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Official Pronouncements

Organisational integration of a VAT group

A VAT group is conditional on financial (common shareholding of at least 50%), organisational and business integration. Organisational integration means that the subsidiary must follow the instructions of the parent without being able to develop a will of its own. Business integration means that the business of the subsidiary must support or complement that of the parent. Consequently a company without an active business (e.g. an intermediate holding company) cannot be a VAT group member. However, the ECJ held a year ago that the VAT Directive does not exclude a non-business from membership of a VAT group merely for that reason alone (case C-85/11 *Commission v. Ireland* judgment of April 9, 2013). The Supreme Tax Court has also tightened its organisational requirements on a subsidiary to qualify as a group member. Under the new definition it is no longer sufficient to show that the subsidiary cannot develop a will of its own. The parent must be able to enforce its own will at all times. This can be through common directors, or through the appointment of an employee of the parent as managing director of the subsidiary (judgment VR 18/13 of August 8 2013).

The finance ministry has now taken the view that the ECJ case cited permits but does not require a member state to allow non-businesses into a VAT group. It therefore stands by its previous interpretation of German law. As a second point, it has amended the VAT Implementation Decree to require a more definite involvement of the parent in the management of the subsidiary. This involvement can be through an associated company outside the VAT group, although the involvement does not bring a non-business associate into the group.

Reverse charges in the building trade

The VAT Act provides for reverse charging building and related work for other businesses in the same trade. The VAT implementation decree specified that the recipient's building activity must be more than purely nominal, that is, it should have accounted for at least 10% of turnover in the previous year. On August 22, 2013 the Supreme Tax Court held, following an ECJ judgment, that the reverse charge depended upon the recipient business's use of the supply for its own turnover of the same nature. On the other hand, the 10% limit had no basis in law and should be ignored, In consequence, some supplies that were previously reverse charged fell under regular taxation, whilst others previously taxed by the supplier now fell under the reverse charge scheme. The finance ministry published these judgments in its official journal on February 14, 2014 and amended its VAT Implementation Decree to follow the new law for all transactions completed after that date. It has now added to its decree to cover practical issues, especially with transactions in progress on the changeover date:

- The recipient of the supply furnishes proof that the supply is to be used for an onward supply of the same type with a written statement to the supplier. This statement may be made in the contract itself, or separately. It must, however, identify the project for which the supply serves as an input. The reverse charge obligation remains if, in the event, the supply is actually put to a different purpose, unless the supplier was aware the statement was false.

- A supply to one member of an *Organschaft* is reverse charged even if the qualifying output is made by another member.
- No objection will be taken to taxation under the previous rules of supplies made or started before the changeover date provided both parties take the same position.
- If payments in advance were taxed on the one basis and the final settlement after the changeover date is to be taxed on the other, both parties should amend their treatment appropriately. However, the amendment may be dispensed with if the recipient is fully entitled to input tax deduction and both sides take the same position. In that case, the final settlement will be taxed differently from the advance or progress payments.
- Invoices for advance or progress payments issued before the changeover date but not paid until afterwards are to be corrected to conform to the new rules, as the date of payment, rather than the date of the invoice is decisive in such cases.

Supreme Tax Court Cases

Final PE loss abroad offset at home

An ice cream manufacturer operated a loss making branch in Belgium. Ultimately, he decided to wind up the Belgian venture and sell the assets. This resulted in a further loss. The Belgian tax office recognised the German taxpayer's right to a loss carry forward. The German tax office took this to mean that the taxpayer still had a theoretical possibility of offset in Belgium and that it was therefore not called upon to allow the loss in Germany as "final".

The Supreme Tax Court has now held that the Belgian loss must be allowed in Germany once it is clear that there is no longer a realistic prospect of obtaining relief in Belgium. This follows from repeated ECJ judgments in the same vein. The prospects of obtaining relief can be denied for either legal or for practical reasons. The legal entitlement of the taxpayer to an indefinite carry forward in Belgium was not, in the case at issue, in dispute. However, the taxpayer maintained, and the court agreed with him, that having effectively sold the Belgian business, he had ceased to earn Belgian business income, and thus no longer had anything against which the loss could be offset. That the Belgian business had been closed down and the appropriate notices sent to the respective authorities was for the court, sufficient evidence of the lack of intention to earn income in Belgium. The loss was therefore "final" and, as such, to be relieved in Germany. Should by any manner of chance, relief become available in Belgium at some future point, the German deduction could be reversed under the "new facts" provision of the Tax Management Act. There was thus no chance of abuse.

