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Editorial

In German VAT law, special derogations bestow a unique dynamic on the leasing of immovable property. For example, subject to certain conditions, a lessor can opt to pay VAT on property leased to another company. Waiving the tax exemption permits the lessor to deduct input tax related to construction work and other input purchases. The criteria for the lessor to exercise an option to tax vary according to the age of the building. Input tax deduction on rental expenses requires a valid invoice, just as it does for all other

input purchases made by the tenant. A rental contract could suffice as an invoice, but only if it meets all invoicing requirements. If this is not the case, input tax deduction will be denied and the VAT, currently at 19 %, will become a cost element for the tenant.

Furthermore and generally, the provision of additional services has to be considered separately. Where dependent ancillary services such as the provision of water are concerned, invoicing follows the VAT treatment of the property lease. The supply of electricity by a lessor has, however, to date been considered taxable by the financial authorities, even in cases where the property lease was VAT-exempt. The German Federal Tax Court has deviated from this perspective with respect to the leasing of stalls to market traders and now also with respect to the leasing of camping areas. The judgement on this matter, of relevance for leases of immovable property in general, is presented in this edition of the newsletter.

We also report on the legal developments at EU level. In particular, it is now definite which reduced rates Member States may apply permanently. In the "Sandra Puffer" case, the European Court of Justice (ECJ) comments on its previous judgement in the "Seeling" case. The use of VAT identification numbers is of key importance within the common market; a submission by the German Federal Tax Court to the ECJ approves this.

Yours

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News from Brussels

Directive amendment as of 1 June 2009 – reduced rates of VAT

On 5 May 2009, the Council of the European Union adopted Directive 2009/47/EC amending the VAT Directive 2006/112/EC as regards reduced rates of VAT. The Directive largely implements the agreement made on 10 March 2009 to allow optional reduced rates of VAT on a permanent basis for labour-intensive services (see MwSt.VAT Newsletter of April 2009). With effect from 1 June 2009, Annex III of Art. 98 (2) to the VAT Directive will be changed or supplemented as follows:

- No. 6: supply, including on loan by libraries, of books on all physical means of support (including brochures, leaflets and similar printed matter, children's picture, drawing or colouring books, music printed or in manuscript form, maps and hydrographic or similar charts), newspapers and periodicals, other than material wholly or predominantly devoted to advertising;
- No. 10a: renovation and repairing of private dwellings, excluding materials which account for a significant part of the value of the service supplied;
- No. 10b: window-cleaning and cleaning in private households;
- No. 12a: restaurant and catering services, it being possible to exclude the supply of (alcoholic and/or non-alcoholic) beverages;
- No. 19: minor repairing of bicycles, shoes and leather goods, clothing and household linen (including mending and alteration);
- No. 20: domestic care services such as home help and care of young, elderly, sick, or disabled;
- No. 21: hairdressing.

In contrast to the agreement of 10 March 2009, the new No. 12a of Annex III no longer refers to just restaurant services but instead specifies "restaurant and catering services". This is in accordance with the new terminology of Art. 55 and Art. 57 of the VAT Directive (however, see also § 3a (3) (3) (b) of the German VAT Act in the version applicable from 1 January 2010). The insertion effects an amendment to the English and French versions and now has a wider application than purely the services in restaurant operations.

The wording in Annex III No. 6 is also new. "Books on all physical means of support" extends to supplies of books (book contents), as long as these are on a means of support, i.e. physically available. This means that audio books, for example, now fall under No. 6; downloaded book content, however, does not.



UK reverse charge derogation renewed

The Council of the European Union also decided to extend the UK derogation, expiring on 30 April 2009, to 30 April 2011. The UK may continue to apply the reverse charge procedure to supplies of certain goods with a value of GBP 5,000 or more. This means that the purchaser of the goods must self-account for VAT. The following goods are affected:

- Mobile phones, being devices made or adapted for use in connection with a licensed network and operated on specified frequencies, whether or not they have any other use
- Integrated circuit devices, such as microprocessors and central processing units, in a state prior to integration into end user products.

Amendments aimed at combating tax fraud

In its meeting held on 9 June 2009, the ECOFIN Council decided to amend the VAT Directive aimed at tackling VAT fraud in relation to imports. The Member States are obliged to implement the amendments in their national laws with effect from 1 January 2011.

