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**The special schemes for  
small enterprises and farmers in EU VAT  
on the example of Germany**

by

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# Summary

In the European Union there are special schemes in Value Added Tax that Member States may adopt. Those rules are set out in the VAT Directive. Two of those special schemes are the special scheme for small enterprises and the common flat-rate scheme for farmers. Along to the provisions of the VAT Directive there is also some case law from the CJEU that clarifies the application of the schemes.

Germany is a EU Member State and adopted those two schemes - or more specifically from the three options for the small enterprises scheme, Germany adopted the exemption scheme. Those rules are set out in the German turnover tax act - the *Umsatzsteuergesetz*.

However, when a Member State adopts a provision from the VAT Directive it has to be in line with the Directive. When comparing firstly the German provisions on the exemption scheme for small enterprises and the provisions of the Directive there is no deviation from EU law. One may however discuss if the German threshold of 17.500 Euros is set too low. On the other hand regarding the common flat-rate scheme for farmers some deviations do exist in the German turnover tax act. It is arguable whether the exclusion in § 24 UStG of commercial enterprises by virtue of legal form is contrary to the principle of neutrality. The German legislation now provides for the option to be either taxed according to the § 24 UStG (and therefore be excluded from the special scheme) or according to a judgement of the BFH (and therefore be able to be taxed according to the common flat-rate scheme). It is also discussed whether the flat-rate compensation percentage is set too high. But besides that, the provisions of the UStG on those two special schemes are in line with the VAT Directive.

When a Member State adopts the exemption scheme for small enterprises or the common flat-rate scheme for farmers the affected taxable persons have to face several considerations. In both schemes the taxable person may also opt to be subject to the normal VAT arrangements - or in some cases a taxable person may also decide according to which of those two special schemes he could be taxed. The different circumstances of the taxable person will affect the decision under which scheme the farmer or small enterprise wants to be taxed. But also the administration relief advantage may have an influence on that decision. On the other hand also the Member State has - besides the administration relief - to face several risks. Those are also circumventions or abusive bypasses either of the schemes or the normal VAT arrangements, due to the fact that there is no deduction of input VAT when being subject to either one of those schemes.

All in all, an implementation of both special schemes is desirable for both - the taxable persons and the tax authorities of the EU Member States.

# Abbreviation list

Abs.	<i>Absatz</i> = paragraph
AG	Advocate General
Art.	Article
BFH	<i>Bundesfinanzhof</i> = Federal Fiscal Court
BMF	<i>Bundesministerium der Finanzen</i> = Federal Ministry of Finance
CJEU	Court of Justice of the European Union
EU	European Union
et seq	<i>et sequens</i> = and the following
Nr.	<i>Nummer</i> = number
p.	page/paragraph/point
S.	sentence/ <i>Seite</i> = page
Sixth Council Directive	Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes
TFEU	Treaty on the Functioning of the European Union
USt	<i>Umsatzsteuer</i> = Turnover Tax
UStAE	<i>Umsatzsteuer-Anwendungserlass</i> = Turnover Tax Application Decree
UStG	<i>Umsatzsteuergesetz</i> = Turnover Tax Act
VAT	Value Added Tax
VAT Directive	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

# 1 Introduction

## 1.1 Background

The European Commission proposed in a communication for the VAT system in the European Market in 2011. The reform suggests a simple, efficient, neutral, robust and fraud proof system.<sup>1</sup>

One interesting issue regarding this communication is of course the special schemes in VAT for selected taxable persons, which Member States may implement into their domestic tax acts. The communication did neither specifically refer to the special schemes for small enterprises - like the exemption scheme - nor to the common flat-rate scheme for farmers. However, those schemes may raise several questions regarding the communication by the European Commission.

Firstly regarding the simple VAT system it should be noted that small enterprises and farmers face high compliance costs, which are over the capacity of those taxable persons. Nevertheless, businesses do even face higher burdens when they are engaged in intra-EU trade. Therefore the communication suggests a single set of clear and simple VAT rules.<sup>2</sup> Secondly the issue of an efficient and neutral VAT system may even cause more obstacles to the schemes. First of all an exemption might cause distortions and therefore must have some economic, social or technical reason to apply.<sup>3</sup> It is also stated that similar goods and services should have the same VAT rate.<sup>4</sup> Furthermore, neutrality requires equal treatment regarding the right of deduction and only limited restrictions of that right.<sup>5</sup> Those features might be in conflict with the special schemes.

Nevertheless, the Member States may implement the two special schemes for small enterprises and farmers into their domestic tax acts. For example Germany applied that option and implemented the special scheme of exemption for small enterprises and the common flat-rate scheme for farmers into the national turnover tax act - the *Umsatzsteuergesetz*. However, the German tax act has to comply with EU law. And even if the EU Member State implemented the respective special schemes correctly it remains questionable whether those special schemes are actually beneficial for the small enterprises and the farmers as well as for the tax authorities of the Member States.

These issues shall therefore be examined in this thesis.

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<sup>1</sup> Commission, 'Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the future of VAT - Towards a simpler more robust and efficient VAT system tailored to the single market' European Commission COM(2011) 851 final (Brussels, 6.12.2011)

<sup>2</sup> Ibid, pp. 5-6

<sup>3</sup> Ibid, p. 10

<sup>4</sup> Ibid, p. 11

<sup>5</sup> Ibid, p. 6

## 1.2 Purpose

The purpose of this thesis is to assess whether the German tax law regarding the special schemes for turnover tax of small enterprises and farmers in §§ 19 and 24 UStG are compatible with EU law. Furthermore, it will be examined whether those special schemes are beneficial in general. Therefore the considerations for small enterprises and farmers on the one hand and the risks and benefits for the governments and tax authorities of the EU Member States on the other hand will be stated.

## 1.3 Method and material

The research method adopted is the legal dogmatic method, as primary and secondary legal sources will be analysed critically.<sup>6</sup> Therefore an external approach of legal research is used.<sup>7</sup> Though there is also influence from the normative approach as the law will be described and analysed theoretically and empirically.

Firstly, when examining whether the German tax law is in line with EU law a comparative perspective will be given in which the EU law is compared with the German domestic law.<sup>8</sup> Subsequently, a firm theoretical analysis will be given in which the author explains the current law and considers whether those special schemes are beneficial. This will be evaluated through a neutrality analysis as the impact of the VAT on the final price as well as the cost and margins will be considered. Thus, not only a descriptive approach but also a normative approach will arise.<sup>9</sup> Arguments in favour and against the tax legislation on special schemes for small enterprises and farmers will be given. In a two-step approach those arguments will be examined and evaluated.<sup>10</sup>

The material for this thesis includes primary EU legislation - as several treaties - and secondary EU legislation - which is mainly the VAT Directive - as well as case law of the CJEU and Advocate General Opinions. However, also the German tax legislation on turnover taxes - the *Umsatzsteuergesetz* - as well as case law by the BFH is material for this thesis. Furthermore, the material contains publications by the European Commission and the German Government, commentaries, books, academic journals and online sources.

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<sup>6</sup> Prof. Dr. Sjoerd Douma, *Legal Research in International and EU Tax Law* (Kluwer 2014), p. 17 et seq

<sup>7</sup> Ibid, p. 28

<sup>8</sup> Prof. Dr. Sjoerd Douma, *Legal Research in International and EU Tax Law* (Kluwer 2014) p. 30; Jan M. Smits, *The Mind and Method of the Legal Academic* (Edward Elgar 2012), p. 26

<sup>9</sup> Prof. Dr. Sjoerd Douma, *Legal Research in International and EU Tax Law* (Kluwer 2014), p. 30; Jan M. Smits, *The Mind and Method of the Legal Academic* (Edward Elgar 2012), p. 24

<sup>10</sup> Prof. Dr. Sjoerd Douma, *Legal Research in International and EU Tax Law* (Kluwer 2014), p. 33



## 1.4 Delimitation

For this thesis, the VAT Directive and the German *Umsatzsteuergesetz* will only be illuminated on the newest version as of June 2016. Regarding the common flat-rate scheme for farmers there will be no special attention drawn to supplies to another Member State or another State outside the Community according to Art. 303 VAT Directive. It is also not the aim of this thesis to work out an optimal or perfect implementation and what an optimal threshold or optimal flat-rate would be in those matters. Furthermore, the thesis cannot examine in full whether the CJEU recognizes a national court decision as clear and adequate to result in a correct implementation. Neither, will the thesis focus on the abusive practices regarding the presented special schemes. Also, there will be no detailed rating whether those schemes comply with the principle of fiscal neutrality, which is an expression of the principle of equal treatment in the EU.<sup>11</sup>

## 1.5 Outline

Firstly, a short introduction into the EU law framework as it stands today will be given. As indirect taxation is harmonized within the EU and the VAT Directive has to be implemented into national law the rules set on special schemes in the VAT Directive will be examined. It has to be distinguished between the different special schemes for small enterprises set out in Articles 281 to 294 VAT Directive. Following this special scheme the common flat-rate scheme for farmers will be clarified which is ruled in Articles 295 to 305 VAT Directive. Subsequently, the German tax law rules on special schemes shall be explained firmly. Therefore, firstly the adopted German special scheme for small enterprises will be stated according to § 19 UStG. Then the flat-rate scheme for farmers pursuant to § 24 UStG will be explained.

Thus, the special schemes will be analysed. First of all the German tax law on turnover tax ruled in the *Umsatzsteuergesetz* will be examined in light of EU law - the VAT Directive and the case law of the CJEU. Both of the special schemes will be compared to EU law and analysed critically.

Subsequently it will be examined whether the special schemes are beneficial for the taxable persons and the tax authorities. Therefore the tax effect for the small traders and the farmers who are subject to the special schemes will be evaluated. Next the consequences for the EU Member States will be examined. Accordingly some possible risks when applying the implemented schemes will be stated. In conclusion, it will be discussed whether it is beneficial to implement those special schemes into domestic tax law. Last but not least the conclusion will reflect the outcome of this thesis and will give a short outlook.

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<sup>11</sup> Case C-174/08 *NCC Construction Danmark A/S v Skatteministeriet* [2009] I-10567

## 2 EU Law Framework

### 2.1 Overview of EU Law

In 1951, the Treaty of the European Coal and Steel Community introduced the fundamentals of the European Union.<sup>12</sup> With the introduction of the Treaties of Rome in 1957, the European Economic Community and the European Atomic Energy Community was established.<sup>13</sup> Further treaties developed the Community and created the European Union.<sup>14</sup> There are currently three Treaties that apply - the Treaty on European Union, the Treaty on the Functioning of the European Union and the Treaty establishing the European Atomic Energy Community.<sup>15</sup> Nowadays 28 Member States form the EU.<sup>16</sup>

There is to distinguish between primary EU law and secondary EU law. The Treaties form the primary EU law.<sup>17</sup> Besides the Fundamental Freedoms, the TFEU also provides for several written principles.<sup>18</sup> Secondary EU law includes regulations, directives, decisions, recommendations and opinions, which are stated in Art. 288 TFEU.<sup>19</sup> Lastly, the purpose of the Court of Justice of the European Union is to verify the correct interpretation of law.

### 2.2 Harmonization of indirect taxation within the EU

The Council may adopt provisions to harmonize turnover taxes when it is necessary to ensure the establishment and functioning of the internal market of the EU and to avoid distortion of competition, due to Art. 113 TFEU.

According to Art. 288 TFEU a directive shall be binding as to the result to be achieved but leaves it open to the national authorities of the Member States to decide on form and method.

For Value Added Taxation the important directive is the VAT Directive - Directive 2006/112/EC. However, that directive was established through other directives that were in place before. Firstly, on 11 April 1967 the First Council Directive 67/227/EEC was adopted on the harmonization of legislation of Member States concerning turnover taxes. The directive proposed a harmonized common system of VAT in the EU. Furthermore, the Second Council Directive 67/228/EEC introduced methods of the application of the common system of VAT (Art. 1). Thereafter the Sixth

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<sup>12</sup> Traité instituant la Communauté européenne du charbon et de l'acier (Paris, 18 avril 1951)

<sup>13</sup> Traité instituant la Communauté économique européenne (Rome, 25 mars 1957)

<sup>14</sup> Klaus-Dieter Borchardt, *The ABC of European Union law* (Publications Office of the European Union 2010), pp. 12-14

<sup>15</sup> *Ibid.*, p. 15

<sup>16</sup> Treaty of the accession of the Republic of Croatia to the European Union (Brussels, 5 December 2011)

<sup>17</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), p. 5

<sup>18</sup> *Ibid.*, pp. 25-26

<sup>19</sup> *Ibid.*, p. 20

Council Directive 77/388/EEC of 17 May 1977 was adopted, which was then replaced by the VAT Directive. VAT is harmonized within the EU and the aim of the VAT Directive is to harmonize and coordinate the laws of the Member States.<sup>20</sup>

But yet, pursuant to Art. 288 TFEU the Directive has to be implemented by the Member State to achieve binding force. When implementing, a Member State must also consider the objectives of the directive.<sup>21</sup> Furthermore, the correct implementation requires special regard to the content, the nature of the measure and the effective application and enforcement in practice.<sup>22</sup>

The VAT Directive especially differentiates between provisions in which the Member State "shall" or "may" apply a provision. When the Member State "may" adopt a provision it is up to that State to adopt that provision but the domestic tax act still has to comply with the VAT Directive.

A provision of the directive may have direct effect.<sup>23</sup> When a directive is correctly implemented, its effects are directly applicable to individuals through the implemented provision.<sup>24</sup> It should be noted that problems might arise when the Member State has not implemented a directive correctly.<sup>25</sup> Thus, the CJEU stated in case *Becker*<sup>26</sup> that a provision has to be unconditional and sufficiently precise to have direct effect.<sup>27</sup>

### **2.3 The common system of VAT**

According to point 5 of the preamble of the VAT Directive the aim of the Value Added Taxation is to be simple and ensure neutrality.

Pursuant to Art. 1 (2) VAT Directive, the VAT is a general tax on consumption, which applies to all goods and services. It also applies on all stages of production and distribution. The tax is proportional to the price of the goods and services. Several transactions may take place during the production and distribution channel before the tax is finally charged. Thus, on all stages the VAT is calculated on the price of goods or services at the applicable rate.