Supreme Tax Court judgment I R 48/11 of February 5, 2014 published on April 23

Old "thin cap" rule breaches non-discrimination clause of double tax treaty

Up to 2007, interest paid to a foreign shareholder with at least 25% of the share capital or his related party was disallowed to the extent the "thin capital" rule came into play. This rule required that interest bearing shareholder finance did not exceed initially three times the shareholders' equity. Later, this debt/equity ratio fell from 3:1 to 1.5:1. In 2010, the Supreme Tax Court held that the debt/equity ratio breached the non-discrimination clause of the Swiss double tax treaty – because it disallowed an expense merely because of the foreign shareholder. The Supreme Tax Court has now confirmed this finding in a second judgment on the loan taken out by a GmbH with an Irish bank in order to finance a local business acquisition. The GmbH and the bank were related parties as they were both wholly-owned by the same US company. The terms of the loan were at arm's length, although the amount brought the debt/equity ratio well over the allowed limit. However, application of the rule was precluded by the non-discrimination clause in the US double tax treaty. The court emphasised that, in this regard the Swiss and US treaties followed the OECD model treaty, thus giving a clear message that the old "thin capital" would not generally be applicable to companies held from treaty countries.

For 2008, the "thin capital" rule was replaced by the "interest limitation" basically restricting the deductible net interest expense to 30% of EBITDA. However, the interest limitation does not apply in a number of cases (such as where the total net interest cost for the year does not exceed €3 m, the borrower is not part of a group or where at least 90% of the net interest expense is paid to creditors with an equity interest of no more than 25% in the company). The "interest limitation" does not obviously discriminate against foreign owners; however the present case against the "thin capital" rule may well offer support in developing arguments against its successor.

Supreme Tax Court judgment I R 30/12 of January 16, 2014 published on April 9

Interest limitation unconstitutional?

A family-owned GmbH with a network of 13 foreign subsidiaries objected to the interest limitation rule as being in breach of the constitutional requirement for equality of taxation in like circumstances. This rule essentially disallows net interest expense in excess of 30% of EBITDA. However, it does not apply to businesses that are not members of groups and it also does not apply where the annual net interest expense is under €3 m. According to the official explanation at the time, it was introduced to replace the "thin capital" rule rejected by the ECJ and was intended to meet the same objective of countering the perceived abusive practice of shifting taxable income abroad through interest expense. However, it cannot openly discriminate against payments to institutions in other EU member states and thus applies to all interest payments regardless of the location of the recipient.

The Supreme Tax Court has confirmed in a resolution granting a stay of execution pending a final court decision that there is doubt as whether the interest limitation meets the constitutional requirement of equality of taxation. It applies indiscriminately, regardless of any suspicion, or even possibility, of abuse, and thus goes beyond what is necessary to achieve its legitimate object. Start-ups, companies in financial difficulties and interest paid to German lenders were quoted as examples. On the other hand, it does not apply to companies with a total interest expense of (now) less than €3 m or to businesses that are not members of groups. It therefore does not "catch" all possible abuses and may therefore be an unsuitable tool in respect of its stated object. The court also pointed out that its total revenue is only minor in relation to tax revenue as a whole and that only relatively few taxpayers are affected. Hence possible overriding considerations in the public interest lose their significance.

Supreme Tax Court resolution I B 85/13 of December 18, 2013 published on April 16, 2014

Group tax considerations not good cause for breaking local tax group agreement

A German operating subsidiary of a British group was held by a KG (limited partnership) wholly owned by the Dutch country holding of the British parent company. This four-tier structure was essentially disadvantageous in that it led to UK taxation of German income under CFC rules. However, it also enabled the operating subsidiary to conclude a profit pooling agreement with the KG, its immediate parent, in order to offset its own trade tax profits with the losses brought forward by the latter. Such profit pooling agreements must run for five full years and may only be cancelled for good cause. During the course of the agreement, the KG changed the year-end of the subsidiary and, with the same effective date, sold its shares to the German country holding for the rest of the group's operations. The tax office refused to accept the profit pooling agreement.

