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## Content

European Court of Justice:  
cleaning of common parts of an  
apartment block not a tax-exempt  
service ancillary to lease

European Court of Justice:  
input VAT deduction as part of a  
disposal of shares

European Court of Justice:  
transfer of a portfolio of insurance  
contracts subject to VAT

German Federal Tax Court:  
implementation of the ruling of  
the European Court of Justice in  
the Salix case

German Federal Tax Court:  
indirect economic integration as  
part of a VAT group

Draft of an act to implement EU  
tax provisions and other tax rules

Preview

Seminar Notes



## Editorial

Asset or share deal? This is one of the many decisions sellers and buyers have to make with regard to corporate transactions. The question is also relevant to VAT law, because the VAT treatment of transfers of companies varies across the Member States and is subject to complex regulations. The related judgment on the disposal of shares, passed by the European Court of Justice in the "AB SKF" case, concerns in particular the question of whether input VAT can be deducted on a share deal and moreover, a treatment as a non-taxable transfer of a business as a going concern could be considered.

This edition of our newsletter also provides information about two other important rulings issued by the European Court of Justice. One of them ("RLRE Tellmer Property sro") deals with the invoicing of costs ancillary to the zero-rated leasing of property and necessitates a review of the current treatment under German law. The other ("Swiss Re Germany Holding GmbH") answers the questions referred by the German Federal Tax Court on the transfer of portfolios of insurance contracts.

We also present a further ruling by the Federal Tax Court on VAT groups. The questions on economic and organizational integration are often of practical importance to companies.

In the last article, our newsletter offers an insight into a new draft act, the "Act to implement EU tax provisions and other tax rules." Alongside the VAT exemption for universal postal services, the draft also contains planned amendments to EC Sales Lists in conjunction with the VAT package 2010.

I would like to wish you all the best for 2010 and look forward to continuing to welcome you as a reader in the New Year.

Yours

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Partner, Frankfurt



## European Court of Justice: cleaning of common parts of an apartment block not a tax- exempt service ancillary to lease

ECJ, ruling of 11 June 2009 (case C-572/07— RLRE Tellmer Property sro)

In its ruling of 11 June 2009 concerning supplies in the Czech Republic, the European Court of Justice (ECJ) stated its position on the scope of VAT exemption on leases. At issue was the question of whether separately invoiced cleaning of common parts of an apartment block can be VAT exempt as a dependent service ancillary to a VAT exempt lease (see § 4 (12a) UStG for leases in Germany). First of all, the ECJ emphasizes – in line with its previous judgments – that the meaning and scope of the term lease are autonomous within Community law and thus must be given a definition that is independent of any civil law peculiarities at national level. From this, it concludes that, even if the service of cleaning the common parts of a building accompanies the lease of the property, it does not necessarily qualify as a VAT exempt leasing activity. If, as in the reference case, the cleaning service is invoiced separately, the ECJ does not see any reason to VAT exempt it as a dependent service ancillary to the lease, because, under these circumstances, the two services can be separated from each other.

### The case

In the case under consideration, an owner of rented apartment blocks claimed that the costs of cleaning the common parts of these apartment blocks, for which it invoiced its tenants separately, should be VAT exempt. The cleaning work was carried out by employed caretakers. Whereas the lessor invoked the principles of principal and ancillary supply, the Czech tax authorities believed the cleaning charges should be subject to VAT.

#### **Please note:**

Until now, the German authorities have treated the “supply of heat, water, and warm water, the provision of washing machines, the cleaning of hallways and stairs, and the provision of stairway lighting” as VAT exempt ancillary supplies (Section 76 (5) sent. 3 of the VAT guidelines (UStR 2008)). It will no longer be possible to maintain this view to the full extent in the light of this ECJ ruling, at least in situations where premises are not provided for the sole use of the tenants and the services that extend beyond the lease are invoiced separately. The German Federal Ministry of Finance (BMF) already gave its views on the supply of electricity as ancillary to a lease in its guidance of 21 July 2009. Concerning electricity the BMF agreed with a judgement of the German Federal Tax Court and did not preclude anymore VAT exemption (see the August/September edition of the VAT Newsletter) It remains to be seen whether the financial authorities will give an updated statement of their position on ancillary services.