The amendment affects § 5 (1) (3) of the German VAT Act (UStG) (Art. 143 (d) of the VAT Directive), which specifies exemption from VAT for the importation of goods followed by an intra-Community supply of goods performed to a taxable person in another Member State (or followed by an intra-Community transfer of goods to the importer's own disposal). An insertion in Art. 143 (2) of the VAT Directive will make it necessary for the importer of the goods to provide the competent authorities with the following additional details – at a minimum – in order to apply the exemption:

- The VAT identification number of the importer in the Member State of importation;
- The VAT identification number of the customer to whom the goods are supplied in another Member State or the own VAT identification number in the Member State of arrival when the goods are subject to an intra-Community transfer from the Member State of importation;
- The evidence that the imported goods are intended to be transported or dispatched from the Member State of importation to another Member State. However, Member States may provide that this evidence be indicated to the competent authorities only upon request.

Further, the Commission is proposing to introduce for certain transactions an obligatory joint and several liability. This concerns the supplier in case of an intra-Community supply of goods, if he does not or incorrectly submit his recapitulative statement. The supplier shall be held jointly and severally liable for the payment of VAT due on the intra-Community acquisition (in detail COM(2008) 805 final of 1 December 2008). Up to now no political agreement has been reached on this proposal.

Please note

that Germany has been joined by the Member States Austria, Bulgaria, Denmark, Estonia, Hungary, Latvia and Lithuania in declaring in a Statement into the Council Minutes that they do not wish to make use of the extended scope of reduced VAT rates (new Numbers 10a, 10b, 12a, 19, 20 and 21). However, in Germany, it remains to be seen whether the political initiatives announced by some parties will lead to an implementation in the medium term, in particular for restaurant and catering services.

European Court of Justice: illegitimate liquidity advantages for businesses claiming input tax deduction?

In its ruling of 23 April 2009, the European Court of Justice (ECJ) had to state its position as to whether the liquidity advantage a company gains from an input tax deduction over another company with only output sales that diminish eligibility for input VAT deduction and a private consumer contravenes the general principle of equal treatment or constitutes unjustified aid in accordance with Art. 87 (1) EC.

The case

The initial circumstances of the current case are similar to those in the ECJ ruling in the "Seeling" case (ECJ, ruling of 8 May 2002, case C-269/00): the claimant Sandra Puffer claimed full input VAT deduction on the building costs of a building used for private purposes but treated as forming, in its entirety, part of the assets of her business. In addition to the specific question of the so-called "standstill ruling" in Art. 176 (2) of the VAT Directive, the Austrian national court questioned above all whether:

- the liquidity advantage arising from the ECJ "Seeling" case unfairly benefits only the taxable person to the detriment of the non-taxable person, and
- the liquidity advantage resulting from the "Seeling" case in favour of a taxable person with output sales eligible for input VAT deduction against a taxable person with only output sales ineligible for input VAT deduction constitutes an infringement of Art. 87 EC on incompatible State aid.



ECJ, ruling of 23 April 2009, case C-460/07 ("Sandra Puffer")

The ECJ rejects the claim that either case constitutes an illegitimate liquidity advantage or contravenes the general principle of equal treatment. A comparison should not be made between a taxable person and a non-taxable person, but only between two taxable persons. It does not constitute an infringement of Art. 87 (1) EC, simply because the condition of it being an intervention by a State – a requirement for it to constitute incompatible aid – is not met. The right to deduct input VAT derives directly from the VAT Directive.

The statements on the so-called allocation rights and on the extent of the liquidity advantage are also of general interest. Without quoting the statements it made in the "VNLTO" decision (ECJ, ruling of 12 February 2009 – case C-515/07), the ECJ has reinforced its previous position on the so-called allocation rights, at least in relation to capital goods:

- The company can continue to allocate capital goods wholly to its business, even if they are not primarily used for business purposes, and to claim the full input VAT deduction, provided that this is not precluded under § 15 (2) UStG.



Clarification is also provided by the ECJ's statements on input VAT deduction when the taxable person generates only VAT-exempt turnover, or, more precisely, VAT-exempt turnover with no possibility of input VAT deduction. In these cases, the taxable person is not helped by the "Seeling" ruling, either:

- The company cannot claim input VAT deduction, not even via taxation of goods and services provided free of charge for private use if it otherwise generates only VAT-exempt turnover which rules out the deduction of input VAT (BFH, ruling of 11 March 2009, ref. no. XI R 69/07).

The ECJ thus confirms the judgement of the German Federal Tax Court on the prohibition of input VAT deduction in respect of objects wholly allocated to the business assets and partly used for non-business purposes if the taxable person otherwise generates only tax-exempt turnover which precludes input VAT deduction.