The following table shows an example of the system of VAT with the German normal tax rate of 19%:

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<sup>20</sup> Paul Craig, Gráinne du Búrca, *EU Law - Text, Cases and Materials* (Fifth Edition, Oxford University Press, 2011), p. 192

<sup>21</sup> Case C-14/83 *Sabine von Colson and Elisabeht Kamann v Land Nordrhein-Westfalen* [1984] ECR 01891, §15

<sup>22</sup> Sacha Prechal, *Directives in EC Law* (Second, Completely Revised Edition, Oxford University Press, 2005), p. 32

<sup>23</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), p. 83

<sup>24</sup> Case C-8/81 *Ursula Becker v Finanzamt Münster-Innenstadt* [1982] 00053, §19

<sup>25</sup> *Ibid*, §20

<sup>26</sup> Case C-8/81 *Ursula Becker v Finanzamt Münster-Innenstadt* [1982] 00053

<sup>27</sup> *Ibid*, §25

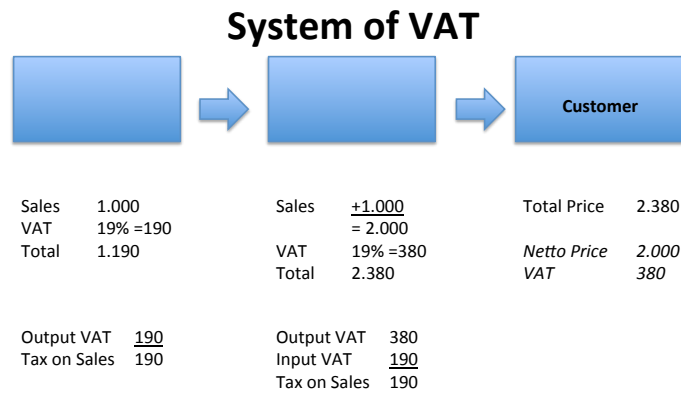


Figure 1: Normal system of VAT when the customer is the final consumer

The taxable person at the second (or any other) stage of distribution may deduct the 190 Euros of input VAT and charges 380 Euros of output VAT (which the taxable person has to refer to the tax authorities). The final consumer has to bear the whole tax burden of 380 Euros.

The situation is however entirely different if one of the entrepreneurs is exempt from VAT. This table shows a situation in which the customer is a taxable person:

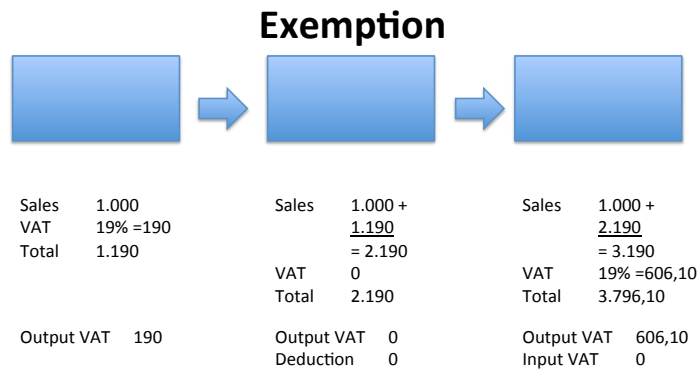


Figure 2: Exemption when the customer is a taxable person who is able to deduct input VAT

When the transactions of a taxable person are exempt from VAT, that taxable person may not deduct the input VAT for a certain good or service. However, there will also be no VAT on the transaction. Therefore the VAT has a cumulative effect as the price for the exempt transactions will be higher because the price will include the input VAT which occurred as costs for the exempt entrepreneur.<sup>28</sup> When the customer is a taxable person himself he may not deduct VAT - as there is no VAT on that transaction - but will charge VAT on the following transaction.

The situation is however different if the customer is the final consumer because he may not deduct the VAT. As there is no VAT for this transaction the final consumer faces a lower total price than compared to a good or

<sup>28</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), p. 264

service for which he would have to pay VAT. In Appendix 1 and 2 an example is shown, how an exemption effects the different transactions.

In order to safeguard the correct collection of VAT there are more specific rules about the obligation to pay, the identification of taxable persons, the invoicing rules of taxable transactions, accounting and VAT returns. Especially Art. 242 requires the keeping of accounts. Also a taxable person has to keep register of goods dispatched or transported by him or to him, Art. 243. Furthermore, the entrepreneur has to store copies of all the invoices issued by him or to him, Art. 244.

### 3 Special schemes in the EU

#### 3.1 Purpose

As already explained, taxable persons are required to keep accounts in sufficient detail for VAT purposes. The authorities check this application due to Art. 242 VAT Directive. However, that obligation can result in difficulties for certain retailers and other small taxpayers. Therefore, the Member States may or must adopt special schemes.

In total, there are six different special schemes provided for by the VAT Directive. For small enterprises (Art. 281 et seq), for farmers (Art. 295 et seq), for travel agents (Art. 306 et seq), for second-hand goods, works of art, collectors' items and antiques (Art. 311 et seq), for investment gold (Art. 344 et seq) and for non-established taxable persons supplying electronic services to non-taxable persons (Art. 357 et seq).

These special schemes exist mainly because of the administrative burden for the small undertakings or farmers<sup>29</sup> but also because of VAT fraud and tax evasion - especially in the fields of investment gold.<sup>30</sup> In case *Schmelz*<sup>31</sup> concerning a small enterprise it is specifically stated that the objective of the special scheme is to guarantee the effectiveness of fiscal supervision in order to combat possible tax evasion, avoidance and abuse.<sup>32</sup> Moreover, one main aim is the administrative simplifications intended to support the creation, activities and competitiveness of small enterprises and assuring a reasonable relationship between administrative charges in connection with fiscal supervision and the small amounts of tax to be connected with.<sup>33</sup>

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<sup>29</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), pp. 1185 & 1189

<sup>30</sup> Stefano Capaccioli, 'VAT Taxation of Gold in the European Union' [2014], Volume 2, in: EC Tax Review, p.85 et seq, p. 86

<sup>31</sup> Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel* [2010] ECR I-10465

<sup>32</sup> *Ibid*, §63

<sup>33</sup> *Ibid* §63; Kokott, Advocate General's Opinion, 17 June 2010, Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel*, p. 33

The special schemes for small enterprises, farmers and public auctions are optional to introduce for the Member States while the other special schemes must be adopted by all EU Member States. This thesis will focus on the special schemes for small enterprises and farmers.

Interestingly, small traders may qualify for the flat-rate scheme for farmers if they are not subject to the normal VAT arrangements or the special scheme for small enterprises. On the other hand also farmers may be subject to the special schemes for small enterprises.<sup>34</sup>

### **3.2 Special schemes for small enterprises**

A special scheme for small enterprises may be introduced by the Member State. The Member States may then use simplified procedures for small undertakings as they might have difficulties because of their activities or structure to apply the usual VAT arrangements.<sup>35</sup> Article 272 (1) (d) VAT Directive specifically states that Member State may release taxable persons covered by the exemption for small enterprises provided for in Articles 282 to 292 from certain or all obligations of the VAT Directive.

There was already an option for a special scheme for small enterprises in the Second Council Directive of 11 April 1967.<sup>36</sup> Therefore the special scheme for small enterprises has always been an issue in VAT in the European Union.

Currently there are three different schemes that apply for small enterprises in the VAT Directive. There has to be distinguished between the simplified charging and collection of VAT (Art. 281), the exemption scheme (Art. 282-290) and the graduated relief scheme (Art. 282-292).

#### **3.2.1 Simplified charging and collection of VAT**

Art. 281 VAT Directive provides for a simplified procedure for charging and collection of VAT. When a Member State has difficulties to apply the normal VAT arrangements to small enterprises because of their activities or structure they may adopt this procedure. The Member States must set conditions and limits and consult the VAT Committee upon adoption. The simplified procedure could be a flat-rate scheme for charging and collecting VAT under the condition that there is no reduction of the charging and collection of VAT.

There is one case dealing explicitly with the simplified charging and collection of VAT, which is Case *Commission v Austria*<sup>37</sup>. Under the

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<sup>34</sup> Klenk, 'UStG §24' [2015] 75th updated version, in: Sölch/Ringleb Umsatzsteuergesetz, C.H.Beck, p. 213

<sup>35</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), p. 1185

<sup>36</sup> Ben Terra, Julie Kajus, *Commentary - A Guide to the Recast VAT Directive* (last reviewed 1 July 2015, IBFD, 2015), p. 5037

<sup>37</sup> Case C-128/05 *Commission v Republic of Austria* [2006] ECR I-09265

Austrian legislation international passenger transport providers - who are not established in that Member State and whose turnover in Austria is less than 22.000 Euro per year - do not need to submit tax return forms and pay the net amount of VAT.<sup>38</sup>

The Court of Justice of the European Union firstly emphasized that the application of a special scheme to a small undertaking is an exception to the normal rules of the VAT Directive. However, this scheme must be applied only to the extent that it is necessary to achieve its objective.<sup>39</sup>

On the contrary to the joined cases *Direct Cosmetics and Laughtons Photographs* C-138 & 139/86<sup>40</sup> where the CJEU held that Member States have broad power to chose how to introduce the simplified procedure into domestic tax law<sup>41</sup>, the CJEU emphasized in *Commission v Austria* that the broad power only regards the choice whether to adopt simplified procedures or not.<sup>42</sup>

However, the Austrian exemption results in the fact that VAT is neither declared nor paid.<sup>43</sup> Thus, the CJEU states that Art. 281 does not allow for small undertakings to be exempt completely from the obligation to pay VAT. The provision only states that charging procedures may be simplified but there is no possibility for an undertaking to be completely exempt from VAT. Furthermore, in the Austrian legislation the VAT is not charged and there is no more charging procedure. The flat-rate scheme that is mentioned as an example in the provision is an illustration that small enterprises are still required to pay VAT.<sup>44</sup>

Therefore the Court comes to the conclusion that "simplified procedures" do not result in a total lack of charging and collecting the VAT.<sup>45</sup> The Court further states that other special schemes refer specifically to the expression "exemption from tax" while Art. 281 does not have such a wording.<sup>46</sup>

In conclusion, when applying the special scheme for charging and collecting VAT Member States are still obliged to charge VAT from the small enterprises and only the obligations for small businesses are simplified. Each Member State has to define the rules for such a scheme, which could be for example a flat-rate scheme.

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<sup>38</sup> Ibid, §1

<sup>39</sup> Ibid, §22

<sup>40</sup> Joined Cases C-138/86 and C-139/86 *Direct Cosmetics Limited and Laughtons Photographs Limited v Commissioners of Customs and Excise* [1988] 03937

<sup>41</sup> Ibid, §§41-42

<sup>42</sup> Case C-128/05 *Commission v Republic of Austria* [2006] ECR I-09265, §23

<sup>43</sup> Ibid, §24

<sup>44</sup> Ibid, §25

<sup>45</sup> Ibid, §25

<sup>46</sup> Ibid, §26

### 3.2.2 Exemption

Many countries in the European Union adopted the special scheme of exemption. From the 28 EU countries only Spain, the Netherlands and Sweden have not adopted the exemption for small enterprises according to Articles 283 to 287 in the VAT Directive.<sup>47</sup> Nevertheless, even Sweden is currently discussing to implement an exemption for small enterprises with a threshold of 30.000 SEK.<sup>48</sup>

#### 3.2.2.1 *Scope of the Exemption Scheme*

The exemption special scheme only applies for the supply of goods and services by small enterprises. However, according to Art. 283 it does not apply to transactions carried out on an occasional basis, supplies of new means of transport or supplies of goods or services carried out by a taxable person who is not established in the Member State in which the VAT is due. Furthermore, Member States may exclude other transactions from this special scheme.

According to Art. 284 (1), Member States who applied an exemption for small enterprises under the option of Art. 14 of the Second Council Directive of 11 April 1967 are allowed to continue to apply their arrangements for the special scheme, under the condition that it is in conformity with the VAT Directive. Furthermore, Member States who exempted taxable persons with a threshold less than the equivalent in national currency of 5.000 European units of account at the conversion rate on 17 May 1977 are allowed to raise their threshold up to those 5.000 Euros.

On the other hand, according to Art. 285, Member States who have not applied an exemption for small enterprises due to the option of Directive 67/228/EEC may introduce an exemption for taxable persons whose annual turnover is not higher than 5.000 Euros.

Moreover, Member States who exempted taxable persons before the 17 May 1977 with a threshold equal or higher than the equivalent in national currency of 5.000 European units of account at the conversion rate on that date - may raise their threshold to maintain the value of the exemption in real terms, according to Art. 286.

Art. 287 provides for a list of thresholds for Member States who entered into the European Union after 1 January 1978. The list starts with Greece who accessed to the EU in 1981<sup>49</sup>, with a threshold of 10.000 European unions of account. After the introduction of the Euro - as book money in

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<sup>47</sup> European Commission, 'Annex 1: VAT Thresholds (January 2016)' <[http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/vat/traders/vat\\_community/vat\\_in\\_ec\\_annexi.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/traders/vat_community/vat_in_ec_annexi.pdf)> accessed 18 April 2016

<sup>48</sup> Skatteverket, 'Omsättningsgräns för mervärdesskatt' (Promemoria) Dnr 131 117911-16/113, 21.03.2016

<sup>49</sup> Treaty of accession of the Hellenic Republic to the European Economic Community and to the European Atomic Energy Community (Brussels, 24 May 1979)



1999 and as cash money in 2002<sup>50</sup> - the list of thresholds mainly refers to Euros. Firstly, for the Czech Republic who joined in 2004<sup>51</sup> a threshold of 35.000 Euros is stated until Croatia who joined in 2013<sup>52</sup> for whom also a threshold of 35.000 Euros is set. However, the threshold for the countries varies down to 10.000 Euros for Poland and Cyprus with a threshold of 15.600 Euros and up to 35.000 Euros for Czech Republic, Hungary, Slovakia, Romania and Croatia and even up to 35.700 for Malta if the activity mainly concerns supply of goods.

The turnover for the purpose of serving a reference for the threshold by the Member State has to be determined according to Art. 288. It consists in the value of supplies of goods and services that are taxed, the value of transactions which are exempt with the deductibility of the VAT paid at the preceding stage, the value of transactions which are exempt in connection with exportation, international transport, certain transactions treated as exports or supply of services by intermediaries. Furthermore, the turnover shall include the value of real estate transactions, financial transactions and insurance services, except those transactions, which are ancillary transactions. The disposal of tangible or intangible capital assets of an enterprise shall however not be considered for the calculation of the turnover.

All in all, the exemption for small enterprises results in the fact that the taxable person is not entitled to deduct the input VAT and may not show output VAT on invoices, according to Art. 289.

Nevertheless, due to Art. 290, that taxable person may opt for normal VAT arrangements or for the special scheme of simplified procedures provided by Art. 281. If so, the taxable person shall be entitled to any graduated tax relief under national legislation.