## European Court of Justice: input VAT deduction as part of a disposal of shares

### ECJ, ruling of 29 October 2009 (case C-29/08 – AB SKF)

In its ruling of 29 October 2009, the ECJ gave a broad response to questions relating to the disposal of shares. The matters in question concerned whether:

- the disposal of shares constitutes a taxable transaction;
- such a transaction might be regarded as a non-taxable transfer of a business;
- a taxable disposal is exempt from or subject to VAT;
- it is possible to deduct input VAT on the input services purchased in connection with the disposal, if the purpose of the disposal was to obtain funds to finance other activities of the group;
- it is of significance if the disposal takes place in stages.

#### Disposal of shares

Taking into consideration its previous rulings on the scope of economic activity of a holding, the ECJ initially confirms that the acquisition and holding of shares only constitute economic, i.e. business, activity if the share acquisition is carried out in order to secure involvement in the management of the company in which the holding has been acquired, where it constitutes a direct, permanent, and necessary extension of a taxable activity, or when it is carried out as part of a commercial share-dealing activity. For the purposes of equal treatment and in compliance with the principle of neutrality, the ECJ recognizes the disposal of holdings as being of an economic nature when the holding itself was qualified as an economic activity.



#### Transfer of a business as a going concern

VAT Directive 2006/112/EC grants Member States the right to treat the transfer of a totality of assets or a part thereof – whether for consideration or not – as not being a supply of goods or a supply of services. Although holders of shares cannot, from a legal perspective, sell the assets of the company in which they hold those shares, the ECJ nevertheless permits classification as a (non-taxable) transfer of a business as a going concern if the disposal of the shares entails the total or partial disposal of the assets of the company concerned. The question, however, of how the business disposing of the holdings might prove this has not been clarified.

#### VAT exempt sale of shares

With reference to Art. 135 (1) f) of the VAT Directive 2006/112/EC – which corresponds to § 4 (8) f) and e) German VAT Law (UStG) whereas in accordance with § 9 (1) UStG, an option of VAT liability does exist – the ECJ endorses VAT exemption if the disposal of shares is taxable. It is thus regarded as a transaction in shares and securities, because the disposal is liable to create, alter, or extinguish parties' rights and obligations in respect of securities.

#### Input VAT deduction on input services connected to the disposal of shares

Citing its ruling in the Cibo case (ECJ, ruling of 27 September 2001, case C-16/00), the ECJ again stresses that input VAT deduction is only permissible if a direct and immediate link exists between the input transaction in question and an output transaction that gives rise to an entitlement to deduct and, in particular, is not VAT exempt. In his Opinion of 12 February 2009, the Advocate General took

the stance – which, incidentally, matched the interpretation of the German Federal Government – that a direct and immediate link can always be drawn between the input services under discussion and the VAT exempt disposal of shares, thus precluding deduction of input VAT. In contrast, the ECJ draws attention to the fact that the purpose of the disposal of shares was to raise capital to finance the group's other activities. It is therefore conceivable that the expenditure incurred can either be incorporated into the price of the shares (in which case deduction of input VAT would be ruled out) or can be assigned to the cost components of the company's products (in which case deduction of input VAT would be permissible), a decision which, incidentally, is the responsibility of national courts. To sum up, the ECJ holds that a direct and immediate connection exists if:

- the input transaction is either linked in this way to a taxable output transaction and the cost of the input transaction is incorporated into the price of this output transaction, or
- the expenditure incurred for the input service can be attributed to general costs, which are linked to the company's economic activity as a whole, provided that the costs of the input service are components of the costs of the goods or services that the company supplies or provides as part of its economic activity.

The ECJ expressly establishes treatment that is equal to those cases in which the possibility of input VAT deduction without taxable output transactions – such as the *Cibo* case – had to be considered and, in the absence of a taxable output transaction, was only based on allocation to general costs.