Note:

The ECJ's "Seeling" ruling still offers a not insignificant financial advantage where non-business but not necessarily private usage is classed as a taxable good or service provided free of charge. In cases of turnover which is only VAT-exempt, such as a VAT-exempt lease, VAT-exempt financial services, etc., the exploitation of the "Seeling" principles is prevented. These principles can only be applied for activities subject to VAT, or for VAT-exempt activities on which input VAT deduction is permitted (for example, export revenues).

German Federal Tax Court: influence of the recipient's VAT identification number on place of supply

One of the questions referred to the ECJ in the German Federal Tax Court's decision of 1 April 2009 (reference for a preliminary ruling) is that of the place of supply of a service in accordance with § 3a (2) (3) (c) (1) and (2) UStG (valid to 31 December 2009).

The case

The case concerns a German biotechnology company which operates in the field of tissue engineering.

In its laboratory it grows cells from cartilage taken from patients. These cells are implanted back into the patient in the form of a collagen membrane. The purchasers of these cell proliferation services are based outside Germany and have foreign VAT ID numbers, which the German company recorded in its invoices.

Reference for a preliminary ruling made to the ECJ, decision of 1 April 2009 (ref. no. XI R 52/07)

The BFH initially rejects classification as a supply of goods and assumes that the German company's business activities – proliferation of cells – are a service, in the absence of transfer of the power of disposal over the removed cells. The BFH poses the question to the ECJ as to whether:

- the cartilage removed from the patients is movable physical property;
- the cell proliferation can be viewed as "work" in the sense of § 3a (2) (3) (c) (1) UStG;
- the transfer of the place of supply as described in § 3a (2) (3) (c) (2) UStG already applies if the supplier of the service indicates the VAT ID number of the supply recipient in its invoices;
- and, finally, assuming the place of supply is in Germany, whether the tax-exemption norm of § 4 (14) UStG interpreted as curative treatment in human medicine can be applied.

Of particular importance for the harmonised common market is the issue of using the VAT ID numbers. In their VAT guidelines (Section 36 (6) (3) in conjunction with 42c (3) UStR 2008), the tax authorities stipulate that in general, for a potential transfer of place of supply, an explicit agreement must be made on the usage of the VAT ID number before the goods or services are supplied. Clearly, the BFH does not share this opinion. For the BFH, such an additional agreement neither facilitates trade nor can it be derived from the wording of the relevant directive. The ECJ's answer to this particular question and, above all, how its answer is influenced by potentially differing instructions in other Member States will be of interest.

Note:

From 1 January 2010 there will be no special rules regarding the place of supply for work performed on movable physical property in the area of services provided by companies for other companies (so-called business-to-business turnover)..

The place of supply of such services will be determined from 1 January 2010 in accordance with the new regulation on business services – § 3a (2) UStG – and will no longer depend on the VAT ID number used. Rather, the place of supply will be the place where the recipient's business operates, provided that the recipient is receiving the service on behalf of his company. According to the legal reasoning, however, the VAT ID number will continue to play a decisive role: if the recipient of the supply provides a foreign ID number, the service will be classified as having been used for his business. In addition, the recipient of the supply should run his business in the country from which the VAT ID number he uses originates. Thus, the question referred to the ECJ as to what should be understood by "the VAT ID number used" has grown in importance, even for the legal situation after 1 January 2010.

German Federal Tax Court: electricity as a dependent ancillary service

Pursuant to § 4 (12) (2) UStG, only short-term leases of camping areas are subject to VAT; this is not the case for long-term leases. Contrary to Section 78 (3) (7) in conjunction with Section 76 (6) (1) UStR 2008, the BFH's ruling of 15 January 2009 (ref. no. V R 91/07) adjudged the supply of electricity by campsite operators to be a service ancillary to the lease of the land. This case concerned a dispute between the tax authorities and a campsite operator who, in addition to the leasing of pitches to long-stay campers, also treated the provision of electricity as a tax-exempt supply in accordance with § 4 (12a) UStG. The BFH concurred with the campsite operator and treated the supply of electricity as a tax-exempt service ancillary to and dependent on the lease, as described in § 4 (12a) UStG.

Note:

According to the latest interpretation of the BFH, the distinction between an independent and a dependent ancillary service is defined exclusively from the perspective of an average consumer and takes into account the nature of the turnover in question. The ultimate consequence is that this removes from the company any possibility of making an independent assessment. However, the BFH did confirm its assessment criteria laid down in its ruling of 24 January 2008 (ref. no. V R 12/05). In this decision the BFH again interpreted the provision of electricity and water to market stalls as a service ancillary to and dependent on the leasing of pitches, and rated the supply overall as tax-exempt in accordance with § 4 (12a) UStG.

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