

1 Introduction

In contrast to personal taxes (e.g. income tax), German Value Added Tax ("**VAT**") is a tax on transactions. VAT is a sales tax which is levied at all levels of taxable supplies of goods and services made by a taxable person in the course of any business activity carried on in Germany and on the importation of goods from other states.

The German VAT Act ("**VATA**") is harmonised under the EU-wide VAT system. Therefore, decisions of the European Court of Justice have an important impact on the interpretation of the VATA.

Due to the possibility for entrepreneurs to deduct VAT (input tax) paid for received services or goods if these are related to taxable output transaction or certain VAT-exempt transactions, the tax payment is generally neutral for the business of the entrepreneur. This means that VAT is not an expense item but it is only a pass-through item. Only for private individuals or certain tax-exempt entrepreneurs, VAT paid to customers is a final expense.

2 Taxable Events

The following events are – inter alia – subject to the VATA;

- Supply of goods and services rendered by an entrepreneur for remuneration within Germany for its business;
- Importation of goods from territories outside the EU into Germany (Import VAT) and
- Intra-EU acquisitions (supply of goods from another member state of the EU to Germany).

Even if the aforementioned events are subject to the VATA, it ultimately has to be determined whether VAT is actually due. The VATA provides for certain VAT exemptions (see section 5 below). VAT will only be levied if the respective event is subject to the VATA and a tax exemption does not apply.

3 VAT liability

3.1 Entrepreneurs

Any individual, corporation or partnership carrying out trade or professional activities with the objective of earning income is generally treated as a tax-liable entrepreneur under the VATA. As a result, sole proprietors and self-employed persons as well as commercial entities, whether incorporated or not, are subject to the VATA.

The VAT liability of entrepreneurs begins with the initial business activities and ends once all legal relations of the business, including with the tax authorities, are completed.

3.2 Exemptions

(a) Small entrepreneur

If the annual turnover of the preceding calendar year did not exceed an amount of €17,500 and will presumably not exceed an amount of €50,000 in the current calendar year, the so-called "small-entrepreneur" (*Kleinunternehmer*) is generally not entitled to separately charge VAT in its invoices and can therefore not take advantage of the input tax relief.

However, the entrepreneur may waive the tax exemption and opt for regular taxation and input tax deduction. The entrepreneur is bound by such waiver for a minimum period of five years.

(b) VAT group

If one or more entities are integrated financially, economically and organisationally into the business of a German top parent entity, the entities build a VAT group. As a consequence, the VAT group as a whole will be regarded as only one entrepreneur. Consequently, the German top parent entity is liable for all VAT obligations (e.g. registration, tax filings, VAT payments) of the VAT group.

The domestic supply of goods and services between the members of the VAT group are not subject to VATA. However, the regime of the VAT group only applies for German entities. In the event of an international group of entities, the most significant German entity is deemed to be the entrepreneur liable for VAT.

(c) Holding companies

Entities that acquire, hold and sell interests in companies are generally not liable for VAT. However, if such a holding company is actively engaged in the day-to-day business of the respective subsidiary, the business activities of the holding company (e.g. acquisition, retention and disposal of interests) can be treated as taxable events. The same applies with regard to the supply of management services (e.g. administrative, financial or technical services for subsidiaries).

4 Place of Transaction

Supplies of goods or services are only subject to VAT if the place of transaction is in Germany.

4.1 Supply of goods

As a matter of principle, the supply of goods for consideration takes place in Germany, if the goods are located in Germany at the time when the power to dispose of the goods is transferred.

If the goods are dispatched or transported, the place of supply is generally where the dispatch or transport begins. This also applies for export and an intra-EU supply of goods.

However, there are several exceptions to these general provisions. In particular the following exceptions should be considered:

- If goods are dispatched or transported from a non-EU member state into Germany, the place of supply of the good is Germany if the supplier or its carrier owes the Import VAT.
- If goods are dispatched or transported by a supplier or its carrier from one EU member state to Germany (distance sales), the place of supply is where the dispatch or transport ends if the recipient is, for example, a private consumer and to the extent that the supplier's annual sales are above certain thresholds (€100,000 for Germany).
- If several entrepreneurs conclude sales agreements for the same good and this good is directly dispatched or transported from the first entrepreneur to the last recipient ("chain transaction" – *Reihengeschäft*), there are always at least two different places of supply: one place with regard to the so-called "moved supply" (*bewegte Lieferung*) and one or more places with regard to the so-called "dormant supplies" (*ruhende Lieferungen*). The determination of these places depends on each individual case.
- The place for the supply of work and materials (*Werklieferungen*) is generally where the work is rendered.