The Supreme Tax Court has now upheld the tax office position, although with a more detailed reasoning. Its first point was that the change of year-end meant that the agreement would now run for less than the full five years originally agreed. However, the measure was the agreement at the time of signature. It remained open to the parties to ensure in the final year that it did, in fact, run for at least 60 months, such as by agreeing an extension to the new year-end of the subsidiary. This first finding in favour of the group was, however, nullified by the court's next point, that the sale of the shares in the subsidiary within the group was not a sale for "good cause". It emphasised that the purpose of the provision was to ensure that tax groups were not formed or broken arbitrarily to suit the needs of the moment and a “good cause” could only be accepted as such, if it lay beyond the sole influence of related parties (e.g. a sale of the shares to outside interests). Foreign tax considerations were irrelevant, the more so in this case, given that the UK CFC rules were known when the agreement was signed. The court mentioned the possibility that the parties might have intended on signature to cancel the agreement once its German object of trade tax loss offset had been fulfilled, but did not expand on this beyond saying that such intent would in any case call the five-year minimum period into question. Its conclusion was that a change of circumstance solely at the behest of the ultimate parent did not meet the tax law requirement for the exclusion of arbitrary application of the rules.

Supreme Tax Court judgment I R 45/12 of November 13, 2013 published on March 26, 2014

Application for tonnage tax from year of first voyage

Up to December 31, 2005 application for tonnage tax on the income from ships sailing in international waters was to be made in the year of the first earnings or in one of the two years immediately following. The finance ministry took this to mean that the first year of the application period was the year in which the first, incidental, operating income was earned or expense incurred. On this basis a tax office rejected an application for tonnage tax made in the year of a newly built ship’s maiden voyage as having been filed out of time. It pointed out that the first operating expense – “negative income” – had been incurred over three years ago. The expense referred to was bank interest on a loan taken out to finance the first instalment paid to the shipbuilders.

The Supreme Tax Court has now contradicted this position by holding that the application period does not begin to run until all the conditions are met. This includes actual operations in international waters. Thus the tonnage tax application for a new ship cannot be filed before the year of her maiden voyage.
It should be noted that the law changed for 2006. From then on, application for tonnage tax must be made in the year in which the ship was taken into commission. Earlier incidental income or expense is to be ignored.

Supreme Tax Court judgment IV R 15/13 of January 16, 2014 published on April 30

Tonnage tax option does not exclude partner’s earnings prior to commissioning

Under the tonnage tax provision of the Income Tax Act the option for tonnage tax must be exercised in the year the ship is commissioned and takes effect from the beginning of that year. Profits and losses stemming from the ship in prior periods, e.g. while she is being fitted out or working up, are to be set to zero, if necessary in retrospect. Shipping partnerships allocate their tonnage tax income to the partners in profit-sharing ratio. Charges by partners for their services to the partnership are allocated to them separately as additional elements of partnership income outside the scope of the tonnage tax rules. The Supreme Tax Court has now held that this latter provision also applies to such charges during the pre-commissioning period.

This judgment fell in response to a claim that the rule on partners’ services does not specifically mention periods before the option, and the rule setting the results of those periods to zero should therefore apply to the full partnership earnings of each partner. However, the court looked to the purpose of separating partners’ services from tonnage tax operations – to close a loophole allowing employees and others with a very minor partnership share to tax their remuneration on a very small portion of the tonnage base. It saw this purpose as equally relevant before and after commissioning and therefore decided that any ambiguity in the wording of the provision should be resolved in favour of a common approach.

Supreme Tax Court judgment IV R 19/10 of February 6, 2014 published on March 26

No refund of electric power tax on customer bad debt

A regional electricity company claimed a refund of the electric power tax implicit in its bills to customers that had since become irrecoverable through death or bankruptcy of the debtor. The customs office refused for lack of a legal provision and declined to accept arguments based on general principles. The Supreme Tax

Court has now confirmed this position.

Electric power tax, like other excise taxes and duties, is constituted as a tax on the supplier to be passed on to the final consumer through its effect on the price charged. However, there is no direct link through the invoicing chain and the amount involved is not shown separately. The company argued that it regularly suffered from customer bad debts and that in these instances the purpose of the tax was missed, it being left with the burden. It should therefore be entitled to a refund under the provision in the Tax Management Act allowing a tax office to waive a tax charge otherwise due, though manifestly unfair in the circumstances. To this the court replied that customer bad debt was a general feature of the operating circumstances of electricity companies and that at some 0.12% the present company's bad debt ratio was not exceptional. A refund could not be granted under a provision intended for special circumstances, and a claim could also not be based on a perceived failure of tax purpose merely because the burden could not, in the event, be passed on. As the court pointed out, any business was faced with the possibility of not being able to pass on to its customers all excise duty borne on its costs, but this did not invalidate the concept.