### Disposal in stages

The question of the disposal taking place in stages is, in the ECJ's opinion, insignificant, provided that the disposal occurs within the context of the overall transaction.

### The case

The issue in question was the right to deduct input VAT of the Swedish stock corporation AB SKF, which intended to dispose of its holdings in two subsidiaries, a 100% shareholding in company A and a 26.5% shareholding in company B. It planned to dispose of these holdings in order to obtain funds to finance other activities of the group. The possibility of deducting input VAT arose from services related to the valuation of the securities and legal advice.

#### **Please note:**

The latest ECJ judgment marks a continuation of the so-called holding rulings. It is in line with the guidance from the German Federal Ministry of Finance (BMF) from 26 January 2007 (ref. no. IV A 5 – S 7300 – 10/08 – para. 13), according to which the disposal of shares held for business purposes is VAT exempt. The question of a possible transfer of a business as a going concern is, however, not dealt with by the BMF guidance. It also sets out a different approach to assessing input VAT deduction. Whereas the tax authorities only wish to preclude input VAT deduction in all cases involving a VAT exempt disposal of shares (exception: customers from outside the EU), the ECJ, on the other hand, advocates ascertaining which costs the expenditure incurred as a result of the input service had been incorporated into. The business is, however, required to make a declaration and provide evidence if necessary.

## European Court of Justice: transfer of a portfolio of insurance contracts subject to VAT

### ECJ, ruling of 22 October 2009 (case C-242/08 – Swiss Re Germany Holding GmbH)

In its ruling of 22 October 2009, the ECJ set out its position on the VAT treatment of a transferred portfolio of insurance contracts. The main question under dispute was whether such a transfer constitutes a supply of goods or a supply of services and, consequently, whether this supply can be VAT exempt as a supply of financial services or an insurance transaction. To begin with, the ECJ does not regard a portfolio of insurance contracts to be tangible property and therefore considers the transfer to be a supply of services. As the transfer of a portfolio of insurance contracts is separate from the services to be performed under an insurance contract, the ECJ rejects classification as an insurance transaction and thus application of the VAT exemption in accordance with Art. 135 (1) a) of the VAT Directive (cf. § 4 (10) a) UStG). It also excludes treatment as a banking or financial transaction as defined in Art. 135 (1) a) to g) of the VAT Directive (cf. § 4 (8) a) to i) UStG) because, for the latter, the purpose of VAT exemption is not fulfilled. Finally, the ECJ also rejects splitting the service into a transaction concerning debts – if the insurance contract being transferred has a positive value – and an assumption of obligations – if the insurance contract being transferred has a negative value. The decisive factor is the contractual acquisition of all insurance contracts at an overall price. Citing its treatment of the supply in question as a service, the ECJ rejects application of the VAT exemption in accordance with § 4 (28) UStG. As a result the transfer of a portfolio of insurance contracts is subject to VAT.



### The case

In the case under review, an insurance company based in Germany considered that the transfer of a portfolio of a total of 195 life insurance contracts to an insurance company based in Switzerland should be VAT exempt. A negative value was fixed for a number of the transferred contracts, reducing the overall cost of acquiring all of them. The transferred insurance contracts concerned exclusively undertakings established in Member States other than Germany or in third States, which had to give their consent to the transfer.

#### **Please note:**

The treatment of these supplies as supplies of services means that, from 1 January 2010, and in compliance with the new basic business-to-business rule in § 3a (2) UStG, the place of supply of such services will always be where the recipient runs his business. The question of whether such a portfolio transfer could be considered a transfer of a business as a going concern (not taxable pursuant to § 1 (1a) UStG) remains unanswered. It is also unclear whether, in derogation of Section 24 (1) sent. 2) UStR, a transfer of a client base is to be treated as a supply of services.