### **3.2.2.2 Territorial Scope**

There is one case that dealt with this particular special scheme. This case is case *Schmelz* C-97/09<sup>53</sup>. Ms. Schmelz was resident in Germany and rented out an apartment situated in Austria.<sup>54</sup> She considered herself to be a small undertaking and therefore to be exempt from the payment of turnover tax in

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<sup>50</sup> European Commission, 'Phase 4: Three stages to EMU - From Maastricht to the euro and the euro area, 1991 to 2002' <[http://ec.europa.eu/economy\\_finance/euro/emu/road/three\\_stages\\_en.htm](http://ec.europa.eu/economy_finance/euro/emu/road/three_stages_en.htm)> accessed 2 May 2016

<sup>51</sup> Treaty of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic to the European Union (Athens, 16 April 2003)

<sup>52</sup> Treaty of the accession of the Republic of Croatia to the European Union (Brussels, 5 December 2011)

<sup>53</sup> Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel* [2010] ECR I-10465

<sup>54</sup> *Ibid*, §20

Austria. Thus, she did not charge tax on the rent.<sup>55</sup> However, the Austrian *Finanzamt* found that she was not able to benefit from the exemption for small undertakings, as she was neither resident nor established in Austria.<sup>56</sup> On the other hand, small undertakings that were established in the territory of Austria were granted an exemption from VAT and therefore lost their right of deduction. Hence the Court had to examine whether the Austrian legislation was in line with the freedom to provide services in Art. 56 TFEU and the general principle of equal treatment.<sup>57</sup>

In her AG Opinion Kokott stated that the special scheme for small enterprises is still only partially harmonized. But yet the scheme is a derogation from the general system of VAT, has to be interpreted strictly and can only be applied in order to achieve the objective.<sup>58</sup> Thus, it had to be considered whether the provisions are contrary to primary rules of EU law - such as the Fundamental Freedoms of the TFEU.<sup>59</sup>

The Court came to the conclusion that the fact that a small undertaking established outside Austria is excluded from the benefit from the VAT exemptions constitutes a restriction on the freedom to provide services.<sup>60</sup> Subsequently, the Court considered whether the restriction could be justified by overriding reason in public interest to guarantee the effectiveness of fiscal supervision.<sup>61</sup>

Thereafter, the question remained whether the legislation complied with the principle of proportionality. Thus, the legislation must be appropriate for securing the objective and must not go beyond what is necessary to attain that objective.<sup>62</sup> The Court then stated that the restriction to benefit for the exemption of small undertakings - only when the undertaking is established within that territory - is appropriate to ensure the effectiveness of fiscal supervision. It is appropriate, since it aims to ascertain whether the conditions to benefit from the exemption are met, given that undertakings retain the documents relating to all of their economic activities in the place of their establishment.<sup>63</sup> Nevertheless, the Court considered it difficult for the Host Member State to determine the effective supervision of activities of the small undertaking.<sup>64</sup>

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<sup>55</sup> Ibid, §21

<sup>56</sup> Ibid, §22

<sup>57</sup> Ibid, §33

<sup>58</sup> Kokott, Advocate General's Opinion, 17 June 2010, Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel*, p. 32

<sup>59</sup> Ibid, p. 45

<sup>60</sup> Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel* [2010] ECR I-10465, §53

<sup>61</sup> Ibid, §57

<sup>62</sup> Ibid, §58; Case C-318/07 *Hein Persche v Finanzamt Lüdenscheid* [2009] I 00359, §52

<sup>63</sup> Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel* [2010] ECR I-10465, §59

<sup>64</sup> Ibid, §60

The Court further noted that the aim of the special scheme is to guarantee the effectiveness of fiscal supervision in order to combat possible tax evasion, avoidance and abuse.<sup>65</sup> Furthermore, the scheme has the objective that administrative simplifications intended to support the creation, activities and competitiveness of small undertakings and also to retain a reasonable relationship between administrative charges in comparison with fiscal supervision and the small amounts of tax.<sup>66</sup>

Pursuant to Art. 272(1)(d), Member States may release small enterprises from obligations of the VAT Directive, which inform the tax authorities of the activities which are subject to VAT in the territory of the Member State.<sup>67</sup> Hence, those small enterprises do not have a VAT identification number in which they are established. Member States will therefore not have information about the turnover of the small enterprise.<sup>68</sup> Only when complex formalities would be adopted for the collection of relevant data and for the identification of possible abuse the Host Member State could verify the applicability of the special scheme. Furthermore, requests from the tax authorities in the Member State of establishment for administrative assistance from the tax authorities of all other Member States of the EU for the purposes of exchanging data would be needed.<sup>69</sup>

The Austrian legislation avoids a situation under which a taxable person can escape taxation of activities under the exemption for small enterprises - even though if those activities would be pursued in only one Member State, those activities would exceed the threshold and therefore not be covered by the exemption. This fact is not correspondent with the need to encourage only providing the exemption to small undertakings.<sup>70</sup>

The Court emphasized that at the current stage of evolution of the VAT system, the objective is to guarantee the effectiveness of fiscal supervision in order to combat fraud, tax evasion and possible abuse. Furthermore, the objective of the exemption for small enterprises is to support the competitiveness of those enterprises. Those grounds justify the limitation of applying the VAT exemption and the annual turnover taken into account only in the Member State where the enterprise is established.<sup>71</sup>

Therefore the legislation does not go beyond what is necessary to ensure the two objectives.<sup>72</sup> The Court came to the conclusion that the legislation is

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<sup>65</sup> Ibid, §63

<sup>66</sup> Ibid, §63; Kokott, Advocate General's Opinion, 17 June 2010, Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel*, p.33

<sup>67</sup> Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel* [2010] ECR I-10465, §64

<sup>68</sup> Ibid, §65

<sup>69</sup> Ibid, §69

<sup>70</sup> Ibid, §70

<sup>71</sup> Ibid, §71

<sup>72</sup> Ibid, §72

valid<sup>73</sup> and that the term 'annual turnover' shall mean "the turnover generated by an undertaking in one year in the Member State in which it is established".<sup>74</sup>

In conclusion, the special scheme of exemption for small enterprises only applies to taxable persons who are established in that Member State.

### **3.2.3 Graduated relief**

The third special scheme is the graduated relief, which is stated in Art. 282 - 292 VAT Directive. The rules governing, which transactions apply and which transactions are excluded as well as how the turnover is determined, are similar to those of the exemption scheme.

On the other hand, taxable persons who enjoy graduated tax relief are subject to the normal VAT arrangements, Art. 291. Thus, those small enterprises have to register for VAT purposes and receive a relief on a part of their turnover.

Under the scheme the turnover gradually decreases with the increase of the turnover and therefore the total tax burden is reduced. For example a small enterprise receives graduated tax relief when the turnover is over the threshold of the exemption scheme but the turnover is under the threshold set by the EU country for the graduated tax relief. This scheme has the effect that only VAT has to be paid for the VAT that is over the exemption threshold.<sup>75</sup>

Hence, a Member State can apply the exemption and the graduated relief scheme at the same time. The EU country will set those rules if the country decides to apply a graduated tax relief for small enterprises.

### **3.3 Common flat-rate scheme for farmers**

Another special scheme is the flat-rate scheme for farmers, which may be introduced by the Member State. The fundamental of this scheme is again that farmers have difficulties to keep detailed records, which are necessary for a VAT return. The difference to small enterprises is that farmers sell their goods mostly to manufacturers, wholesalers and other taxable persons. If those transactions would be excluded this situation would lead to an accumulation of taxes - as then the non-deductible input VAT would be included as a cost factor in the price of the goods and services. The aim of

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<sup>73</sup> Ibid, §76

<sup>74</sup> Ibid, §77

<sup>75</sup> Jarkko Harju, Tuomas Matikka, Timo Rauhanen, 'The Effect of VAT Threshold on the Behavior of Small Firms' [30.06.2015] (VATT Institute for Economic Research (Helsinki, Finland)), p. 6

the special scheme is to avoid accumulation of taxes and to ensure tax neutrality.<sup>76</sup>

Special provisions regarding special treatment for farmers were already included in the Second Council Directive of 11 April 1967. In that Directive the EU Member States were allowed to introduce a special system for undertakings in the agricultural sector when the application of the normal VAT system would constitute difficulties.<sup>77</sup>

### **3.3.1 Scope of the common flat-rate scheme**

Also for farmers, Art. 272 (1) (e) VAT Directive emphasizes that Member State may release taxable persons covered by the common flat-rate scheme for farmers from certain or all obligations of the VAT Directive.

The provisions for the common flat-rate scheme for farmers are given in Art. 295 - 305 VAT Directive. Firstly, Art. 295 provides for an overview of all the definitions - such as who is considered to be a farmer. For example a farmer is carrying out agricultural, forestry or fishing activities. The agricultural products and services are specifically listed in Annexes VII and VIII of the VAT Directive. However, Art. 296 (1) VAT Directive states the purpose of the scheme:

Where the application to farmers of the normal VAT arrangements, or the special scheme [for small enterprises] (...), is likely to give rise to difficulties, Member States may apply to farmers (...) a flat-rate scheme designed to offset the VAT charged on purchases of goods and services made by the flat-rate farmers.

It is up to the Member States to exclude certain categories of farmers from that provision pursuant to Art. 296 (2).

In general, under this scheme a farmer is exempt from VAT.<sup>78</sup> Therefore the flat-rate farmer does not charge VAT and deduct the input VAT (Art. 302). However, such a farmer is entitled to a flat-rate - a standard amount calculated through the flat-rate compensation percentage to the turnover of the farmer, Art. 295 (5) - on his goods and services, which is paid either by the tax authorities or the customer. If the flat-rate is paid by the customer (Art. 301 (1) sec. 1) that customer is able to deduct it if he is a taxable person himself. The rules for that flat-rate compensation percentage are set by the Member States pursuant to Art. 297. Those percentages may vary for the different kinds of division - forestry, agriculture and fisheries. However, Member States shall still notify the Commission before applying the chosen percentage. Due to Art. 298, the percentage has to be calculated according to macro-economic statistics for flat-rate farmers for the preceding three

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<sup>76</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), pp. 1189 - 1190

<sup>77</sup> Ben Terra, Julie Kajus, *Commentary - A Guide to the Recast VAT Directive* (last reviewed 1 July 2015, IBFD, 2015), p. 5074

<sup>78</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), p. 1190

years. Special notice should be given to the fact that the compensation percentage should not be as high as to have the effect of obtaining the refunds greater than the input VAT charged, according to Art. 299.

This special scheme only applies to goods and services of agricultural products and services to taxable persons who are not themselves flat-rate farmers in the same EU Member State (Art. 300 (1) & (3)), and in case of agricultural products to non-taxable legal persons in another EU Member State for which the intra-Community acquisition of goods apply (Art. 300 (2)). Therefore the flat-rate scheme only applies when there is a supply to other businesses but not to other flat-rate farmers or private customers. In those cases the flat-rate compensation has to be paid by the customer or by the public authorities, pursuant to Art. 301 (1). For any other transaction that is not stated in Art. 300 the flat-rate compensation has to be paid by the customer, Art. 301 (2).

Nevertheless, the flat-rate compensation is no VAT and does not have to be referred to the national tax authorities. On the contrary, the farmers may keep the flat-rate compensation to compensate the non-deductible input VAT. The customers of the agricultural product or service are able to recover those amounts through their own VAT returns, if they are taxable persons, which are able to deduct VAT pursuant to Art. 167 et seq. (Art. 301 (1) sec. 1).

Furthermore, Art. 303 gives more specific details about the flat-rate compensation percentages in situations of an intra-Community supply while Art. 305 specifies the conditions for the scheme in situations of distance sales.

Also in the special scheme for farmers, the flat-rate farmer may opt to be subject to normal VAT arrangements or to be subject to the simplified procedures stated in Art. 281. The rules and conditions for this option are laid down by the Member States, see Art. 296 (3).

All in all, for the farmer this scheme results in the fact that he may not deduct the input VAT when buying resources. Nevertheless, when he sells his goods and services - under the condition that this transaction equals an agricultural product or service - those supplies will be taxed according to a flat-rate. The flat-rate compensation is paid to the flat-rate farmer either by the customer or by the tax authorities and he can keep the flat-rate compensation in order to offset the non-deductible input VAT. When the customer is a taxable person he may deduct that flat-rate.

### 3.3.2 Different Aspects developed in the CJEU case law

There has been some case law about this special scheme and that has to be considered by the Member States.

The first case dealing with this issue is case *Commission v. Italy*<sup>79</sup>. The case concerns the complaint that the flat-rate compensation percentage in Italy was set at a too high level as well as that the flat-rate compensation percentage is also applicable for the supply of goods and services to other flat-rate farmers.<sup>80</sup> The CJEU firstly considered whether the set percentage was higher than those, which would be fixed according to the macro-economic statistics.<sup>81</sup> The Court came to the conclusion that Italy had failed to fulfil its obligations in setting the flat-rate compensation percentage too high.<sup>82</sup> Regarding the applicability to supply of goods and services to other flat-rate farmers the Court repeated the Sixth Council Directive and thus stated that the flat-rate compensation should not be applied in case of goods or services to flat-rate farmers or non-taxable persons. Furthermore, stating the flat-rate amount on an invoice would not make sense, as the buyer of the service would not be able to deduct the input tax.<sup>83</sup> Therefore the Court found that Italy failed to fulfil its obligations regarding that provision.<sup>84</sup>

Another case is *Detlev Harbs*<sup>85</sup>, which is a German case. In that case the question arose whether a farmer - who is subject to the common flat-rate scheme - leased his farm while he continued to farm himself on the rest of his farm, may treat that income as subject to the special scheme or if he has to tax it under the general scheme of VAT.<sup>86</sup> The CJEU firstly emphasized that the special scheme represents an exception to the general scheme of VAT. Like for the other schemes the scheme therefore should be applied to the extent that is necessary to achieve the objective.<sup>87</sup> Furthermore, any exception to a general rule should be interpreted strictly.<sup>88</sup> The aim of the provision is to offset the tax charged on purchases of goods and services made by farmers through a flat-rate compensation payment to farmers.<sup>89</sup> However, the Court described that the special scheme does not apply to all persons who are formally a farmer but only to those who apply fall under those provisions stated in (now) Art. 295.<sup>90</sup> The CJEU then considered that

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<sup>79</sup> Case C-3/86 *Commission v Italian Republic* [1988] 03369

<sup>80</sup> *Ibid.*, §3

<sup>81</sup> *Ibid.*, §10

<sup>82</sup> *Ibid.*, §§15-16

<sup>83</sup> *Ibid.*, §21

<sup>84</sup> *Ibid.*, §22

<sup>85</sup> Case C-321/02 *Detlev Harbs v Finanzamt Rendsburg* [2004] I-07101

<sup>86</sup> *Ibid.*, §14

<sup>87</sup> *Ibid.*, §27; Léger, Advocate General's Opinion, 11 March 2004, Case C-321/02 *Detlev Harbs v Finanzamt Rendsburg*, p. 31

<sup>88</sup> Case C-321/02 *Detlev Harbs v Finanzamt Rendsburg* [2004] I-07101, §27; Case C-83/99 *Commission v Kingdom of Spain* [2001] I-00445, §19

<sup>89</sup> Case C-321/02 *Detlev Harbs v Finanzamt Rendsburg* [2004] I-07101, §29

<sup>90</sup> *Ibid.*, §31

there is no express reference to leasing in (now) Art. 295 (4) and Annex VII in the VAT Directive.<sup>91</sup> The letting therefore does not fall within the scope of the common flat-rate scheme for farmers<sup>92</sup> and the Court concluded that the turnover from that income must be taxed under the normal VAT arrangements.<sup>93</sup>

Another case dealing with the granting of hunting licenses is *Stadt Sundern*<sup>94</sup>. Also this case, is a German case. The question arose whether other supplies of agricultural products and services that are supplied by a farmer who is subject to the flat-rate scheme are also subject to the common flat-rate scheme.<sup>95</sup> Then the CJEU referred to *Detlev Harbs* and therefore came to the conclusion that other transactions remain subject to the general scheme of VAT.<sup>96</sup> Subsequently the question was examined whether the granting of hunting licences is also an agricultural service.<sup>97</sup> But due to the same reasoning as in *Detlev Harbs* the Court concluded that the granting of hunting licences is not a supply of an agricultural service and therefore not subject to the common flat-rate scheme for farmers.<sup>98</sup>

Also joined cases *Ślaby and Kuć*<sup>99</sup> deal with the common flat-rate scheme for farmers. It was considered whether a natural person is a taxable person for the disposal of land.<sup>100</sup> However, the Court followed *Detlev Harbs* and *Stadt Sundern* in stating that a transaction other than the supply of agricultural products and agricultural services provided by the flat-rate farmer remain subject to the general scheme of the VAT Directive.<sup>101</sup> In that case the CJEU found it not important for the outcome of the case whether the person is a flat-rate farmer or not.<sup>102</sup>

To sum up from the last three cases, any other supply of a flat-rate farmer that does not fall within the provisions of Art. 295 is subject to the normal treatment of the VAT Directive.