The company then argued that it should be entitled to a refund under the equal treatment requirement of the constitution by analogy to the refund available to suppliers of fuel oils (petrol and diesel) on default of their customers. The court refused this, too, saying that the two sets of circumstances were not the same. The excise duty on petrol and diesel was some 50% of the price charged to the filling station (author's note: electric power tax is charged at a flat rate of €20.50/MWh, which is well below 10% of the price charged to households) and the refund mechanism had been enacted specifically at the request of the oil lobby. In any case, the petrol duty refund was only available for individual amounts over €5,000.

Supreme Tax Court case VII R 8/12 of December 17, 2013 published on March 19, 2014

No constitutional doubt on trade tax charge on companies

A company operating a chain of filling stations on leased property objected to its disproportionate trade tax burden in comparison to that borne by sole traders or natural person partners. Its objections were based on the unequal treatment arising from the non-deductibility of the trade tax from the profit chargeable to corporation tax in the face of the (usually) significant relief from a trade tax credit against the income tax due. This lack of deductibility was exacerbated for corporations with significant rental costs due to the disallowance of one-quarter of the deemed implicit interest. The taxpayer also made the point that the lack of a trade tax deduction was inconsistent with the nature of the tax as a business expense. However, the Supreme Tax Court did not agree that any of these points offended against the constitution, in particular against the equal treatment provision or the ownership guarantee from excessive taxation.

The court based its judgment on the circumstances of the tax reform of 2007 taking effect for 2008. This reform abolished the deduction for trade tax as a business expense whilst introducing a significant relief from its burden in the form of a credit for natural persons. However, the same reform also cut the corporation tax rate from 25% to 15%. The object of the reform was to improve the apparent German tax climate in comparison to neighbouring countries by reducing the nominal rates of taxation whilst broadening the basis of assessment. This objective was constitutionally legitimate, particularly as there was no constitutional requirement for any aspect of the previous trade tax system. The corporation tax rate reduction reduced the effective tax burden on corporations and it was legitimate to partly compensate this with a trade tax increase in the interests of improving the transparency of the tax system. The reformed tax burden on corporations was not generally excessive and there was no constitutional requirement to levy the same burden on corporations and sole traders.

Supreme Tax Court judgment of I R 21/12 of January 16, 2004 published on May 7

Provision for insurance agent's future policy costs at conservative estimate

Insurance companies generally pay their agents a commission for each policy on conclusion of the contract. However the agents' agreements require them to service policyholders throughout the life of the policy for no further reward. This work is essentially administrative and is aimed at ensuring the insurance company is kept up to date on changes of policyholders' personal details – address, bank account and similar. It may also involve forwarding claims. To that extent, so the Supreme Tax Court, the agent has not yet fully fulfilled his contractual obligations towards the insurance company on receipt of his commission and must therefore provide for the remaining expense to be incurred. The provision is to be based on anticipated actual costs – i.e. it does not reflect the agent's own time and, to that extent, differs from the concept of unearned income – based primarily on past experience. Past experience should be supported by records kept by the agent of his activities. However, provision may still be made if the records are inadequate, although given that the agent is seeking to document a provision in his own interests, any estimate should be "at the lower end of the scale". The provision is for a long-term obligation and should therefore be discounted. The discount should run until the date of the first anticipated call on the agent's services for the particular policy. This, too, should be based on past experience appropriately documented.

Supreme Tax Court judgment X R 25/11 of December 12, 2013 published on April 23, 2014

Foreign tax credit to reflect personal allowances

The credit against the German tax due on foreign income is the lower of the foreign tax actually paid and the German tax to be charged on the income in question. Under the Income Tax Act, this comparison is to be made separately for each country of source (per country limitation) and the German tax to be charged is to be based on the tax due on the worldwide income allocated over the countries of source. A resident couple with investment income from Germany and six other countries disputed these calculations and pressed for credit limitation to the total incremental German tax due on the foreign income. The case went to the ECJ, which held that the limitation should be based on the comparison of the foreign income to the worldwide income remaining after deduction of the personal allowances and other reliefs based on individual personal circumstances. The main point made by the ECJ in this judgment was that personal reliefs should be granted by the country of residence and they should not be "watered down" by effective exclusion in proportion to the foreign income.

The Supreme Tax Court has now followed this judgment in respect of all personal allowances and reliefs except for the saver's allowance (€801 per person p.a.).This allowance is to be allocated over investment income from all sources, that is, over the foreign income in the proportion that income bears to the total. The court also turned to the calculation of the limitation on a per country basis. This is prescribed in the statute (Income Tax Act) and does not hinder the free movement of capital. On the contrary it is necessary in the public interest in the preservation of taxing rights between states. Otherwise Germany would effectively be crediting irrecoverable excess tax credit from one country against her claim to taxation on the income from another.

