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MoF: Premature termination of a service contract in the telecommunications sector

In a recent circular, the Federal Ministry of Finance (MoF) commented on the VAT treatment of compensation payments in the event of a premature termination of telecommunication contracts with a minimum commitment term.

Payments that a telecommunications provider receives as a compensation payment in the case of a premature termination by the customer of a service contract with an agreed minimum term are consideration for the provision of a service (supply of services).

This circular must be applied in all open cases.

Source:

Federal Ministry of Finance circular of 18 October 2024 (III C 2 - S 7100/19/10004 :007), published on 11 October 2024.

Note: In a decision of 16 January 2014, case V R 22/13, the Supreme Tax Court had in detail addressed the issue whether certain payments qualify as taxable supplies under German VAT law. The court decided that compensation or damage payments are generally not considered remuneration for VAT purposes if the payment is not made in exchange for a supply of goods or services but rather to compensate for a loss or damage.

The Supreme Tax Court further stated that an exchange of services for consideration within the meaning of Section 1 para. 1 no. 1 VAT Act exists where a taxable person waives a legal position to which he is entitled, whether on a statutory or contractual basis. The waiver to exercise a professional or commercial activity in whole or in part is a taxable supply of services for consideration according to Section 3a para. 4 no. 9 VAT Act.

In the case at issue, the IT service provider had reached a settlement with its customer to terminate the IT service contract prematurely. For this premature termination, the IT service provider received payments described as “compensation for services not rendered or damages”. However, for the Supreme Tax Court it was not relevant whether there is an objective or subjective impossibility for the fulfilment of the services originally agreed upon or whether the payment is described or referred to as compensation for damages.

Keywords

compensation payment, telecommunications