The latest case dealing with the special scheme is *Commission v. Portugal*<sup>103</sup>. This infringement procedure deals inter alia with the Portuguese farmers special scheme under which those farmers were exempt

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<sup>91</sup> Ibid, §33

<sup>92</sup> Ibid, §36

<sup>93</sup> Ibid, §37

<sup>94</sup> Case C- 43/04 *Stadt Sundern v Finanzamt Arnsberg* [2005] I-04491

<sup>95</sup> Ibid, §§14 & 17

<sup>96</sup> Ibid, §20

<sup>97</sup> Ibid, §§14 & 22

<sup>98</sup> Ibid, §§30 & 31

<sup>99</sup> Joined Cases C-180/10 and C-181/10 *Jarosław Ślaby v Minister Finansów and Emilian Kuć, Halina Jeziorska-Kuć v Dyrektor Izby Skarbowej w Warszawie* [2011] I-08461

<sup>100</sup> Ibid, §26

<sup>101</sup> Ibid §48; Case C-321/02 *Detlev Harbs v Finanzamt Rendsburg* [2004] I-07101, §31/36; Case C- 43/04 *Stadt Sundern v Finanzamt Arnsberg* [2005] I-04491, §20

<sup>102</sup> Joined Cases C-180/10 and C-181/10 *Jarosław Ślaby v Minister Finansów and Emilian Kuć, Halina Jeziorska-Kuć v Dyrektor Izby Skarbowej w Warszawie* [2011] I-08461, §52

<sup>103</sup> Case C-524/10 *Commission v Portuguese Republic* [2012]



from payment of VAT and a flat-rate compensation percentage of 0% was applied.<sup>104</sup> The CJEU emphasized once again that the objective of the provision is simplification and to set off the amount of input VAT.<sup>105</sup> However, the objective of simplification cannot justify the introduction of an exemption, which is not provided for by the VAT Directive.<sup>106</sup> Furthermore, when a flat-rate farmer does indeed pay VAT it is against that objective not to grant compensation for the paid VAT.<sup>107</sup> Subsequently, the Court referred to the neutrality in competition - which desires that within the territory of each Member State similar goods and services should bear the same tax burden. The aim of the special scheme for farmers is also to preserve the neutrality of VAT.<sup>108</sup> However, it should be noted that the flat-rate compensation does not lead to full VAT neutrality. Then the Court states:

It does however achieve the highest neutrality possible taking into account the need to reconcile that payment and the objective of compensation with the objective of simplification of the rules to which flat-rate farmers are subject, which is also one of the objectives of the flat-rate scheme for farmers [...]<sup>109</sup>

The CJEU comes to the conclusion that Portugal has failed to fulfil its obligations regarding the special scheme.<sup>110</sup>

All in all, according to the stated case law it can be said that the special scheme constitutes an exception to the normal VAT arrangements and has to be interpreted strictly and therefore only agricultural supplies, which are stated in the provisions regarding the special scheme, are subject to the flat-rate farmers scheme.<sup>111</sup> Furthermore, the flat-rate compensation percentage should not be set too high or at least not higher than the macro-economic statistics. On the other hand also percentages set at a nil rate are contrary to the VAT Directive, as well as an exemption from VAT for farmers.<sup>112</sup>

However, the main goals of the scheme are the simplification and the offsetting of input VAT as well as the neutrality of VAT.

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<sup>104</sup> Ibid, §1

<sup>105</sup> Ibid, §48; Case C-321/02 *Detlev Harbs v Finanzamt Rendsburg* [2004] I-07101, §29; Case C- 43/04 *Stadt Sundern v Finanzamt Arnsberg* [2005] I-04491, § 28

<sup>106</sup> Case C-524/10 *Commission v Portuguese Republic* [2012], §50

<sup>107</sup> Ibid, §51

<sup>108</sup> Ibid, §52; Kokott, Advocate General's Opinion, 22 September 2011, Case C-524/10 *Commission v Portuguese Republic*, §§45-48

<sup>109</sup> Case C-524/10 *Commission v Portuguese Republic* [2012], §53

<sup>110</sup> Ibid, §63

<sup>111</sup> see for instance: Case C-321/02 *Detlev Harbs v Finanzamt Rendsburg* [2004] I-07101, §§27, 31

<sup>112</sup> Case C-524/10 *Commission v Portuguese Republic* [2012], §68

## 4 Special schemes in Germany

Germany accessed to the European Union in 1958. It was one of the six countries, which formed the fundamentals of the EU and cooperated economically.<sup>113</sup> As already explained in Chapter 2.2 Indirect Taxation is harmonized within the EU, Art. 113 TFEU. However, AG Kokott in *Schmelz* refers to partial harmonization concerning the special scheme of exemption for small enterprises.<sup>114</sup> The VAT Directive is the important directive in the field of turnover taxes<sup>115</sup> and according to Art. 288 TFEU a directive is binding for the Member States but the choice of form and method is up to the Member State. Hence, EU Member States have to adopt the measures into their domestic tax acts. However, those effects will be examined in Chapter 5.1.

The special schemes for small enterprises and farmers are not implemented in every EU country. The Member States may adopt special schemes for small enterprises and farmers. Germany adopted special rules in the *Umsatzsteuer* for small enterprises in § 19 UStG and for farmers in § 24 UStG. Those are also presented in German in Appendix 5 and 6.

### 4.1 Small enterprises

In § 19 UStG the taxation of small enterprises is regulated (*Besteuerung der Kleinunternehmer*). With the introduction of the Sixth Council Directive Germany adopted the UStG and in 1980 Germany adjusted § 19 UStG in implementing an exemption for small enterprises under a certain threshold.<sup>116</sup>

§ 19 (1) UStG states, that there is no turnover tax - *Umsatzsteuer* - for a supply of goods or supply of services for consideration within the territory of Germany by a taxable person who is established within the territory of Germany when the overall turnover of the previous year is below 17.500 Euro and the turnover of the current year will not exceed 50.000 Euro. For this regime turnover shall include the overall turnover in connection to the received remuneration reduced by the turnover in connection to fixed assets.

The special regime for small enterprises does not apply to taxable persons who are not established in Germany, for taxable transaction for that the reverse charge mechanism applies, in situations when VAT is shown on the invoice even though there is no entitlement for it and in cases of triangulation within the Community. If the taxpayer however comes under the special scheme of small enterprises the obligations for Intra-Community

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<sup>113</sup> Traité instituant la Communauté économique européenne (Rome, 25 mars 1957)

<sup>114</sup> Kokott, Advocate General's Opinion, 17 June 2010, Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel*, p. 32

<sup>115</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), p. 83

<sup>116</sup> Schüler-Täsch, 'UStG §19' [2015], 75th updated version, in: Sölch/Ringleb *Umsatzsteuergesetz*, C.H.Beck, p. 3

acquisition of goods, the right of option for taxation, the requirement to state the VAT amount payable in an invoice, the requirement to state the VAT identification number in an invoice and the rules of deductions do not apply.

Nevertheless, pursuant to § 19 (2) UStG the taxable person is able to declare to waive the application of § 19 (1) UStG until the tax becomes incontestable. When the tax occurs, the taxable person is bound for at least five years. The withdrawal has to be declared at the latest in the year where it should be applied.

§ 19 (3) UStG gives rules about the overall turnover. The turnover shall consist in the value of all taxable transactions excluding several exempt transactions which are stated in § 4 Nr. 8 (i), Nr. 9 (b), Nr. 11 - 28 UStG and the incidental transactions thereof. If the taxable person used the derogation from the chargeable event that the VAT becomes chargeable no later than the time the payment is received, then also the overall turnover has to be calculated due to that derogation. If the taxable person carries out the economic activity only for a part of the year, then the actual overall turnover has to be converted into an overall annual turnover. Every commenced month is to be considered a full month for the conversion except when the conversion at a daily level would lead to a lower overall annual turnover.

However, pursuant to § 19 (4) the special scheme for small enterprises does not apply for supplies of new means of transport. Regarding those transactions specific obligations for deductions shall apply.

All in all, the UStG states that there is no VAT for small enterprises under the threshold. Those small traders remain however taxable persons and they perform taxable transactions, they are solely exempt from VAT.<sup>117</sup> They are somewhat treated as non-taxable persons. However, those small enterprises still have to declare their annual turnover tax returns and also to declare - in principle - quarterly pre-declarations.<sup>118</sup> Taxable persons falling under the special scheme of exception for small enterprises do not have a right of deduction. Furthermore, they also do not have the right to show VAT on invoices.<sup>119</sup>

It should also be noted that this exemption only applies to taxable persons who are below the threshold. § 19 UStG describes a subjective exemption and it applies to the entrepreneur at issue and not for parts of his business. If an entrepreneur has more than one business the turnover of all of those businesses has to be below the threshold in order to apply for § 19 UStG. That is also the case when there is a VAT group - in that case all bodies

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<sup>117</sup> Schüler-Täsch, 'UStG §19' [2015], 75th updated version, in: Sölch/Ringleb Umsatzsteuergesetz, C.H.Beck, p. 1

<sup>118</sup> Korn, 'UStG §19' [2015] 14th edition, in: Bunjes/Geist Umsatzsteuergesetz, C.H.Beck, p. 1

<sup>119</sup> Ibid, p. 4

belonging to the group in total have to be below the small enterprise exemption threshold.<sup>120</sup>

## 4.2 Farmers

Germany also chose to adopt the common flat-rate scheme for farmers. The provisions of the VAT Directive are implemented in § 24 UStG (*Durchschnittssätze für land- und forstwirtschaftliche Betriebe*). The fundamentals of the provision exist since its implementation in 1967 - only some minor adaptations were made.<sup>121</sup>

The flat-rate percentage for farmers for supplies of forestry products while excluding sawmill products is set at a rate of 5,5%, § 24 (1) Nr. 1 UStG. The flat-rate percentage for supplies - to which the normal reduced rate (which amounts to 7% in Germany, §12 (2) UStG) does not apply - of sawmill and alcoholic beverages, excluding supplies of goods abroad and supplies of services except those to which the reduced rate applies is set at a rate of 19%, § 24 (1) Nr. 2 UStG. This percentage equals the normal *Umsatzsteuer* rate in Germany. The remaining supplies of goods and services have a flat-rate percentage of 10,7%, § 24 (1) Nr. 3 UStG. The exemptions in the UStG except those listed in § 4 Nr. 1 - 7 UStG as well as the option to tax when exempt under normal arrangements do not apply.

Pursuant to § 24 (1) S. 3 UStG the flat-rate compensation amounts to 5,5% in cases of supply of forestry products except sawmill products and to 10,7% in all other cases. However, the flat-rate farmer is not entitled to any deductions of his input VAT charged. The flat-rate has to be shown on the invoice, § 24 (1) S. 5 UStG.

Thus, the supply of forestry products (§ 24 (1) Nr. 1 UStG) has a flat-rate of 5,5% while the flat-rate farmer may keep the full 5,5% as a flat-rate compensation. Supplies specified in § 24 (1) Nr. 2 have a flat-rate of 19% while the flat-rate farmer is only entitled to a flat-rate compensation of 10,7%. The flat-rate farmer may keep the 10,7% of flat-rate compensation and has to refer the remaining 8,3% to the tax authorities. In all the other cases - those specified in § 24 (1) Nr. 3 UStG and those which are listed in Annex 2 and exports and transactions abroad which are not listed in Annex 2 - the agricultural products and services have a flat-rate of 10,7% while the flat-rate farmer is entitled to the full 10,7% as flat-rate compensation. Thus, the farmer does not need to refer taxes to the tax authorities.<sup>122</sup> If the customer is a taxable person who is able to deduct VAT, he may deduct the flat-rate pursuant to § 15 UStG.

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<sup>120</sup> Ibid, p. 9

<sup>121</sup> Leonard, 'UStG §24' [2015] 14th edition, in: Bunjes/Geist Umsatzsteuergesetz, C.H.Beck, p. 16

<sup>122</sup> Finance Office Professional, 'Land- und Forstwirtschaft/ UMSATZSTEUER' (Lexikonbeitrag) <[https://www.haufe.de/finance/finance-office-professional/land-und-forstwirtschaft-umsatzsteuer\\_idesk\\_PI11525\\_HI1635996.html](https://www.haufe.de/finance/finance-office-professional/land-und-forstwirtschaft-umsatzsteuer_idesk_PI11525_HI1635996.html)> accessed 6 May 2016

Subsequently § 24 (2) UStG clarifies what should be considered to be agricultural, forestry and fisheries undertaking. Germany considers a subsidiary establishment that belongs to the undertaking as belonging to the establishment. However, a commercial enterprise by virtue of German legal form is not considered to be an establishment pursuing agricultural production activities even if all the other requirements for a agricultural, forestry or fisheries undertaking are fulfilled. This condition will be examined more in detail in Chapter 5.1.2.2.