Supreme Tax Court judgment I R 71/10 of December 18, 2013 published on April 2, 2014 following the ECJ judgment C-168/11 *Beker and Beker* of February 28, 2013

"Stay away" days of hospital staff commuters to Switzerland

A German resident doctor worked in a Swiss hospital. His duties sometimes required him to remain on stand-by following the end of his regular shift and also to be on call at weekends for operations or for going round the wards. Since he was required to report at the hospital within ten minutes of being called in, he rented a small flat near his place of work as local accommodation. On such stand-by days or when he was required to work on weekends, he did not return to Germany at the end of his previous day's shift. He claimed to the tax office that he should count each day on which he did not go home to Germany for occupational reasons as a "stay away" day within the meaning of the cross-border commuter provision of the double tax treaty. This brought him over the treaty limit of 60 days with the consequence that his employment income became fully taxable in

Switzerland only. The tax office countered with its own calculation, bringing the total “stay away” days to slightly below 60, with the consequence of full taxation of the employment income in Germany relieved only by a credit for the Swiss tax deducted at source which should, however, not exceed 4.5% of the total salary paid. Any excess over this amount should be recovered in Switzerland.

The Supreme Tax Court has now gone a step beyond the tax office with its own calculation showing the “stay away” days to be far below the 60 day treaty limit. The protocol to the treaty specifically states that “the assumption of a regular return to the place of residence shall not be precluded by occupational circumstances requiring continuous work over several days”. Shift workers and hospital staff are mentioned in the protocol as examples. The Supreme Tax Court took this to mean that the doctor on stand-by following a regular shift could only count a single “stay away” day at the end of his stand-by or weekend duty and only then if he did not then return home to Germany for occupational reasons. Thus a period on duty on Friday, followed by stand-by over the weekend followed by the next period of regular duty on Monday gave Sunday as the single possible “stay away” day.

Supreme Tax Court judgment I R 23/12 of November 13, 2013 published on April 23, 2014

Shares sold to be specifically identified by serial numbers

The capital gain on shares sold depends on their base cost. This may not be immediately obvious if less than the entire investment in a particular stock is sold and the investment was acquired at different times from different sources. This was the case at issue before the Supreme Tax Court where the seller argued that the shares sold could not be specifically identified following a one-for-ten share split and the taxable gain from the sale should therefore be calculated taking the highest base cost first. The court, though, held that if it really was impossible to identify the specific source of an investment, the base cost should be taken as the average cost of acquisition. However, it would usually be possible to identify the individual shares sold by their serial numbers. This held true for the present case of a share-split following an acquisition, since the new shares issued could be directly linked to the old shares cancelled. The court also added that had a GmbH’s share(s) been sold, identification would have been clear from the contract of sale (a GmbH does not issue share certificates and shares do not have to be for identical amounts. Indeed, initially each shareholder often holds a single share for his or her portion of the share capital. If necessary, shares can be split – for example to facilitate the sale of only part of a holding – although splits will always be documented in the notarial deed for the primary transaction – e.g. contract of sale.)

Supreme Tax Court judgment IX R 45/12 of December 11, 2013 published on April 23, 2014

Charitable donations in other EEA countries only deductible if all German formalities are observed

A German taxpayer made a donation to the Russian Orthodox Church in Rome. The actual recipient was an Italian registered charity in the legal form of an association. The taxpayer sought a deduction in Germany on the grounds that the association served a charitable purpose recognised as such in Germany and that it would have qualified in Germany for the tax privileges of a charity had it been German resident. It thus met the formal requirements for tax relief on donations to EEA charitable associations. The tax office refused this request, stating that it was unclear that the association and its management had restricted themselves solely to the activities privileged under German law.

The Supreme Tax Court held that the objections of the tax office were irrelevant as the deduction was in any case to be disallowed by reason of a deficiency in the association’s charter. German law requires all charities to include provisions in their charters to ensure that any assets remaining on dissolution can only be used for charitable purposes. This fact must be apparent from the charter itself without reference to other documents. Typically, the requirement is met by naming the purpose for which the funds are to be used or the association to which they are to be transferred. The Italian charter in the case at issue provided that any remaining assets be transferred to a “non-business organisation, preferably one linked to the patriarchate in Moscow or belonging to the Russian Orthodox

Church". The Supreme Tax Court saw this wording as too vague as it did not, on its own, preclude the use of the funds for purposes not privileged under German law. The court emphasised the importance of adherence to the German formality.