4.2 Supply of Services

The implementation of the EU VAT Package in 2010 has significantly changed the rules for the place of supply of services. The place of taxation depends not only on the nature of the service supplied but also on the status of the customer receiving the service. A distinction must be made between a taxable person acting as such (business acting in its business capacity) and a non-taxable person (a private individual who is the final consumer).

In case of the supply of services by a business to a consumer ("**B2C service**"), the place of supply is at the supplier's place of establishment. However, if the business provides the service from its permanent establishment, the place of the permanent establishment is the relevant place of supply.

In case of the supply of services by a business to (i) a business for business purposes, (ii) a non-business legal person with a VAT identification number or (iii) a legal person operating for business and non-business purposes ("**B2B service**"), the place of supply is at the recipient's place of business. If the service is rendered to a permanent establishment of the recipient, the place of supply is at the place of such permanent establishment.

These principal rules for B2C and B2B services are only applicable if special provisions for certain types of services are not applicable. The most important types of special services are the following:

- The place of the supply of services connected with immovable property is where the immovable property is located.
- The place of short-term hiring of a means of transportation is generally where the means of transportation is in fact available to the customer.
- The place of the supply of services relating to, for example, (1) cultural, scientific, or entertainment activities and services in relation to fairs and exhibitions, (2) general restaurant and catering services and (3) valuations of and work on movable tangible property in the case of B2C services is where those services are physically carried out.
- The place of the supply of certain services to a customer with a residence outside of the EU is where the customer is resident or domiciled. Such services are, for example, the use of patents, copyrights, tax and legal consulting services and services rendered in electronic form.

4.3 Further Special Provisions

(a) Intra-EU acquisition of goods

An Intra-EU acquisition of goods is normally deemed to be carried out at the place where the goods are located at the time when the dispatch or transport ends. Goods acquired by a business in its business capacity or by a non-taxable legal person (for example, a public authority) are subject to VATA.

(b) Transport of passengers and goods

The place of supply of passenger transport is where the transportation takes place. Only this part of the transportation is subject to the VATA, which is deemed to be a domestic transportation distance. The same applies with regard to the transport of goods as a B2C service, other than Intra-EU transport. In the case of a B2C Intra-EU transport of goods (goods departing from one EU state and arriving in another), the transport is taxed at the place of departure.

5 VAT Rates and VAT Exemptions

The standard VAT rate for supplies of goods or services in Germany currently amounts to 19%. A reduced rate of 7% exists for certain basic goods and services like food, books, animals, theatre tickets and hotel accommodations.

As already mentioned in section 2 above, the VATA also contains an extensive catalogue of supplies of goods and services, which are generally VAT-exempt. These include, for example:

- Intra-EU supplies
- Export supplies
- Financial services (e.g. granting loans)
- Insurance services
- Buying and selling real estate
- Long-term letting of real estate

For some of such VAT-exempt supplies, for example, the sale and letting of real estate, the entrepreneur is entitled to opt for the taxation of these supplies under certain circumstances.

In most cases, an entrepreneur providing goods or services which are VAT-exempt is not allowed to deduct input tax. The most relevant exceptions to this rule are exporting goods from Germany to a country outside of the EU and the Intra-EU supply of goods. Although these turnovers are zero-rated supplies, the supplier is allowed to deduct input VAT.

6 Reverse Charge regime

For certain supplies of goods and services and under further conditions, not the supplier but the recipient shall be liable to pay VAT to the German tax authority ("**Reverse Charge Regime**").

In general, the VAT liability of the recipient only applies if the recipient is an entrepreneur. For some taxable turnovers, this also applies to recipients that are legal persons.

The Reverse Charge Regime is particularly applicable with regard to the supply of work and materials, the supply of gas, electricity, heat and cold, as well as the supply of services to the extent that these services are provided by an entrepreneur residing abroad. Such a "foreign entrepreneur" is an entrepreneur who does not have a domicile, statutory seat, place of management or permanent establishment in Germany. However, if the entrepreneur has a permanent establishment in Germany but the supply of services or goods is not rendered from this permanent establishment, the Reverse Charge Regime still applies.

The scope of the Reverse Charge Regime also covers - inter alia - turnover that is subject to the German Real Estate Transfer Tax Act if the supplier opts for VAT, construction work, the supply of objects that are assigned as security, cleaning of buildings, transfer of certain emission rights, supply of certain kinds of gold, and the supply of mobile phones to the extent that the invoiced sum amounts to at least €5,000.

The Reverse Charge Regime is not available in the case of certain supplies of passenger transport provided by an entrepreneur residing abroad. This also applies with regard to services in relation to granting access authorization for fairs, exhibitions and congresses in Germany as well as catering services on board of ships, planes and trains.

7 Requirements of Invoicing

An invoice may be any document in paper or electronic form. There are no specific requirements for the format of an invoice. Instead of an invoice, the recipient of the supply may issue a settlement statement (self-billing by means of credit invoice (*Gutschrift*)) if the parties agree accordingly.