If the taxable person also pursues other business activities, those activities have to be considered to belong to a separate business entity, according to § 24 (3) UStG.

However, pursuant to § 24 (4) UStG, the taxable person has the option to declare that his turnover should not be subject to the flat-rate scheme but to the normal VAT arrangements. He has to apply that option until the tenth day of the concerned calendar year to the tax authorities - *Finanzamt*. That declaration bounds the taxable person for at least five subsequent years and in case of disposal of the business, the purchaser is bound to that period. This option can be revoked to the beginning of the calendar year. However, that revoke has to be declared until the tenth day of the concerned calendar year. That period may be extended when otherwise it is undesirable to remain the legal remedies.

## **5 Critical analysis of the German special schemes in the light of EU law**

### **5.1 Validity of German law**

As mentioned - especially in Chapter 2.2 - due to Art. 288 TFEU, a directive is binding for the Member States while the form and method is up to the Member State. Hence, the Member State may implement the provisions of the directive, invoke the domestic legislation to make national law compatible with the directive or otherwise the Member State may fail to implement the directive.<sup>123</sup> The Court confirms that five requirements have to be fulfilled by the Member States in order to safeguard a correct implementation. Those requirements are also referred to as the "five tests". For this purpose the measure has to show completeness, effectiveness, legal certainty, clarity/ precision and publicity/transparency.<sup>124</sup>

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<sup>123</sup> Markus Klamert, 'Judicial implementation of directives and anticipatory indirect effect: connecting the dots' [2006], Volume 43, in: *Common Market Law Review*, p. 1251 et seq, p. 1262

<sup>124</sup> *Ibid*, p. 1263

As Germany is a Member State of the European Union since 1958<sup>125</sup>, Germany was obliged to adopt the VAT Directive into domestic law and did so through the *Umsatzsteuergesetz*.<sup>126</sup>

### 5.1.1 Special scheme for small enterprises

First of all, Germany adopted the special scheme for small enterprises of exemption in § 19 UStG, which is stated in Art. 282 - 290 VAT Directive. The other two special schemes - namely the simplified procedures for charging and collection and the graduated relief are not implemented into the *Umsatzsteuergesetz*.

#### 5.1.1.1 Threshold

Germany did not provide for an exemption before the adaptation of § 19 UStG in 1980 due to the Sixth Council Directive. According to Art. 285 VAT Directive Germany had the possibility to exempt taxable persons with a turnover that was not higher than 5.000 Euros or the equivalent in the national currency - which was the *Deutsche Mark* at that time.<sup>127</sup> Pursuant to Art. 286 VAT Directive, Member States may raise the threshold in order to maintain the value of exemption in real terms. Nowadays Germany provides for a threshold of 50.000 Euros for the current year while having a turnover in the year before of 17.500 Euro, § 19 (1) UStG. Therefore a small trader has to be under the threshold of 17.500 to constantly apply for the exemption scheme. The threshold that Germany applies is therefore consistent with the limitations of Art. 286 VAT Directive.<sup>128</sup>

From an economic point of view, one may wonder in general what the optimal threshold for such an exemption is. In short, the threshold has to comply with "the need to trade-off the tax revenue that is lost by raising the threshold against the administrative and compliance costs saved by (respectively) the tax authorities and taxpayer"<sup>129</sup>.

Comparing the threshold of the different EU Member States, it shows that the United Kingdom has the highest threshold of (equivalent) 114.397 Euro. On the other hand, Finland has the lowest threshold of 8.500 Euro - followed by Greece with a threshold of 10.000 Euro. Some countries differ the threshold regarding certain transactions. The average (lowest) threshold amounts to 30.489,00 Euro. This calculation is demonstrated in Appendix 7. It shows that Germany applies a threshold that seems to be below average - considering the 17.500 Euro.

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<sup>125</sup> Traité instituant la Communauté économique européenne (Rome, 25 mars 1957)

<sup>126</sup> Case C-8/81 *Ursula Becker v Finanzamt Münster-Innenstadt* [1982] 00053, §18

<sup>127</sup> Schüler-Täsch, 'UStG §19' [2015], 75th updated version, in: Sölch/Ringleb *Umsatzsteuergesetz*, C.H.Beck, p. 3

<sup>128</sup> Korn, 'UStG §19' [2015] 14th edition, in: Bunjes/Geist *Umsatzsteuergesetz*, C.H.Beck, p. 2

<sup>129</sup> Michael Keen, Jack Mintz, 'The optimal threshold for a value-added tax' [2004], Volume 88, in: *Journal of Public Economics*, pp. 559 et seq, p. 562

Furthermore, the German Federal Chamber of Tax Consultancy's is of the opinion that the threshold should be raised. The chamber argues that the threshold has not been adapted since over ten years and would simplify the administrative burden even more. More small enterprises would then be subject to the special scheme, which would reduce the work of tax authorities and the relevant enterprises.<sup>130</sup>

All in all, the threshold is in line with the legal provisions in the VAT Directive. However, it remains doubtful whether the threshold as it stands today shows the value of the exemption in real terms.

#### **5.1.1.2 General Aspects**

The requirement - that the exemption shall apply to the supply of goods and services by small enterprises in Art. 282 - is fulfilled by § 19 (1) S. 1 UStG. The transactions that are excluded through Art. 283 VAT Directive, are also excluded in the German tax act. It should be noted that Germany does not regard occasional activities as taxable transactions pursuant to Art. 12 VAT Directive. The supply of new means of transport is excluded in § 19 (4) UStG and the supplies of goods or services carried out by taxable persons who are not established in Germany - what is also excluded by the earlier mentioned *Schmelz* case - are excluded through the pure wording of § 19 (1) S. 1 UStG. As explained in Chapter 3.2.2.2, this limitation constitutes a restriction that is justified by the need to safeguard the coherence effectiveness of fiscal supervision in order to combat fraud, tax evasion and possible abuse.<sup>131</sup>

Art. 288 VAT Directive also requires that disposals of tangible or intangible capital assets of an enterprise are excluded for the calculation of the turnover. This is also excluded by § 19 (1) S. 2 UStG.

Furthermore, § 19 (1) S. 4 UStG claims inter alia that there is no deduction of input tax and the tax should not be stated on the invoices. This is required by Art. 289 VAT Directive. Last but not least, the VAT Directive sets the condition that there has to be an option for the taxable person who is exempt to apply for the normal VAT arrangements or simplified procedures. This option is given in § 19 (2) S. 1 UStG.

In conclusion, German tax law regarding the special scheme for small enterprises is in line with EU law, which is ruled through the VAT Directive and the case law. As form and method of the adoption of the provision is still up to the Member State, Germany implemented some very specific provisions that are not provided for by the VAT Directive. These are especially the procedures how to opt for normal USt arrangements and

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<sup>130</sup> Inga Bethke, 'Praxisprobleme in der Umsatzsteuer - Teil 1: Hinweise der Bundessteuerberaterkammer an den Gesetzgeber' [2014], in: Deutsches Steuerrecht (DStR), p. 680 et seq, p. 682

<sup>131</sup> Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel* [2010] ECR I-10465, §§53 & 71

therefore waive the application of § 19 UStG. But also the transactions, which Germany excludes from the application of § 19 UStG such as taxable transaction for that the reverse charge mechanism applies, in situations when VAT is shown on the invoice even though there is no entitlement for it and in cases of triangulation within the Community. However, Art. 283 (2) VAT Directive allows Member States to exclude transactions other than those referred to in the VAT Directive. Therefore it is in line with the VAT Directive to adopt those special exemptions.

Furthermore, § 19 UStG provides that the obligations for Intra-Community acquisition of goods, the "usual" right of option for taxation and the requirement to state the USt identification number in the invoice do not apply. However, those specific provisions should be in line with the provisions of the VAT Directive as Art. 273 allows Member States to implement other obligations which are necessary to ensure the correct collection of VAT.

Thus, the requirements of the VAT Directive are fulfilled. Also the condition stated in the *Schmelz* case is fulfilled. Therefore the German tax law on the exemption of small enterprises is in line with the EU law and correctly implemented. Only may only question whether the threshold shows the value of the exemption in real terms. § 19 UStG ensures completeness, effectiveness, legal certainty, clarity and precision as well as publicity and transparency and therefore the "five tests" is fulfilled.

### **5.1.2 Common flat-rate scheme for farmers**

Germany also implemented the special common flat-rate scheme for farmers in § 24 in the *Umsatzsteuergesetz*.

#### **5.1.2.1 General Aspects**

All the agricultural production activities referred to in Annex VII of the VAT Directive, which are considered to be subject to the special scheme, comply with the operations stated in § 24 (2) UStG.

Regarding all the other definitions of Art. 295 VAT Directive, § 24 UStG is also in line with those.<sup>132</sup>

Furthermore, due to Art. 296 (3) VAT Directive there has to be an option for the flat-rate farmer to apply for normal VAT arrangements. That option is fulfilled by § 24 (4) UStG. Art. 302 of the VAT Directive requires that the flat-rate farmer shall not be entitled to deduction of the input VAT charged in respect of the particular transactions, which is ensured through § 24 (1) S. 4 UStG.

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<sup>132</sup> Klenk, 'UStG §24' [2015] 75th updated version, in: Sölch/Ringleb *Umsatzsteuergesetz*, C.H.Beck, p. 209



The case law of the CJEU as in *Harbs* and *Stadt Sundern* is recognized in German tax case law and therefore considered in tax matters.<sup>133</sup> This matter is also safeguarded through the pure wording of § 24 (1) S. 1 UStG stating that it applies for transactions within the scope of the agricultural and forestry undertaking.<sup>134</sup> For instance, the BFH concluded in judgement *V R 28/03*<sup>135</sup> that the lease of hunting permits is precluded from the flat-rate scheme for farmers. The Court stated that only transactions stated in the VAT Directive fall under that scheme.<sup>136</sup> Furthermore, Germany allows for the disposal of used machinery (UStAE 24.2 Abs. 6 S. 2), the leasing of land<sup>137</sup> and the lodging and feeding from holiday guests on the farm<sup>138</sup> not to fall under the flat-rate scheme of the VAT Directive but instead to be subject to the normal USt treatment.<sup>139</sup> Furthermore, the BFH considers in its latest judgement<sup>140</sup> concerning whether horse pensioning management could fall within § 24 UStG - which it does not - that § 24 UStG is compatible with Art. 295 et seq of the VAT Directive due to the settled case law of the BFH<sup>141</sup>. Therefore the BFH considers that § 24 UStG is in line with the VAT Directive.

Furthermore, there is no more right of deduction when the flat-rate scheme for farmers is applicable. This is set through Art. 302 VAT Directive and stated in § 24 (1) S. 5 UStG.

### ***5.1.2.2 Exclusion of commercial enterprises by virtue of legal form***

It is however doubtful whether the requirement stated in § 24 (2) S. 3 - that a commercial enterprise by virtue of German legal form should not be considered to be an establishment pursuing agricultural production activities even though all the other requirements for an agricultural, forestry or fisheries undertaking are fulfilled - is conform with EU law. The VAT Directive does not state such a condition.

<sup>133</sup> see for instance: BFH-Urteil vom 25.11.2004 (V R 8/01) BStBl 2005 II, S. 896; BFH-Urteil vom 22.09.2005 (V R 28/03) BStBl 2006 II, S. 280

<sup>134</sup> Leonard, 'UStG §24' [2015] 14th edition, in: Bunjes/Geist Umsatzsteuergesetz, C.H.Beck, p. 12

<sup>135</sup> BFH-Urteil vom 22.09.2005 (V R 28/03) BStBl. 2006 II S. 280

<sup>136</sup> Ibid, p. 3)

<sup>137</sup> BFH-Urteil vom 6.10.2005 (V R 64/00) BStBl. 2006 II S. 212

<sup>138</sup> BMF, 'Anwendung der Durchschnittssatzbesteuerung nach § 24 UStG auf Vermietungs- und Verpachtungsleistungen - Konsequenzen aus dem BFH-Urteil vom 25. November 2004 - V R 8/01' (Schreiben) vom 28.11.2005, IV A 5, BStBl I 2005, S. 1065

<sup>139</sup> Leonard, 'UStG §24' [2015] 14th edition, in: Bunjes/Geist Umsatzsteuergesetz, C.H.Beck, p. 12

<sup>140</sup> BFH-Urteil vom 21.01.2015 (XI R 13/13) BStBl. I 2015, S. 730

<sup>141</sup> see for instance: BFH-Urteil vom 13.08.2008 (XI R 8/08) BStBl. II 2009, S. 216; BFH-Urteil vom 19.11.2009 (V R 16/08) BStBl. 2010 II, S. 319; BFH-Urteil vom 13.01.2011 (V R 65/09) BStBl. 2011 II, S. 465; BFH-Urteil vom 13.11.2013 (XI R 2/11) BStBl. 2014 II, S. 543; BFH- Urteil vom 10.09.2014 (XI R 33/13) DStR 2015, S. 111

There has already been a case in Germany before the *Bundesfinanzhof*<sup>142</sup> questioning whether that specific provision is contrary to EU law. In that case the Court considered that § 24 UStG is based on the Sixth Council Directive and accordingly § 24 UStG has to be in line with the Directive.<sup>143</sup> According to Art. 296 VAT Directive Member States are allowed to adopt a special scheme when the normal VAT arrangements would result in difficulties for farmers.<sup>144</sup> Nevertheless, the VAT Directive does not contain such a provision as the one in § 24 (2) S. 3 UStG. Furthermore, the Court considers that because of the neutrality principle in the EU a Member State is not allowed to adopt such a provision.<sup>145</sup> The principle of fiscal neutrality requires that economic operators who carry out the same activities should not be treated differently.<sup>146</sup>

Furthermore, the CJEU has made clear that Member States have to apply their discretion in conformity with the aims and principles of the VAT Directive and especially with the principle of neutrality of VAT and the principle of proportionality.<sup>147</sup> The BFH corresponds with the CJEU in that regard.<sup>148</sup> An example of a provision that would be in line with the principle of neutrality is that all taxable persons who have to keep accounts are excluded from the application of § 24 UStG. Though, in principle the Member State is allowed to differentiate between activities.<sup>149</sup>

Due to those reasons, the *Bundesfinanzhof* found that Germany was not allowed to exclude taxable persons because of their legal form from the application of the common flat-rate scheme for farmers. Hence, the provision is not applicable.<sup>150</sup> The question was not considered to have to be referred as a preliminary ruling to the CJEU.<sup>151</sup> However, the BFH could have asked the CJEU whether it is contrary to Articles 295 et seq to exclude the commercial enterprises by virtue of a legal form from the application of the special scheme for farmers or whether the commercial enterprise can demand that the scheme also applies for them.<sup>152</sup>