Supreme Tax Court judgment I R 16/12 of September 17, 2013 published on March 12, 2014

Building trade reverse charge only on inputs for building outputs

The VAT Act provides for reverse charging in a number of specific instances seen as necessary to improve the security of tax collection. One of these is in the building trade and applies to building works and to repair, maintenance, renovation, alteration and demolition services for other builders. This provision was authorised by the European Commission as a "derogation" from the general system of the Sixth (VAT) Directive. However, the ECJ held in another case that the "derogation" be exercised in a way that ensures legal certainty for all involved (judgment C-395/11 *BLV* of December 12, 2012) and the referring court (the other VAT senate of the Supreme Tax Court) took this to mean that the reverse charge at issue presupposed not only that both parties to the transaction were builders, but also that the customer used the supply as input for his own building turnover.

In the present case, the adjudicating senate followed the other senate's view "in the interests of constancy of legal decision" without further review. The present case was brought by a person describing himself as a "building proprietor" who had commissioned a building project from a subsidiary. The proprietor was active in the building trade, although only as a sideline. He reverse charged all the payments on account, but then accepted a final invoice with VAT. The subsidiary went bankrupt four months later and the VAT was never paid to the tax office. The tax office assessed the proprietor as a building trade customer to reverse charge VAT; the Supreme Tax Court has now decided that the assessment can only be upheld if the building work done served the proprietor's own building turnover.

Supreme Tax Court judgment XI R 21/11 of December 11, 2013 published on March12, 2014

No input tax deduction on employer's canteen subsidy

An employer entrusted a caterer with running the staff canteen. The two sides agreed an annual pricing and menu policy as well as an annual budget. The employer provided the facilities and also paid the caterer a subsidy based on the budget. The tax office saw the main supply as being by the caterer to the employees. The subsidy was subject to VAT as a payment by a third party, although the employer could not deduct the input tax as not being the recipient of the supply. The employer argued that the subsidy was paid in the interests of keeping his employees content and thus of improving his recruiting prospects. It was therefore a supply to him for his business and the input tax should be deductible.

The Supreme Tax Court has, in effect, come to the same conclusion as the tax office, although for a different reason. It accepted the employer's business motives for the subsidy as well as his involvement in the canteen planning. The payment was therefore taxable as a supply by the caterer to the employer for the latter's business purposes. However, the business purpose was to enable the employer to grant a free-of-charge benefit to staff – cheap meals – which led to the exclusion of an input tax deduction. As the court went on to point out, it was for each employee to arrange his own midday meal. If he took advantage of the staff canteen in doing so, that was his private affair. An employer subsidy thus contributed to a taxable supply by the caterer. The business interest of the employer was recognised, though, in contrast to meals provided at staff meetings, did not predominate. Thus it did not eclipse the private nature of the supply to the employee.

Supreme Tax Court judgment XI R 4/12 of January 29, 2014 published on April 16

Tour operators' margin taxation also for business customers

The German VAT Act prescribes margin taxation for tour operators supplying the needs of end customers. However, supplies to other businesses are taxed under the normal rules. In September 2013, the ECJ held in a case brought by the European Commission against Spain that this distinction by customer had no basis in the VAT Directive and should therefore be disregarded. The Supreme Tax Court has now followed this judgment in a case of its own brought by a bus company organising educational tours for schools, clubs and other groups. The tax office had previously insisted on full taxation on amounts billed to business customers. However, the Supreme Tax Court has now held that this position, though founded in German law, contradicts a binding ECJ interpretation of community law. A German taxpayer is free to follow community law if this leads in the circumstances to a more favourable result.

Supreme Tax Court judgment V R 11/11 of November 21, 2013 published on April 2, 2014 and ECJ judgment C-189/11 *Commission v. Spain* of September 26, 2013

Tour operator as show organiser if he purchases entire theatre capacity

A package tour operator included a visit to a show as a tour highlight. With this in view, he agreed with the theatre to take over the entire house for an evening for a fixed sum. He then sold or distributed the tickets on his own account, though primarily for or to his own tour members. The Supreme Tax Court has now held that the tour operator sold his tickets as show organiser, that is, VAT-free. He controlled the entire sale, the tickets bore his name alongside that of the theatre and he had assumed the full economic risk of the evening.