An invoice must generally contain the following information:

- The supplier's and customer's full name and address
- The supplier's tax registration number in Germany or its VAT identification number
- The date of issue of the invoice
- A sequential number that uniquely identifies the invoice
- A description of the quantity and nature of the goods supplied or services rendered
- The date of the supply of goods or services

- The consideration for the supplies of the goods or services broken down into applicable tax rates as well as any discounts or rebates (unless included in the consideration)
- The VAT rate applied as well the VAT amount payable or, if the supply is tax-exempt, a note on the tax exemption of the supply
- The German term "*Gutschrift*" or the alternative term used in other official languages (e.g. "Self-Billing")

In some cases, additional information must be included on the invoice:

- If a recipient of a supply is liable to pay VAT (e.g. the supply is subject to the Reverse Charge Regime), the invoice must contain the German term "*Steuerschuldnerschaft des Leistungsempfängers*" or the alternative term used in other official languages (e.g. "Reverse Charge"), and the recipient's as well as the supplier's VAT identification number. However, the invoice may not show the VAT separately.
- In the case of an Intra-EU supply of goods, the invoice must state the supplier's and the recipient's VAT identification number.

Invoices related to Intra-EU supply of goods and to supply of services that are subject to the Reverse Charge Regime, have to be issued by the 15th day of the months following the month of supply.

8 Output and Input Tax, VAT Return and Filing

VAT charged on supplies made is called output tax. In general, the supplier is obligated to pay such VAT to the German tax authorities to the extent that the Reverse Charge Regime does not apply.

A supplier may in turn have incurred VAT on goods and services received (input tax). Such input tax can be offset against output tax provided that the supplier makes taxable supplies. If and to the extent that the input supply is used to render VAT-exempt output supplies, the respective input tax is generally not deductible. However, if, for example, input tax is related to certain VAT-exempt cross-border supplies, the entrepreneur can still claim a deduction of this input tax.

Except for the input tax deductions in the case of Import VAT, VAT on Intra-EU acquisitions and reverse charge tax, the recipient of the supply of goods and services is generally only entitled to deduct input tax if he is in possession of an invoice that meets all requirements under the VAT Act.

VAT must be accounted to the local tax authorities on a monthly or quarterly basis (advance notifications (*Voranmeldungen*)) and additionally on an annual basis (VAT return (*Umsatzsteuererklärung*)). Where input tax paid can be offset against output tax received, only the balance has to be paid. If input tax exceeds output tax, a refund may be obtained. Special rules apply if a taxable person makes both taxable and non-taxable supplies, which have the effect of restricting the input tax relief to the taxable element of supplies received.

In general, advance notifications have to be filed electronically by the tenth day after the end of the relevant advance notification period. The due dates for filing the advance notifications and paying the VAT may be extended for one month by the tax authority upon the request of the entrepreneur.

9 VAT Refund for Foreign Entrepreneurs

Under certain circumstances, foreign entrepreneurs who acquire goods or services in Germany for their businesses may obtain a refund of the input tax through a special input tax refund procedure (*Vorsteuervergütungsverfahren*). This procedure is generally applicable if the entrepreneur does not deliver any goods or render any services for which he owes VAT and is not registered for VAT purposes in Germany. Entrepreneurs residing outside of the EU are generally only entitled to use the input tax refund procedure if the respective country of residence does not levy VAT or a similar tax or, if it does levy such tax, would conversely refund input tax to an entrepreneur residing in Germany (principle of reciprocity).

The application for an input tax refund of an entrepreneur residing in the EU must generally be received by the Federal Central Tax Office (*Bundeszentralamt für Steuern*) within nine months of the end of the calendar year in which the claim to a refund arises. If the entrepreneur resides outside of the EU, the deadline is six months from the end of the calendar year in which the claim to a refund arises.

For entrepreneurs residing in the EU, the respective application must be filed on an official form and transmitted via an electronic portal set up by the EU member state in which the entrepreneur resides. All other foreign entrepreneurs are obligated to transmit the filed and signed application form directly to the Federal Central Tax Office.

Contact Information

Michael Langer

Rechtsanwalt, Steuerberater

T +49 (0)30 72 616 8220

E michael.langer@squiresanders.com

Squire Sanders Berlin

Unter den Linden 14

10117 Berlin

Germany

Squire Sanders Frankfurt

Taunusanlage 17

60325 Frankfurt am Main

Germany

The information provided in this memorandum is based on the legal situation at the end of March 2013. Although thoroughly researched, we cannot give any guarantee for the accuracy, completeness or adequacy of the information compiled.

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations nor should they be considered a substitute for taking legal advice.

© Squire Sanders.