Due to the Communication from the federal ministry of finance of Germany, the *Bundesministerium der Finanzen*, the tax authorities give the

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<sup>142</sup> BFH-Urteil vom 16.04.2008 (XI R 73/07) BStBl. 2009 II S. 1024

<sup>143</sup> Ibid, p. 2.a)

<sup>144</sup> Ibid, p. 2.b)aa)

<sup>145</sup> Ibid, p. 2.b)bb)

<sup>146</sup> Case C-141/00 *Ambulanter Pflegedienst Kügler GmbH v Finanzamt für Körperschaften I in Berlin* [2002] I-06833, §30

<sup>147</sup> Case C-246/04 *Turn- und Sportunion Waldburg v Finanzlandesdirektion für Oberösterreich* [2006] I-00589, §24

<sup>148</sup> BFH-Beschluss vom 12.10.2004 (V R 54/03) BStBl 2005 II, S. 106; BFH-Urteil vom 26.09.2007 (V R 54/05) BFH/NV 2008, S. 170

<sup>149</sup> BFH-Urteil vom 16.04.2008 (XI R 73/07) BStBl. 2009 II S.1024, p. 2b)bb)

<sup>150</sup> Ibid, p. 2b)cc)

<sup>151</sup> Ibid, p. 2.c)

<sup>152</sup> Klenk, 'UStG §24' [2015] 75th updated version, in: Sölch/Ringleb Umsatzsteuergesetz, C.H.Beck, p. 285

commercial enterprises by virtue of legal form the option to choose to be taxed either according to § 24 (2) S.3 UStG or according to the BFH judgement of 16 April 2008 XI R 73/07.<sup>153</sup> In another judgement the BFH confirms this approach and emphasizes the option for commercial enterprises in virtue of legal form is compatible with EU law, as there is no general prohibition of applying that provision.<sup>154</sup>

It should be noted that in direct tax matters the CJEU concluded in *Gielen*<sup>155</sup> that an option does not remedy or neutralize discrimination.<sup>156</sup> Furthermore, in *Test Claimants in the FII Group Litigation*<sup>157</sup> the CJEU states that an optional national legislation, which is contrary to the freedom of movement, does not render that legislation incompatible with EU law.<sup>158</sup> However, in those specific cases it was considered whether the legislation was contrary to the fundamental freedoms while §24 (2) S. 3 UStG is simply contrary to the principle of fiscal neutrality. AG Kokott already stated that the principle of neutrality does not cover general discrimination.<sup>159</sup> It should further be noted that in *Zimmermann*<sup>160</sup> the CJEU held that this principle is not a rule of primary law against which it is possible to test the validity of an exemption.<sup>161</sup> Therefore a case before the CJEU regarding the exclusion of commercial enterprises by virtue of legal form could have been decided differently compared to the judgement in *Gielen*.

As mentioned in Chapter 5.1, five requirements have to be fulfilled in order that a measure is implemented correctly. The legislation has to show completeness, effectiveness, legal certainty, clarity/precision and publicity/transparency.<sup>162</sup> The Court held in *Commission v. France*<sup>163</sup> that the provision has to be implemented with unquestionable binding force.<sup>164</sup> There is no doubt that the option of those enterprises - to decide whether to be treated according to § 24 (2) S. 3 UStG and therefore not being subject to the special scheme or according to the BFH judgement XI R 73/07 and

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<sup>153</sup> BMF, 'Anwendung der Durchschnittssatzbesteuerung auf die Umsätze von Gewerbebetrieben kraft Rechtsform (§24 Abs. 2 Satz 3 UStG)- Konsequenzen des BFH-Urteils vom 16. April 2008 - XI R 73/07 - (BStBL 2009 II S. 1024)' (Schreiben) vom 01.12.2009, IV B 8, BStBL I 2009, S. 1611

<sup>154</sup> BFH-Beschluss vom 28.08.2014 (V B 28/14)

<sup>155</sup> Case C-440/08 *F. Gielen v Staatssecretaris van Financiën* [2010] I-02323

<sup>156</sup> *Ibid.*, §§50-51, 54

<sup>157</sup> Case C-446/04 *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue* [2006] I-11753

<sup>158</sup> *Ibid.*, §162

<sup>159</sup> Kokott, Advocate General's Opinion, 13 December 2007, Case C-309/06 *Marks & Spencer plc v Her Majesty's Commissioners of Customs and Excise*, p. 61

<sup>160</sup> Case C-174/11 *Ines Zimmermann v Finanzamt Steglitz* [2012]

<sup>161</sup> *Ibid.*, §50

<sup>162</sup> Markus Klamert, 'Judicial implementation of directives and anticipatory indirect effect: connecting the dots' [2006], Volume 43, in: *Common Market Law Review*, p. 1251 et seq, p. 1263

<sup>163</sup> Case C-197/96 *Commission v French Republic* [1997] I-01489

<sup>164</sup> *Ibid.*, §15

therefore being subject to the special scheme - is complete, effective, public, transparent while legal certainty is ensured.

One may doubt whether this option provided for through the BFH judgement and the BMF communication provides for clarity and precision. If one interprets the criteria strictly this option would not fulfil with the requirement of clarity and would therefore be wrongfully implemented.<sup>165</sup> However, several case law of the CJEU<sup>166</sup> considered whether national case law decisions are clear and adequate for a correct implementation. Still, there is no clear answer but the considerations by the CJEU tend to a view that national case law is relevant to examine an adequate transposition.<sup>167</sup> It is however not the aim of this thesis to evaluate whether the judgement of the BFH is adequate to ensure clarity and precision.

On the other hand it should also be noted that pursuant to Art. 296 (2) VAT Directive Member States may exclude certain categories of farmers from the special scheme when those farmers are not likely to have administrative difficulties. It is however not clear that the commercial enterprises by virtue of legal form belong to this category.

All in all, the exclusion of commercial enterprises by virtue of legal form from the application of § 24 UStG leaves some questions open. The VAT Directive does not provide for such exclusion. The national court confirms that the provision in § 24 (2) S. 3 UStG is contrary to the principle of fiscal neutrality. Through a BMF Communication those enterprises may choose to be taxed according to the provision in § 24 (2) S. 3 UStG or according to the judgement XI R 73/07. However, it remains questionable whether that option is sufficiently clear in order to assure a correct implementation of the flat-rate scheme from the VAT Directive. One may argue that not stating that option in the tax act itself does not ensure clarity and precision.

### **5.1.2.3 Flat-rate compensation**

The flat-rate compensation percentage has to comply with Articles 297, 298 and 299 and has to be applied according to Art. 300 VAT Directive.

In 2006, the federal council - *Bundesrat*, - considered a rise of the percentages. It was argued that the former flat-rate compensation was set too low as to compensate the input VAT charged and there was a deficit of 300 million Euros. Also, on 1 January 2007 the normal VAT rate in

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<sup>165</sup> Markus Klamert, 'Judicial implementation of directives and anticipatory indirect effect: connecting the dots' [2006], Volume 43, in: Common Market Law Review, p. 1251 et seq, p. 1268

<sup>166</sup> see for instance: Case C-382/92 *Commission v United Kingdom of Great Britain and Northern Ireland* [1994] I-2435, Case C-129/00 *Commission v Italian Republic* [2003] I-14637

<sup>167</sup> Markus Klamert, 'Judicial implementation of directives and anticipatory indirect effect: connecting the dots' [2006], Volume 43, in: Common Market Law Review, p. 1251 et seq, p. 1268

Germany was raised to 19% while the reduced rate remained 7%. Simultaneously, the flat-rate compensation percentages were set on a level of 5,5% and 10,7%.<sup>168</sup>

According to Art. 297 VAT Directive Member States may apply different percentages for forestry, for the different sub-divisions of agriculture and for fisheries. Germany applies different rates to supply of forestry products except sawmill products and all other cases. This is in line with Art. 297 VAT Directive.

The percentage has to be calculated on macro-economic statistics pursuant to Art. 298 VAT Directive. Some argue that the German percentages of 5,5% and 10,7% are considered to be too high - otherwise not as many farmers would decide to be subject to the flat-rate scheme.<sup>169</sup> Such a complaint would be contrary to Art. 298 VAT Directive and also case *Commission v. Italy*. It should also be considered that the compensation should not result in a greater compensation for the farmers than the input VAT charged (Art. 299). On the other hand the percentage is not set at 0% and is therefore compatible with case *Commission v Portugal*.

Art. 301 leaves it open for the Member State to choose whether the flat-rate compensation is to be paid by the customer or by the public authorities. Germany decided not to make a specific reference in the UStG and therefore the customer always has to bear the tax burden.<sup>170</sup> If the customer is a taxable person he may deduct the tax pursuant to Art. 302 VAT Directive. There is no specific reference in § 24 UStG but that is covered by the normal arrangements of the UStG.

#### **5.1.2.4 Other Aspects**

In conclusion, German tax law regarding the special scheme for farmers might be in line with EU law depending on the option of commercial enterprises by virtue of legal form and the flat-rate compensation percentage. Otherwise it is in line with the VAT Directive and the settled case law.

Like for the exemption for small enterprises - Germany implemented some very specific provisions that are not stated in the VAT Directive. Those are for example that exemptions under the normal arrangements as well as the option when exempt under normal arrangements do not apply (§ 24 (1) S. 2 & 3 UStG). Also that the flat-rate has to be stated on the invoice (§ 24 (1) S. 6 UStG). Furthermore, § 24 (4) UStG provides with special procedures how to opt for normal USt arrangements.

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<sup>168</sup> Haushaltsbegleitgesetz 2006 vom 29. Juni 2006 (BGBl. I S. 1402), Artikel 4

<sup>169</sup> Klenk, 'UStG §24' [2015] 75th updated version, in: Sölch/Ringleb Umsatzsteuergesetz, C.H.Beck, p. 140

<sup>170</sup> Ibid, p. 9

Furthermore, for supplies that fall under § 24 (1) Nr. 2 UStG the flat-rate farmer actually has to refer the remaining flat-rate to the tax authorities. For those supplies the flat-rate of 19% applies and only the flat-rate compensation percentage is set at a rate of 10,7%. Therefore the flat-rate farmer has to refer the remaining 8,3% to the tax authorities. If the customer is a taxable person that is able to deduct input tax - what was the main idea behind the special scheme in the first place<sup>171</sup> - he may deduct the flat-rate for the agricultural product or service. This figure shows the explained situation:

### Flat-rate scheme for farmers

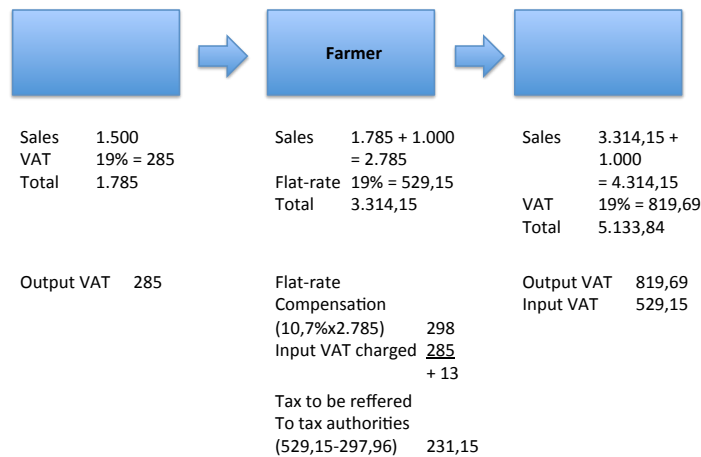


Figure 3: Flat-rate scheme for farmers as applied by Germany in cases specified in § 24 (1) Nr. 2 UStG

The farmer has to refer the 231,15 Euros to the tax authorities which amount to 8,3% of the taxable amount of the agricultural product or service. The flat-rate farmer may keep the 298 Euros flat-rate compensation while the customer - if he is a taxable person that is able to deduct VAT - may deduct the whole 529,15 Euros. There is no foundation provided for cases specified in § 24 (1) Nr. 2 UStG in the VAT Directive. However, Germany found this provision necessary to ensure competition neutrality.<sup>172</sup>

All in all, those specific provisions should be in line with the provisions of the VAT Directive as Art. 273 allows Member States to implement other obligations which are necessary to ensure the correct collection of VAT.

Thus, the requirements of the VAT Directive - except the exclusion of commercial enterprises by virtue of legal form and the option provided for by the BFH judgement - are fulfilled. Also the conditions required for by the case law are met.

<sup>171</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), pp. 1189-1190

<sup>172</sup> Klenk, 'UStG §24' [2015] 75th updated version, in: Sölch/Ringleb *Umsatzsteuergesetz*, C.H.Beck, p. 149

## 5.2 Is it beneficial to have a special scheme?

### 5.2.1 Considerations for the taxable person

From a fiscal viewpoint it is questionable whether those special schemes are beneficial for the farmers and for the small enterprises.

Regarding the small enterprises under the exemption scheme the small enterprise may not deduct the input VAT. However, there will also be no output VAT on transactions by the small enterprise.