The court also held that the hotel meals included in the package were ancillary to the accomodation charges. They were therefore taxable in the country of the hotel. The meals were provided so that the travellers could enjoy the accomodation to its fullest extent without being forced to go out and search for a nearby restaurant. In this position, the court departed from the VAT Implementation Decree of the finance ministry which sees the two services – even in bed and breakfast packages – as separate. However, the court reserved its judgment on the main point of this passage in the decree, that the cost of the breakfast and other meals provided be taxed at the full rate for restaurant services, saying that the ECJ had already held that member states were entitled to restrict the application of a reduced rate option to specific types of service as long as they did so without distorting competition.

Supreme Tax Court judgment V R 33/10 of November 21, 2013 published on March 19, 2014

From Europe

European Council resolves automatic information exchange

Following the international trend (FACTA in the US and a new global standard developed by the OECD), the European Council has now formally amended the Savings Tax Directive to provide for the automatic exchange of information between the tax authorities of member states. The Council has also clarified the definition of “interest”, mainly to close perceived actual or potential loopholes. The automatic exchange of information on non-resident account-holders will now apply in all member states under rules to be transposed into national law by January 1, 2016 to take effect from January 1, 2017. The European Commission with the support of the Council is actively pursuing negotiations with, in particular, Switzerland and the other European non-member states for the adoption of similar standards.

Capital transfer tax not precluded by Sixth Directive

Transfers of shares in Spanish companies holding at least 50% of their assets in real estate are subject to a capital transfer tax if the transfer allows the acquirer effective control over the property. Transactions subject to this tax are specifically exempt from VAT under the VAT Act. A Spanish pension fund acquired 64% of the shares in a property company, bringing its total holding to 67%. It protested against its assessment to capital transfer tax on the grounds that the tax was, effectively, a substitute for VAT and thus precluded by the provisions of the Sixth (and now the VAT) Directive. However, the ECJ has rejected this claim, holding that the capital transfer tax is not similar to VAT and not therefore precluded by the Sixth Directive.

The ECJ case reference is C-139/12 *Caixa d'Estalvis i Pensions de Barcelona*, judgment of March 20, 2014.

Note: the corresponding German tax, real estate transfer tax (RETT), is levied on share transfers in any company owning German real estate that lead to the acquisition of an interest of at least 95%. The two taxes are not identical, although the arguments of the ECJ in support of the Spanish tax also hold good for the German levy.

Energy tax on unlisted products by reference to nearest substitute by use or properties

Two companies – in joined cases – used toluene and white spirit (multi-refined petrol for test and cleaning purposes) respectively as heating agents in a chemical process. Neither of these two products is listed specifically in the Energy Tax Directive or in the Energy Tax Act of German law. The directive seeks to allocate unlisted products according to whether they are used for heating, or as propellants. The German act taxes them "as the energy products to which they are closest in terms of their properties and intended use". In the disputes at issue, both taxpayers claimed that they should be taxed as heating oils. The customs office claimed taxation at the considerably higher rate applicable to petrol on the basis of closer chemical affinity. The ECJ initially saw the use as decisive, until it emerged at the hearing that the heating oils in the directive could not be substituted for toluene or white spirit as they would not bring the reagents to the required temperature. Hence the somewhat ambivalent "either or" finding.

The ECJ case references are C-43/13 *Kronos Titan* (toluene) and C-44/13 *Rhein-Ruhr* (white spirit) joined judgments of April 3, 2014

No input tax deduction on acquisition of intangibles to be placed at disposal of partnership

A German tax consulting partnership transferred its client base to its three partners on dissolution. These transfers were subject to VAT. The former senior partner (with a 60% share) placed his share of the client base at the disposal of a second partnership (in which he held a 95% interest) free of charge. The tax office refused him a deduction for the input tax on the transfer as the asset acquired had not been used for a commercial activity.

The ECJ has now agreed with the tax office. The tax consultant had allowed his second partnership access to his client base free of charge. This permission had been granted without consideration. It had also been granted without any expectation of earning income. The tax consultant had thus paid input tax on a purchase for which there was no valid output transaction. Accordingly, he could not deduct the input tax. The court went on to examine a possible breach of the principle of fiscal neutrality, but did not change its conclusion. Rather, it held that fiscal neutrality was a principle of interpretation and not an absolute principle in its own right. It could therefore not be followed in direct contradiction of unambiguous provisions of the VAT Directive. Reference was also made to the *Polski Trawertyn* judgment (C-280/10 of March 1, 2012) in which the court had insisted on an input tax deduction for partners acquiring capital goods for transfer to a future partnership. However, the court refused to apply the same principle by analogy, as *Polski Trawertyn* addressed a situation where the national law excluded an input tax deduction, regardless of how the transaction was structured. This contrasted with the present case where the tax consultant had deliberately chosen an unfavourable arrangement in disregard of the other available options. There was thus no need to force a deduction at variance with the letter of the law as the only way of achieving the overriding purpose of the system.

