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By PwC Deutschland | 20 January 2014

Project consideration in a public/private partnership split between interest and principal

The Supreme Tax Court has upheld a lower court decision to the effect that the payments to the project partner within a public/private partnership can be split between repayment of principal (payment for the capital investment) and VAT-free interest. This split is possible, even if the exact amounts are not known when the contract is signed.

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A builder contracted with a public authority to rebuild a student hostel. Because the authority did not wish to take out its own finance or to appear as the principal of the builder, the two agreed to finance the project through a so-called public/private partnership. The agreement gave the full right of usage to the builder for the next twenty years, but with the proviso that he should rebuild the hostel as agreed and then let it to the operator. The rent should allow the builder to fully recover his costs over the twenty-year period and should be divided into consideration for the financing – interest free of VAT – and payment by instalments for the investment. The figures were to be fixed later, once the exact investment and interest rates were known. The tax office saw the entire “rent” as payment by instalments for the investment and thus as subject to VAT in total. It based this attitude on a provision in the VAT Guidelines (now the VAT Implementation Decree) excluding separation of the financing cost from the overall cost of the project, if the former was not fixed when the contract was signed. The builder took the view that the provision in the VAT Guidelines had no basis in law and should be disregarded.

The Supreme Tax Court confirmed the judgment of the lower court to the effect that the parties had clearly agreed two separate supplies, of finance and of the building work. They had also agreed the basis for calculating each – based on agreed building budgets – even if the details had not yet been worked out. In any case, it was immediately obvious that no business operator would accept payment deferral over twenty years without cover for the financing cost involved. However, the court’s judgment was confined to confirming that of the lower court and thus did not give guidance on the principles of segregation.

Supreme Tax Court judgment XI R 24/11 of November 13, 2013 published on January 16, 2014

Keywords

builder, capital investment, public/private partnership