## German Federal Tax Court: implementation of the ruling of the European Court of Justice in the Salix case

### BFH, ruling of 20 August 2009 (ref. no. V R 70/05)

In its ruling of 20 August 2009, issued as a subsequent decision in line with the ECJ's ruling in the Salix GmbH & Co. KG case (ECJ, ruling of 4 June 2009, case C-102/08), the BFH stipulated that the leasing or letting of immovable property by a legal body governed by public law is to be treated as a business activity. At issue was the KG's (limited partnership's) input VAT deduction in the context of the construction of a building subsequently leased to a legal body governed by public law that sub-let parts of it to third parties subject to VAT. The KG wanted to establish its leasing activity as tax-liable – and thus obtain an input VAT deduction – by exercising its right of option for taxation. The BFH clarified that in the first place, the legal body under public law has been pursuing a business (i.e. economic according to the VAT Directive 2006/112EC) activity with its long-term leasing activity, as it has acted on the basis of private law. Although the VAT Directive allows such a fundamentally VAT exempt activity to be regarded as a public service operation, and thus non-economic, conformity with the ECJ's declaration requires a statutory provision to this end, which is lacking in Germany. This explains why the legal body in this case was, for its part, able to exercise its option for taxation and perform transactions granting an input VAT deduction, thereby enabling the KG, for its part, to exercise its option and also secure an input VAT deduction, as desired.

### The case

The property leasing company Salix GmbH & Co. KG (KG) constructed and leased an office building and underground car park to the Industrie- und Handelskammer (IHK) Offenbach (Chamber of Industry and Commerce, Offenbach). The IHK used a part of the building and car park for its own purposes, and sub-let the other part of them both on a long-term basis to third parties subject to VAT. On the grounds of its option for taxation of its leasing transactions, the KG claimed a deduction of the input VAT paid in connection with the construction of the building and underground car park.

#### **Please note:**

Germany's legal provision in § 2 (3) UStG has to be interpreted in line with Community law. Alongside its notice that a statutory provision is always required in order to realize the possibility, allowed by Art. 13 (1) (2) of the VAT Directive 2006/112 EC, of treating an (economic) VAT exempt activity the same as a public service operation, the ECJ also issued further clarifications regarding the scope of distortion of competition according to Art. 13 (1) (2) of the VAT Directive 2006/112/EC. On the one hand, such distortion must also be checked for in cases where a legal order allowing equal treatment as defined by Art. 13 (2) of the VAT Directive 2006/112/EC is in place. On the other hand, such distortion is also at work even if competition is distorted to the detriment of the legal body. In this respect, the very presence of a distortion of competition cannot exist if a legal body governed by public law is excluded from an input VAT deduction.

## German Federal Tax Court: indirect economic integration as part of a VAT group

BFH, ruling of 20 August 2009 (ref. no. V R 30/06)

In a further ruling on 20 August 2009, the BFH restated its fundamental position on the requirements for a VAT group as defined in § 2 (2) no. 2 UStG. Only an economically active entity can be a controlling enterprise. Legal bodies governed by public law are also suitable to be controlling enterprises, as long as they are conducting activities under the same legal conditions as private sector participants. This can be assumed to be the case if they are supplying their services on the basis of private law. The BFH now also considers organizational integration to already be in place whenever "management-level employees of the controlling enterprise are working as directors of the group subsidiary." By means of these management-level employees, the controlling enterprise can exercise the same influence on the senior management as in cases of personnel interconnection at the management levels of the controlling enterprise and group subsidiary. For economic integration, the business areas of the controlling enterprise and group subsidiary must be interconnected. Economic integration can also arise when the business areas of various group subsidiaries are interconnected (indirect economic integration). The supply of a service of considerable importance (cf. BFH, ruling of 18 June 2009, ref. no. V R 4/08) is always required and was found lacking by the BFH in this case, where the potential controlling enterprise only charged its subsidiary for the supply of services in the areas of bookkeeping, human resources, payroll accounting, and tax advisory. Irrespective of the question as to whether the controlling enterprise uses these services for business or non-business purposes, services supplied within the scope of the group constitute so-called internal services which can be charged free of VAT if the group has VAT group status.

