

BMF further explains Tax Treatment of Guarantee Commitments, but no Exceptions or substantial Relief

November 2021

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In Brief

In its decree dated 11 May 2021, the German Federal Ministry of Finance (BMF) fundamentally revised the principles of the tax treatment of guarantee commitments offered in return for payment in connection with sales contracts or contracts for work and services.

A guarantee commitment in return for payment will no longer be considered a dependent ancillary service to a purchase, but an independent service on which German insurance premium tax (IPT) is payable. This does not apply to guarantee commitments in connection with full maintenance contracts.

Since the BMF decree dated 11 May 2021 did not provide sufficient clarity, but rather left many questions unanswered, business associations had sent separate submissions to the BMF with their most pressing questions and concerns.

In its responses to the associations, the BMF now explains key terms from the BMF decree of 11 May 2021 and provides guidance on application in individual cases. However, the hoped-for exceptions or relief have not materialized. There remains a broad scope, and thus the need for many companies to either pay IPT from 1 January 2023, or to adapt their business model.

The originally planned application to guarantee commitments from 1 July 2021 was initially postponed until 1 January 2022 by BMF letter dated 18 June 2021. In a letter dated 18 October 2021, the implementation period was extended for a final time by a further year, until 31 December 2022.

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Guarantee commitments in return for payment

In its responses to the business associations, the BMF states that it is decisive whether the guarantor demands an additional payment for the guarantee commitment in addition to the purchase price for the goods. There should be no additional payment and thus no insurance relationship if the guarantee commitment is included in the purchase price of the goods. The precondition for this is, however, that the goods are offered exclusively "including the guarantee" and that the customer cannot purchase the goods "without the guarantee" at a lower price.

Full maintenance contract

According to the definition of the BMF, a full maintenance contract is a contract under which the dealer or a third party promises to comprehensively maintain the functionality of the goods during the contractually agreed term of the contract. In addition to maintenance and inspection obligations, such a contract also includes the dealer's obligation to replace defective (wear and tear) parts or parts that are about to become defective.

A flat rate is paid for this on the basis of a separate contract, which covers regular inspection, maintenance and also replacement parts, whereby adjustment clauses and special arrangements for exceptionally expensive repairs/spare parts may be provided for.

Extension of the manufacturer's guarantee commitment for a separate fee

The BMF also states that the contractual extension of the manufacturer's guarantee commitment for a separate (additional) fee establishes an insurance contract between the customer and the manufacturer. The insurer in this case is the manufacturer.

However, if the guarantee is "extended" by the dealer in his own name, the dealer becomes the insurer. This is an independent guarantee of the dealer, even if the content of the guarantee is identical.

If, in such a case, the dealer has a claim against the manufacturer to indemnify him against the claim in the event of a guarantee claim, there is a reinsurance relationship between them that is exempt from IPT pursuant to Section 4 (1) No. 1 German IPT Act. In its letters to the business associations, the BMF clarifies that for the assumption of a reinsurance it does not matter whether the reinsurer is an insurance company or, for example, the manufacturer.

Input Tax

In its letters, the BMF again refers to the consequences for the input tax deduction outlined under item II of its letter dated 11 May 2021. It confirms that these are mandatory legal consequences of the changed classification of guarantee

commitments as insurance benefits from an VAT exemption according to Section 4 No. 10 VAT Act.

Insofar as input services are used for the performance of VAT-exempt guarantee services, which according to item II. No. 1 of the BMF letter dated 11 May 2021 include not only the granting of guarantee commitments but also services in the event of damage, an input tax deduction claimed in the past must be adjusted in accordance with Section 15a VAT Act. Input tax from the purchase of repair materials must be directly allocated as far as possible or, if this is not possible, apportioned. The statutory simplifications for the apportionment of input taxes pursuant to Section 43 VAT Implementation Ordinance shall not apply to this.

Practical Consequences

The BMF's response to the associations once again makes it clear that guarantee commitments are generally to be regarded as insurance benefits. As the BMF expressly emphasizes, the extension of the transitional period until 31 December 2022 is a final extension of the deadline, which takes into account the acknowledged high conversion effort for the companies. Further exceptions or relief are not to be expected.

As options for companies to avoid their own IPT liability on guarantee commitments, the BMF mentions

- conclusion of so-called full maintenance contracts,
- offer of goods exclusively inclusive guarantees
- or provide insurance coverage from an insurance company.

The analysis whether a guarantee commitment is deemed to be an insurance contract under German IPT law determines whether IPT or VAT is triggered on the respective payment in the individual case. The BMF's explanations to the business associations, which are to be classified as non-binding, provide helpful additional information thereto.

However, an individual analysis of the impact on the company's guarantee commitments and a planning of the further course of action will be unavoidable for most companies with guarantee agreements and will remain complex in many cases. Due to the number of industries, products and service relationships affected, it is expected that many details on the tax classification of individual contracts still have to be analyzed. This will be done based on the IPT Act and case law and, if necessary, coordinated with the tax authorities in the form of binding ruling in order to ensure sufficient planning security.

Obviously, the application of VAT may be more familiar to companies and customers compared to IPT and usually more economically desirable. However, simply not showing the fee for the guarantee separately in invoices and contract documents does not automatically protect against classification as an insurance contract for tax purposes under German IPT law.

The transitional period of one year granted by the BMF is put into perspective for most companies issuing guarantee commitments as an urgently needed preparation period. In particular, a careful inventory of the guarantee commitments offered and planned, an IPT analysis of the contracts based thereon, any necessary coordination with the tax authorities and, in individual cases, also with

the Federal Financial Supervisory Authority (BaFin) have to be taken into account. Depending on the outcome, it may be advisable to adjust the individual guarantee models. In addition, the effects on the input tax deduction must be determined individually and the internal processes in accounting and IT need to be adjusted to the changed tax framework.

Affected companies are therefore advised to start this process promptly in order to be able to offer guarantee commitments in a tax-optimized manner even after 31 December 2022 and to be tax-compliant in time for 1 January 2023.

Sources

BMF answers in October 2021 to business associations' requests.
BMF letter dated 18 October 2021, III C 3 - S 7163/19/10001:001.
BMF letter dated 18 June 2021, BStBl. I p. 871.
BMF letter dated 11 May 2021, BStBl. I p. 781.
BFH ruling of 14 November 2018, XI R 16/17, BStBl. II 2021 p. 461.

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