Since then, it has been open to question whether "full input tax deduction and adjustment in respect of purchases not used for business purposes through the taxation of supplies other than for consideration" also applies to cases in which goods, which do not constitute capital goods, or other services are supplied.

## The case

The case to be determined by the ECJ concerned the VNLTO (an association of Dutch businesses in the agricultural sector), which was, without a doubt, involved in both non-business activities, i.e. the safeguarding and promoting of interests of members who trade in the agricultural sector, and business activities, i.e. providing a number of individual services for which it charged a fee. The VNLTO acquired goods and services which it used both for business (taxable) activities and for other non-business activities. The question at issue was whether the association could claim a full, immediate input VAT deduction on taxable goods and services, where the goods and services purchased related to non-business activities.

## ECJ, ruling of 22 December 2008, case C-515/07 ("VNLTO")

The ECJ held that in 'mixed' use situations, no full, immediate deduction of input VAT followed by taxation as an adjustment to reflect non-business use by the taxable organisation could be made in cases where the mixed use purchase does not consist of a capital goods acquisition.

The ECJ held that the taxpayer had no right to elect to allocate goods and services to the business which are used for business and non-business activities, as is the case with capital goods. Such right to allocate would have the consequence, that the entire purchase of inputs was deemed to have been acquired for business purposes within the meaning of § 15 (1) (1) UStG. In terms of capital goods, the ECJ clearly takes the view that it is still permissible to allocate wholly to the business all capital goods used for business purposes. However, for supplies of goods and services other than capital goods, the acquisition insofar is directly attributable to the 'non-business' sphere where there is no possibility that the goods and services will later be used for business purposes.

According to the ECJ in such case of non-business use, which constitute, as in the present case, VNLTO's main corporate purpose, there can be no use for "purposes other than those of the business" within the meaning of Art. 26 (1) (a) of Directive 2006/112/EC (equivalent to § 3 (9 a) (1) UStG). Only purchases that can be allocated to the business can also be used for purposes other than those of the business.

**Note:**

This assessment by the ECJ impacts on the current application of the law only inasmuch as the authorities previously recognised that taxpayers could opt in certain cases to allocate to the business goods and services other than capital goods and services. However, this approach now appears to have been reconsidered. In leasing cases in particular, this could result in leasing costs being apportioned under § 15 (1) sent. 1 (1) UStG. Input VAT might only be deducted provided that the leasing costs were incurred for business purposes. How far the VAT Guidelines will be adapted remains to be seen.

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## International Network of KPMG



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Wirtschaftsprüfungsgesellschaft

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