The following figure shows an example of a German small enterprise whose annual turnover is below the threshold of 17.500 Euros:

**Exemption for small enterprises**

	→	→																												
<div style="background-color: #4a86e8; width: 100px; height: 40px; margin: 0 auto;"></div>	<div style="background-color: #4a86e8; width: 100px; height: 40px; margin: 0 auto; display: flex; align-items: center; justify-content: center;">Small enterprise</div>	<div style="background-color: #4a86e8; width: 100px; height: 40px; margin: 0 auto; display: flex; align-items: center; justify-content: center;">Taxable person</div>																												
<table style="width: 100%; border-collapse: collapse;"> <tbody> <tr><td>Sales</td><td style="text-align: right;">1.000</td></tr> <tr><td>VAT</td><td style="text-align: right;">19% =190</td></tr> <tr><td>Total</td><td style="text-align: right;">1.190</td></tr> </tbody> </table> <table style="width: 100%; border-collapse: collapse;"> <tbody> <tr><td>Output VAT</td><td style="text-align: right;">190</td></tr> </tbody> </table>	Sales	1.000	VAT	19% =190	Total	1.190	Output VAT	190	<table style="width: 100%; border-collapse: collapse;"> <tbody> <tr><td>Sales</td><td style="text-align: right;">1.000 + <u>1.190</u> = 2.190</td></tr> <tr><td>VAT</td><td style="text-align: right;">0</td></tr> <tr><td>Total</td><td style="text-align: right;">2.190</td></tr> </tbody> </table> <table style="width: 100%; border-collapse: collapse;"> <tbody> <tr><td>Output VAT</td><td style="text-align: right;">0</td></tr> <tr><td>Deduction</td><td style="text-align: right;">0</td></tr> </tbody> </table>	Sales	1.000 + <u>1.190</u> = 2.190	VAT	0	Total	2.190	Output VAT	0	Deduction	0	<table style="width: 100%; border-collapse: collapse;"> <tbody> <tr><td>Sales</td><td style="text-align: right;">1.000 + <u>2.190</u> = 3.190</td></tr> <tr><td>VAT</td><td style="text-align: right;">19% =606,10</td></tr> <tr><td>Total</td><td style="text-align: right;">3.796,10</td></tr> </tbody> </table> <table style="width: 100%; border-collapse: collapse;"> <tbody> <tr><td>Output VAT</td><td style="text-align: right;">606,10</td></tr> <tr><td>Input VAT</td><td style="text-align: right;">0</td></tr> </tbody> </table>	Sales	1.000 + <u>2.190</u> = 3.190	VAT	19% =606,10	Total	3.796,10	Output VAT	606,10	Input VAT	0
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VAT	0																													
Total	2.190																													
Output VAT	0																													
Deduction	0																													
Sales	1.000 + <u>2.190</u> = 3.190																													
VAT	19% =606,10																													
Total	3.796,10																													
Output VAT	606,10																													
Input VAT	0																													

Figure 4: Exemption for small enterprises when the customer is a taxable person who is able to deduct input VAT

Therefore when selling to other taxable persons, the VAT has a cumulative effect as the price for the exempt transactions will be higher as the price includes the input VAT which occurred as costs for the exempt small enterprise.<sup>173</sup>

On the other hand, when the small enterprise opts to be subject to the normal VAT arrangements the exemption does not apply. He is therefore able to deduct the VAT. This might result in an advantage when the small enterprise sells his goods and services to other taxable persons. Then, he can deduct the relatively high input VAT and may therefore set a lower price for his goods and services.<sup>174</sup>

This can be shown comparing the table above and a situation in which the taxpayer opts to the normal arrangements. A good example is shown in Appendix 1. The small enterprise may not deduct the input VAT of 190 Euros and adds it as a cost factor to his total price. Therefore the price he can offer is 2.190 Euros while the total price would be 2.380 Euros (2.000 net) under normal VAT arrangements. The entrepreneur has to refer the 380 Euros to the tax authorities. If the customer is a taxable person he may deduct the VAT himself and therefore only has to focus on the 2.000 Euros

<sup>173</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), p. 264

<sup>174</sup> Korn, 'UStG §19' [2015] 14th edition, in: Bunjes/Geist *Umsatzsteuergesetz*, C.H.Beck, p. 22

net as he is able to deduct the 380 Euros of input VAT. The price would therefore be  $2.380./2.000= +380$  Euros higher when the special scheme does apply. In those circumstances the small enterprise would be better off if he opts for the normal VAT arrangements.

The situation is however different if the small enterprise sells his goods and services to the final consumer - who cannot deduct VAT. The figure shows again a German example:

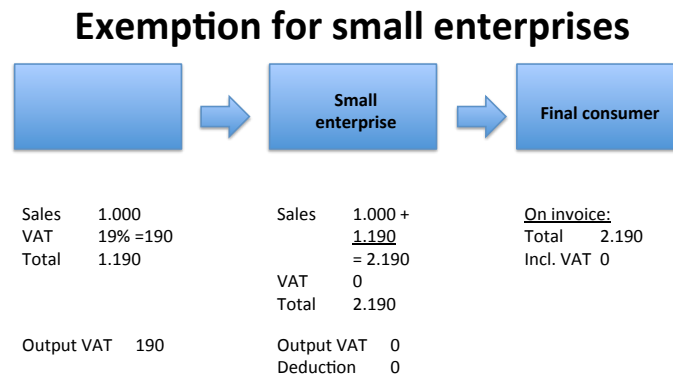


Figure 5: Exemption for small enterprises when the customer is the final consumer

If the small enterprise sells his goods and services to the final consumer he can offer a lower price when he is subject to the exemption scheme. Comparing the numbers in Appendix 2 there is a difference of  $2.190./2.380 = -190$  Euros and therefore the price is 190 Euros lower when the special scheme does apply. Consequently, the small enterprise benefits through the special scheme as he can offer a lower price and therefore has a competitive advantage.

Not being subject to the special scheme for small enterprises would also result in an advantage if the small enterprise has high investment costs with a high input VAT.

Due to all of those considerations, one may therefore conclude that when a small enterprise mainly sells to other taxable persons who are able to deduct VAT, it is better for the small enterprise not to opt being subject to the special scheme of exemption for small enterprises but instead being subject to the normal VAT arrangements. On the other hand, when the small enterprise mainly sells his goods and services to final consumers or other small enterprises that are exempt from VAT, he can offer a lower price for his goods and consequently the special scheme is beneficial for him from a financial viewpoint.

The situation for farmers is different. The considerations for this special scheme were that farmers mainly sell to manufacturers, wholesalers and other taxable persons. If those transactions would be excluded this situation



would lead to an accumulation of taxes - which was shown above. The main goal is to avoid accumulation of taxes and to ensure tax neutrality.<sup>175</sup>

Flat-rate farmers are not exempt but they may also not deduct the input VAT charged. However, for the transaction by the flat-rate farmer there will be a flat-rate compensation, which will be paid to him - at least in Germany paid by the customer. The farmer can keep the flat-rate compensation, which aims to outweigh the effect that the farmer is not able to deduct the input VAT charged. When the customer is a taxable person himself he may deduct the flat-rate.

Under this scheme there is a very slight accumulation of taxes<sup>176</sup> as the non-deductible input VAT charged will be included in the total price as a cost factor. This can be shown through the following German example:

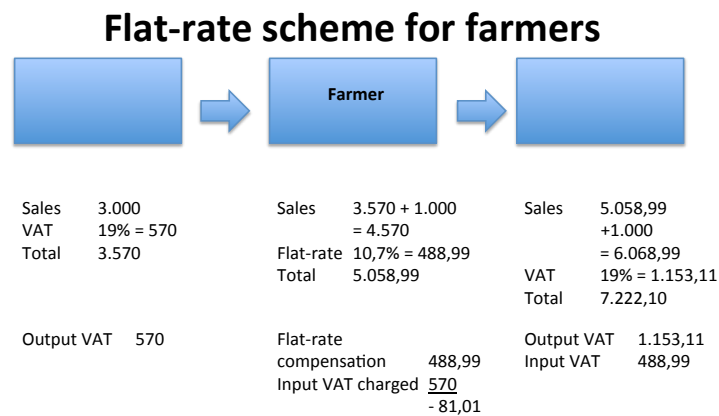


Figure 6: Flat-rate scheme for farmers when the farmer faces high input charges

It should be noted that flat-rate farmers with an above average input charge could opt for the normal VAT arrangements because then they may deduct the high input VAT charged.

Micro-economic statistics have to be used in order to determine the right rate, Art. 298 VAT Directive. Nonetheless, this is an example and in practice the accumulation of taxes does also depend on other facts such as the cost structure of the business. Furthermore, this is a very abstract and specific example from a German flat-rate farmer. For example, in practice the input VAT rate may also be reduced (7%) or the flat-rate compensation percentage may also comprise of 5,5%.

On the other hand, if the flat-rate percentage is too high a farmer might keep more flat-rate compensation than he paid input VAT. In that case it is beneficial from a financial viewpoint for the farmer to be subject to the flat-

<sup>175</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), p. 1189-1190

<sup>176</sup> *Ibid*, p. 1190

rate scheme.<sup>177</sup> The following table shows a German example of a flat-rate farmer who does not face high input charges:

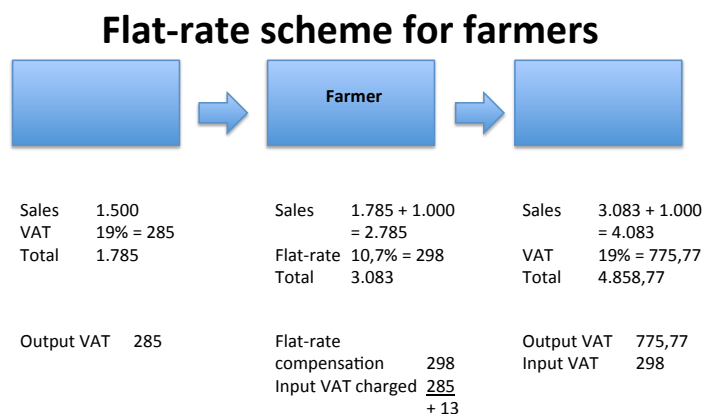


Figure 7: Flat-rate scheme for farmers when the farmer does not face high input charges

In general the flat-rate scheme tends to overcompensate the farmers.<sup>178</sup> Therefore it is profitable for a farmer - except he has "clearly above average input VAT charge" - to be subject to the flat-rate scheme.<sup>179</sup> However, also this is a very specific abstract example.

There is a slight difference to whom the flat-rate farmer sells his goods and services. If he sells to other taxable persons that are able to deduct the flat-rate (what is mainly the case) those customers may deduct the flat-rate. However, if the flat-rate farmer also sells agricultural and forestry products and services to final consumers or other persons that are not able to deduct input VAT the tax rate might matter in that regard. In Germany that is only the case for transactions set out in § 24 (1) Nr. 1 and 3 UStG as there are different percentages of 7% and 19% and of 5,5% and 10,7%. It is only otherwise in cases set out in § 24 (1) Nr. 2 UStG as that provision sets a flat-rate of 19% which is also the normal USt rate. § 24 (1) Nr. 2 UStG therefore secures competition neutrality in VAT.<sup>180</sup> In the other cases the flat-rate farmer can offer a lower tax rate and therefore a lower price for his customers. Nonetheless the main idea of the scheme was that farmers sell mainly to other taxable persons and not to final customers.

Nevertheless, it should be noted if a small enterprise or a farmer opt for the special schemes they are bound for at least five years in Germany (§19 (2) S. 2 and § 24 (4) S. 2 UStG) and therefore have to consider beforehand which scheme is more advantageous for them.

<sup>177</sup> Ben Terra, Julie Kajus, *Commentary - A Guide to the Recast VAT Directive* (last reviewed 1 July 2015, IBFD, 2015), p. 5072

<sup>178</sup> *Ibid.*, p. 5072

<sup>179</sup> *Ibid.*, p. 5072

<sup>180</sup> Klenk, 'UStG §24' [2015] 75th updated version, in: Sölch/Ringleb *Umsatzsteuergesetz*, C.H.Beck, p. 149

An advantage in practice is of course that the administrative burden declines through the application of the special schemes. As mentioned before, under normal circumstances taxable persons are required to keep accounts in sufficient detail for VAT purposes. This obligation can result in difficulties for small enterprises and farmers and therefore Member States may adopt those special schemes.<sup>181</sup> Moreover, regarding the exemption for small enterprises - as adopted in § 19 UStG - the administrative simplifications are intended to support the creation, activities and competitiveness of small enterprises. The scheme shall assure a reasonable relationship between administrative charges in connection with fiscal supervision and the small amounts of tax to be connected with.<sup>182</sup>

When being subject to the normal VAT arrangements one has to face costs for reporting and accounting.<sup>183</sup> Therefore the simplicity in accounting can also lead to a financial advantage.

This is an advantage for small enterprises and farmers that outweighs the accumulation of taxes - even though it is only a slight one regarding the flat-rate scheme for farmers. In conclusion, it is beneficial for a taxpayer to be subject either to the exemption scheme for small enterprises if he supplies most of his goods and services to final consumers or to be subject to the flat-rate scheme for farmers if the farmer does not have high above-average input VAT charges. In general, it can be said that the option to be subject to the scheme is always beneficial as the small enterprise or farmer may choose which tax treatment suits best for him. Furthermore, the administrative advantage and the cost reduction thereof cannot be dismissed. In practice, this advantage might be the cause to choose for the more comfortable scheme - which are possibly the special schemes.

When deciding whether one should opt either to the small enterprise or farmers scheme - it depends on the personal circumstances of the taxable persons. If a farmer whose turnover is below the exemption threshold, is more likely to sell his goods and services to another taxable person in the supply chain, the flat-rate scheme is more beneficial for him as the exemption scheme would result in a cumulative effect.

### **5.2.2 Risks for the Member States**

First of all, both schemes may also be a target for abusive practices.<sup>184</sup>

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<sup>181</sup> Ben Terra, Julie Kajus, *Introduction to European VAT (Recast)* (information available up to 1 January 2016, IBFD 2016), pp. 1185 & 1189

<sup>182</sup> Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel* [2010] ECR I-10465, §63; Kokott, Advocate General's Opinion, 17 June 2010, Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel*, p. 33

<sup>183</sup> Jarkko Harju, Tuomas Matikka, Timo Rauhanen, 'The Effect of VAT Threshold on the Behavior of Small Firms' [30.06.2015] (VATT Institute for Economic Research (Helsinki, Finland)), p. 14

One risk that can occur through the exemption scheme for small enterprises is excess bunching - which is an effect that occurs through the setting of an exemption threshold. Studies in Finland have shown that there is an effect that small enterprises report that their turnover falls under the exemption threshold. This figure shows the tendency to excess bunching through the difference of the observed turnover and the counterfactual distribution.<sup>185</sup> The figure shows that a lot of small enterprises report turnovers, which are below the threshold.

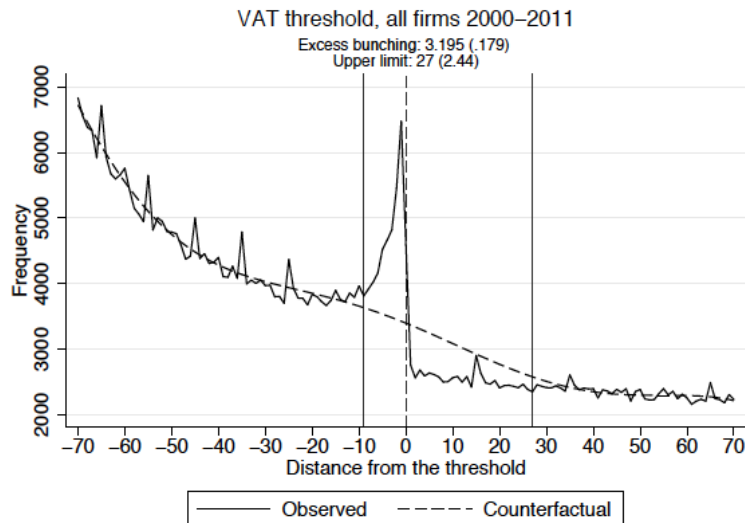


Figure 8: Bunching at the VAT threshold, 2000-2011<sup>186</sup>

The figure also shows that a lot of small enterprises consider remaining under the threshold rather than risking to get over the exemption threshold. If so, those enterprises would then be subject to the normal VAT arrangements. Accordingly, small enterprises might decide to reduce their business efficiency and the growth of small enterprises might be hindered.<sup>187</sup> All in all, it can be said that the threshold might have an effect on the behaviour of the taxpayer.