### The case

The question at issue was whether VAT group status was applicable to the connections between a limited liability company and its majority shareholder, a river cooperative as a legal entity governed by public law. The river cooperative provided the limited liability company with biosolids treated free of charge. The limited liability company then processed these biosolids with further additives into fuel for the river cooperative. The river cooperative charged for the services it supplied to the limited liability company in the areas of bookkeeping, human resources, payroll accounting, tax advisory, and staff provision. Alongside its stake in the limited liability company, the river cooperative also held an 80% stake in a further limited liability company T that let the drying facilities to the limited liability company on property leased by the river cooperative.

#### **Please note:**

The BFH has now specified its comments on organizational integration from its ruling of 3 April 2008 (ref. no. V R 76/05). The interconnection of management personnel between the dominant enterprise and the group subsidiary that was required by that ruling is now only a general requirement for organizational integration. Without defining what "management-level employees" are, the BFH now allows these persons' work at the group subsidiary to suffice in this regard.

## Draft of an act to implement EU tax provisions and other tax rules

### Draft of 17 November 2009

The draft now available envisions a series of important changes in the area of VAT, to enter into force on 1 July 2010 (changes concerning § 27a UStG: on 1 January 2010). The points concerned include a complete re-design of tax-exemption for the supply of universal postal services (§ 4 (11b) UStG) as well as the harmonization of § 18a UStG (EC Sales Lists) with the relevant directive's provisions (Directive 2008/117/EC of 16 December 2008). Among other stipulations, EC Sales Lists must be submitted in general by the 25th day of the following calendar month. Permanent deadline extensions shall not be granted. According to the new rules, only the supply of services that are taxable in another EU Member State as per § 3a (2) UStG must be explicitly reported in the area of supply of services. This reporting requirement only applies when the service recipient runs his business in another Member State, owes taxes at their location for said supply of services.

This is in line with the instructions for filling out the 2010 provisional VAT return and the EC Sales List from 1 January 2010 on (see the [VAT Newsletter of November 2009](#)). These instructions can be taken as information anticipating the planned legal changes. In this respect, the wording of the currently applicable German law goes beyond the requirements of the VAT Directive 2006/112/EC. Supplies of services for which the place of supply, elsewhere within the Community, is determined by a special business-to-business arrangement, e.g. supplies of services connected with immovable property falling under § 3a (3) UStG, must therefore be entered in line 42 of the provisional VAT return and not included in the EC Sales List for the German Federal Central Tax Office, with effect from 1 January 2010.

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## Preview

The next VAT Newsletter will contain the following important information (we received the topics just after editorial deadline):

### ECJ on signature in VAT refund procedure

“ ‘Signature’ of an application for a refund of value added tax, as referred to in the specimen form set out in Annex A to the Eighth Council Directive 79/1072/EEC of 6 December 1979 on the harmonisation of the laws of the Member States relating to turnover taxes – Arrangements for the refund of value added tax to taxable persons not established in the territory of the country, is a Community law notion which must be interpreted uniformly to the effect that such a refund application need not necessarily be signed by the taxable person in person and that the signature of an agent may be sufficient for those purposes.” – see ECJ, ruling of 3 December 2009 (case C433/08 – Yaesu Europe BV).

### BMF on VAT refund procedure as of 1 January 2010

The BMF guidance dated 3 December 2009 (IV B 9 - S 7359/09/10001) includes important information on the input VAT refund procedure as of 1 January 2010. The BMF takes the position for the process of foreign resident businesses in Germany. Furthermore, an indication will be given to German resident businesses for the filing of application in other EU Member states and third countries.

## Seminar Notes

### VAT 2010

18 February 2010 in Frankfurt

23 February 2010 in Dusseldorf

24 February 2010 in Berlin

25 February 2010 in Munich

2 March 2010 in Hamburg

3 March 2010 in Nuremberg

4 March 2010 in Stuttgart

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For more information to the seminars listed above

<http://www.kpmg.de/Umsatzsteuer2010.html>



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## International Network of KPMG

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You can also get up-to-date information via the homepage of [KPMG Europe LLP](#)\* with Belgium, Commonwealth of Independent States (CIS), Germany, Luxembourg, the Netherlands, Switzerland, Spain, Turkey and United Kingdom as member firms.

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\*Please note that neither KPMG International nor KPMG Europe LLP provide any client services.

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