The ECJ case reference is C-204/13 *Malburg*, judgment of March 13, 2014.

Hospital pharmacy sales exempt from VAT if inseparable from medical treatment

A German hospital retained a number of doctors as consultants working (largely) on their own initiative and presenting their own bills. One of their activities was the treatment of cancer out-patients. These activities were exempt from VAT as medical care. In this connection, the doctors prescribed drugs (cytostatics) to be dispensed from the hospital pharmacy. The tax office maintained that the supply by the pharmacy was separate to that by the doctor and could not fall under his medical services exemption. The hospital took the opposite view, that the drugs would not have been supplied without the exempt treatment in support of which they were prescribed and their supply fell under the main exemption.

The ECJ has taken a middle course and so avoided taking responsibility for the final decision. In principle, supplies of pharmaceuticals from hospital or other dispensaries are subject to reduced rate VAT. If, however, the supply is so closely linked to the exempt supply of medical care that the one without the other would be to no purpose, the two can be treated as an exempt medical supply notwithstanding the fact that they were provided by different persons. Whether the two supplies are “inseparable” in this sense is for the referring court to decide.

The ECJ case reference is C-366/12 *Klinikum Dortmund*, judgment of March 13, 2014

All fixed fuel tanks in commercial vehicles to be privileged as originals?

A German haulage business near the Dutch border mounted a second fuel tank on its lorries in order to double their range. To do this, it was necessary to shift the original tank. The customs administration intercepted a vehicle returning from Holland with full tanks and demanded excise duty on the entire load of fuel on board. Its argument was that neither tank was a fixed assembly built in by the manufacturer as the conversion had been done by a local workshop. Accordingly, the fuel carried did not meet the strict criteria for exemption as having been taxed in another member state and imported solely for use in powering the vehicle concerned. The referring court confirmed that this position conformed to German law, but doubted whether the EU Excise Duties Directive could be taken so literally. The ECJ advocate general on the case shares these doubts.

The advocate general points to the fact that the transport market is developing rapidly with an ever increasing range of options. One is therefore no longer able to assume a “standard” range of equipment and accessories for any given vehicle against which imports of fuel for other purposes can easily be established. He also points out that even “standard” fuel tanks are not necessarily built in by the manufacturer of the vehicle. Dislocated assembly and replacements/repairs were cited as examples. He therefore suggests reverting to the original purpose of the exemption in the directive of not taxing a second time the fuel intended to run the vehicle, whilst retaining the second taxation on fuel imported for potentially other uses or even for resale. He therefore suggests the court rule that the concept of fuel tanks affixed by the manufacturer be construed as applying to all fuel tanks permanently installed in the vehicle that are directly linked to its engine or other power supply.

The ECJ case reference is C-152/13 *Forstmann* opinion of April 30, 2014

Reduced rate VAT on e-books up to national court?

A Finnish dealer in e-books (books on CD, CD-ROM and USB sticks) claimed that a book was a book and that his wares should receive the same, favourable VAT treatment as the printed editions. The tax office refused, saying that a book was a printed work subject to a reduced rate of VAT of (now) 10%, whereas an e-book was a general item subject to the standard rate of (now) 24%. The dealer protested that this distinction had no basis in the VAT Directive.

The ECJ advocate general on the case has suggested the court keep to its existing case law and hold the reduced rate list attached to the directive to be a list of options and not of requirements. It should be open to a member state to subdivide the categories in the list in order to reduce the scope of the privilege. However, each subdivision must be recognisable as a homogenous group of like products and that any separate VAT treatment should not distort competition. In the view of the advocate general, it was possible to treat e-books as separate products from printed publications, since they could not be used without technical equipment (such as a reader). However, whether taxing them at a different rate led to distortion of competition depended upon the consumer climate in the country concerned. This could only be determined by the national court. If the average consumer saw printed books as interchangeable with their electronic versions, taxing them at a different rate would distort completion and would not be permitted under community law. If the average consumer appreciation was of different products, no distortion of competition would result from taxing them at different rates. The advocate general concluded his opinion with the remark that any distinction should be based on the comparison between the items themselves and not on the accessibility of the electronic version to other technical functions, such as search engines.

The ECJ case reference is C-219/13 *K* opinion of May 14, 2014.

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