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By PwC Deutschland | 09 December 2024

No VAT free sale of entire business if continued for the benefit of third party

The proceeds from the sale of a self-contained business are not subject to VAT provided the sale includes all assets necessary for the purchaser to continue the operation. In a most recent decision, the Supreme Tax Court held that this only applies to services provided between the transferor and the transferee and does not include transactions that are supplied to third parties.

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Background

The plaintiff, a regional municipal body, took over the operation of a swimming pool from a dissolved special-purpose communal association („*Zweckverband*“) to which it formerly belonged. The special-purpose association transferred all assets of the swimming pool to the plaintiff for €1, the plaintiff in return assumed all liabilities and undertook to maintain the operation until at least 2023. The district and the municipality (city), which were also members of the special-purpose association, undertook to pay the plaintiff “for maintaining the operation” of the swimming pool an amount corresponding to „the previous allocated annual share in the costs for a period of ten years”.

The question before the tax courts was whether these payments constitute an exchange of services subject to VAT or if it falls to the (VAT free) sale of the entire business. The Hesse Tax Court upheld the appeal and confirmed that a VAT free sale of a business took place.

Decision

The Supreme Tax Court decided differently and granted the appeal brought by the tax office. The court of first instance erred in assuming that the services in question are transactions in the context of a sale of a business as a whole. The payments made by the district and the municipality constitute remuneration for the service provided to them by the plaintiff and are as such subject to VAT.

According to Section 1 (1a) VAT Act, transactions in connection with the sale of a business to another entrepreneur for the latter's enterprise are not subject to VAT. A sale of a business is deemed to have taken place if a company or a business that is conducted separately within the structure of a company is transferred in its entirety against payment or free of charge or contributed to a company. The acquiring entrepreneur shall be treated as the legal successor to the seller.

The Supreme Tax Court went on to say that the regulation only applies to services provided between the transferor and the transferee. Non-taxability therefore does not apply to transactions carried out to third parties. Only services directly economically related to the transfer process that enable the continuation of the business are covered but not services with a different independent economic significance such as the agreed continuation of the business by the acquiring entrepreneur as in the case of dispute.

To determine whether a service is connected to a payment in such a way that it is directed towards obtaining a consideration (payment) depends on the agreements between the service provider and the payer. In the case of services that the contracting parties have undertaken to perform in a mutual contract the required (taxable) exchange of services generally takes place. This also applies to an activity that consists of an entrepreneur performing certain public tasks in return for payment on the basis of a contract between him and a public corporation.

On this point the Supreme Tax Court refers to a decision of the European Court of Justice (ECJ) from 22 February 2018 C-182/17 *Nagyszénás Településszolgáltatási Nonprofit Kft* where the ECJ held that „in determining whether the activity at issue in the main proceedings is effected ‘for consideration’, the fact

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that performance of the public tasks constitutes a legal obligation imposed on the municipality (…) is not capable of calling into question the classification of such an activity as a ‘supply of services’ or the direct link between the service provided and the consideration given in exchange“.

Source:

Supreme Tax Court judgment of 29 August 2024 (V R 41/21) published on 5 December 2024.

Keywords

VAT-free, sale of business