Another pattern has been shown in the flat-rate scheme for farmers. For example in one German case a farmer has put another enterprise in the distribution channel prior to himself. This enterprise then made certain investments for the farmer. Because that enterprise was subject to normal

<sup>184</sup> see for instance: Parthasarathi Shome, 'IMF Policy Discussion Paper - Fiscal Affairs Department - Tax Administration and the Small Taxpayer' [May 2004] (International Monetary Fund), p. 22; Suzanne Kingston, 'Case C-97/09, Ingrid Schmelz v. Finanzamt Waldvierte, Judgement of the Court (Grand Chamber) of 26 October 2010, nyr; Case C-72/09, Établissements Rimbaud SA v. Directeur general des impôts, Directeur des services fiscaux d'Aix-en-Provence, Judgement of the Court (Third Chamber) of 28 October 2010, nyr' [2011] (edition 48, Common Market Law Review), pp. 2061 et seq, pp. 2071 et seq

<sup>185</sup> Jarkko Harju, Tuomas Matikka, Timo Rauhanen, 'The Effect of VAT Threshold on the Behavior of Small Firms' [30.06.2015] (VATT Institute for Economic Research (Helsinki, Finland)), p. 20

<sup>186</sup> Ibid, p. 21

<sup>187</sup> Ibid, p. 1

VAT arrangements that enterprise was able to deduct the input VAT charged.<sup>188</sup> The BFH stated that this constitutes an abusive bypass of the application of § 24 Abs. 1 S. 4 UStG.<sup>189</sup>

From some case law that was already explained in Chapter 3.3.2 regarding the farmers' special scheme one can see a tendency that farmers want to profit from the compensation. Also for example in *Heerma*<sup>190</sup> the farmer constructed a cattle shed, which he then rented out to a partnership owned by him and his wife.<sup>191</sup> If this transaction would fall under the flat-rate scheme, his farming business would obtain the flat-rate compensation to compensate the non-deductible input VAT. However, in this case the independency between those businesses was at issue.<sup>192</sup> Nevertheless, in *Detlev Harbs* a similar initial position was examined. Mr. Harbs leased out the use of animal sheds to his son and considered that transaction to be an agricultural service.<sup>193</sup> If that had been correct, Mr. Harbs would have been able to keep the compensation for that leasing. However, the CJEU came to the conclusion that the lease does not fall within the common flat-rate scheme.<sup>194</sup>

### 5.2.3 Advantageousness of the application of the special schemes

To sum up from Chapter 5.2.2 there are risks that a Member State has to face regarding the special schemes of exemption for small enterprises and the special scheme for farmers.

It is also interesting that the Commission stated in SEC(2010) 1455 final that through the judgement in *Schmelz* the exemption for small enterprises is distorted as the scheme is only applicable to taxable persons established in that Member State. In a scenario in which a business has a high turnover in the Member State in which it is not established but only a low turnover in the Member State of establishment the taxable person would still be eligible to the exemption for small enterprises. On the other hand, a small enterprise, which carries out business in another Member State in which it is not established, would not be subject to the exemption.<sup>195</sup>

Regarding the common flat-rate scheme for farmers it is also interesting that the Commission originally intended for the scheme to disappear. The idea

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<sup>188</sup> Klenk, 'UStG §24' [2015] 75th updated version, in: Sölch/Ringleb Umsatzsteuergesetz, C.H.Beck, p. 172

<sup>189</sup> BFH-Beschluss vom 14.12.2001 (V B 184/00 (NV))

<sup>190</sup> Case C-23/98 *J. Heerma v Staatssecretaris van Financiën* [2000] I-00419

<sup>191</sup> *Ibid.*, §§7-9

<sup>192</sup> *Ibid.*, §22

<sup>193</sup> Case C-321/02 *Detlev Harbs v Finanzamt Rendsburg* [2004] I-07101, §§9-10

<sup>194</sup> *Ibid.*, §37

<sup>195</sup> Commission, 'Accompanying document to the Green Paper on the future of VAT towards a simpler, more robust and efficient VAT system' (Commission staff working document) SEC(2010) 1455 final, pp. 83-84

was that farmers would opt to be subject to the normal VAT arrangements or the special scheme for small enterprises.<sup>196</sup>

Regarding the exemption for small enterprises the CJEU stated specifically that the scheme aims to guarantee effectiveness of fiscal supervision in order to combat possible tax evasion, avoidance and abuse.<sup>197</sup> Regarding the common flat-rate scheme for farmers the scheme aims to preserve the neutrality of VAT.<sup>198</sup> However, it should further be noted that the flat-rate compensation does not lead to full VAT neutrality but - in the view of the CJEU - achieves the highest neutrality possible.<sup>199</sup>

Furthermore, those two special schemes are always beneficial for the taxpayers. Even if the application of the scheme would not result in a better situation for the taxpayer the small enterprise or farmer still has the option to apply for normal VAT arrangements. Chapter 5.2.1 developed which option is preferable for the small enterprise or farmer. Due to that option - from a financial viewpoint - it is therefore less likely that the small enterprise or farmer results in a less favourable position than without the existence of such a scheme.

Last but not least the administrative advantage of the small enterprise and farmer and also the tax authorities when applying such a scheme cannot be dismissed. Therefore the schemes are beneficial for both sides - the tax authorities and the taxable persons.

Due to all those reasons and considerations - especially the criteria of administration simplicity and neutrality - the exemption scheme for small enterprises and the common flat-rate scheme for farmers is preferable.

## 6 Conclusion

Germany adopted the exemption scheme for small enterprises and the common flat-rate scheme in the turnover tax act the *Umsatzsteuergesetz*. However, those provisions have to be in line with the Directive to ensure a correct implementation of the schemes.

Regarding the exemption scheme for small enterprises, there is no deviation from EU law. It only remains questionable whether a threshold of 17.500 Euros is too low and should be raised. On the other hand, the German provisions, which are set out for the common flat-rate scheme for farmers, show some more deviations from the VAT Directive. One may discuss whether an exclusion of a certain entity is contrary to the principle of

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<sup>196</sup> Ben Terra, Julie Kajus, *Commentary - A Guide to the Recast VAT Directive* (last reviewed 1 July 2015, IBFD, 2015), pp. 5071-5072

<sup>197</sup> Case C-97/09 *Ingrid Schmelz v Finanzamt Waldviertel* [2010] ECR I-10465, §63

<sup>198</sup> Case C-524/10 *Commission v Portuguese Republic* [2012], §52; Kokott, Advocate General's Opinion, 22 September 2011, Case C-524/10 *Commission v Portuguese Republic*, §§45-48

<sup>199</sup> Case C-524/10 *Commission v Portuguese Republic* [2012], §53

neutrality, which is a form of the principle of equal treatment and provided for in the TFEU. The German Fiscal Court confirmed that in the affirmative. Due to a communication those entities are now able to choose to be taxed either according to the UStG or the BFH judgement. Therefore they may choose to be subject to the scheme or not. Strictly speaking this option does not comply with the criterion that a provision has to be clear to be correctly implemented. Furthermore, also for the flat-rate scheme it is arguable whether the flat-rate compensation percentage is set at a too high level. Nevertheless, assessing all the provisions regarding those two special schemes Germany is in line with the VAT Directive.

Therefore the provisions as implemented by Germany (except the exclusion of commercial enterprises by virtue of legal form) may serve as an example for the implementation of those schemes. It is also a good example to show how Member States actually implement provisions of the VAT Directive as they tend to be more specific. Still, Member States may implement more obligations that are necessary to ensure the collection of VAT.

When a Member State implemented both or one of those special schemes the affected taxable persons have to consider several aspects. In both schemes the exempt small enterprise or the flat-rate farmer may choose to opt to be subject to normal VAT arrangements and therefore not to be subject to a special scheme. Depending on the personal circumstances the taxable person could choose how to be taxed. Either way the small enterprise or farmer has an advantage of being able to choose which scheme suits better. Furthermore the administrative burden declines through the application of such a scheme. This does not only apply for the taxable person but also for the tax authorities of the Member State. Even though several risks may arise for a Member State, the advantage of administration relief prevails in practice. Therefore, through the implementation of the exemption scheme for small enterprises as well as the common flat-rate scheme for farmers is desirable.

Returning to the future of VAT regarding a simpler, more robust, efficient and neutral VAT system, the communication allows exemptions when they have economic social or technical reasons.<sup>200</sup> Furthermore, deviations from the normal VAT rate are disregarded but it is square with that communication to apply a different rate as long as it is not an obstacle to the proper functioning on the internal market.<sup>201</sup>

In general those two special schemes aim to provide for a simpler collection of VAT within one Member State, as well as ensure VAT neutrality.

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<sup>200</sup> Commission, 'Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the future of VAT - Towards a simpler more robust and efficient VAT system tailored to the single market' European Commission COM(2011) 851 final (Brussels, 6.12.2011), p. 10

<sup>201</sup> Ibid, p. 11

However, when a small enterprise or farmer performs business internationally he faces a very complex set of rules.<sup>202</sup> This occurs because the special schemes are only partly harmonized as every Member State may choose to implement such a scheme or not. Furthermore, due to *Schmelz* a small enterprise may only profit from the scheme in the Member State of establishment. Therefore the taxable persons may have difficulties on performing business in another Member State and that fact may cause enterprises to refrain from working internationally. This is however the absolute opposite of the objectives of the European Union.<sup>203</sup>

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<sup>202</sup> Ibid, p. 3

<sup>203</sup> Ibid, p. 4



# Appendix

## 1) Comparison: exempt v taxable transaction when customer is a taxable person who is able to deduct input VAT

### Exemption



Sales 1.000  
VAT 19% =190  
Total 1.190

Sales 1.000 +  
1.190  
= 2.190  
VAT 0  
Total 2.190

Sales 1.000 +  
2.190  
= 3.190  
VAT 19% =606,10  
Total 3.796,10

Output VAT 190

Output VAT 0  
Deduction 0

Output VAT 606,10  
Input VAT 0

### Taxable transaction when customer is a taxable person who is able to deduct input VAT



Sales 1.000  
VAT 19% =190  
Total 1.190

Sales 1.000 +  
1.000  
= 2.000  
VAT 19% =380  
Total 2.380

Sales 1.000 +  
2.000  
= 3.000  
VAT 19% =570  
Total 3.570

Output VAT 190

Output VAT 380  
Deduction 190

Output VAT 570  
Input VAT 380

## 2) Comparison: exempt v taxable transaction when customer is final consumer

### Exemption



Sales 1.000  
VAT 19% =190  
Total 1.190

Sales 1.190  
+1.000  
= 2.190  
VAT 0  
Total 2.190

Total Price 2.190  
*Netto Price* 2.190  
VAT 0

Output VAT 190  
Tax on Sales 190

Output VAT 0  
Deduction 0

**Taxable transaction when customer is final consumer**



Sales 1.000  
 VAT 19% = 190  
 Total 1.190

Sales +1.000  
 = 2.000  
 VAT 19% = 380  
 Total 2.380

Total Price 2.380  
 Netto Price 2.000  
 VAT 380

Output VAT 190  
 Tax on Sales 190

Output VAT 380  
 Input VAT 190  
 Tax on Sales 190

**3) Comparison: flat-rate scheme for farmers v normal VAT arrangements when the farmer faces high input charges**

**Flat-rate scheme for farmers**



Sales 3.000  
 VAT 19% = 570  
 Total 3.570

Sales 3.570 + 1.000  
 = 4.570  
 Flat-rate 10,7% = 488,99  
 Total 5.058,99

Sales 5.058,99  
 +1.000  
 = 6.068,99  
 VAT 19% = 1.153,11  
 Total 7.222,10

Output VAT 570

Flat-rate compensation 488,99  
 Input VAT charged 570  
 - 81,01

Output VAT 1.153,11  
 Input VAT 488,99

**Normal VAT arrangements when the farmer faces high input charges**



Sales 3.000  
 VAT 19% = 570  
 Total 3.570

Sales 3.000 + 1.000  
 = 4.000  
 VAT 19% = 760  
 Total 4.760

Sales 4.000 + 1.000  
 = 5.000  
 VAT 19% = 950  
 Total 5.950

Output VAT 570

Output VAT 760  
 Input VAT 570

Output VAT 950  
 Input VAT 570

4) Comparison: flat-rate scheme for farmers v normal VAT arrangements when the farmer does not face high input charges

**Flat-rate scheme for farmers**



Sales 1.500  
 VAT 19% = 285  
 Total 1.785

Sales 1.785 + 1.000  
 = 2.785  
 Flat-rate 10,7% = 298  
 Total 3.083

Sales 3.083 + 1.000  
 = 4.083  
 VAT 19% = 775,77  
 Total 4.858,77

Output VAT 285

Flat-rate compensation 298  
 Input VAT charged 285  
 + 13

Output VAT 775,77  
 Input VAT 298

**Normal VAT arrangements when the farmer does not face high input charges**



Sales 1.500  
 VAT 19% = 285  
 Total 1.785

Sales 1.500 + 1.000  
 = 2.500  
 FVAT 19% = 475  
 Total 2.975

Sales 2.500 + 1.000  
 = 3.500  
 VAT 19% = 665  
 Total 4.165

Output VAT 285

Output VAT 475  
 Input VAT 285

Output VAT 665  
 Input VAT 475

## **5) Umsatzsteuergesetz (UStG) § 19 Besteuerung der Kleinunternehmer**

(1) Die für Umsätze im Sinne des § 1 Abs. 1 Nr. 1 geschuldete Umsatzsteuer wird von Unternehmern, die im Inland oder in den in § 1 Abs. 3 bezeichneten Gebieten ansässig sind, nicht erhoben, wenn der in Satz 2 bezeichnete Umsatz zuzüglich der darauf entfallenden Steuer im vorangegangenen Kalenderjahr 17 500 Euro nicht überstiegen hat und im laufenden Kalenderjahr 50 000 Euro voraussichtlich nicht übersteigen wird. Umsatz im Sinne des Satzes 1 ist der nach vereinnahmten Entgelten bemessene Gesamtumsatz, gekürzt um die darin enthaltenen Umsätze von Wirtschaftsgütern des Anlagevermögens. Satz 1 gilt nicht für die nach § 13a Abs. 1 Nr. 6, § 13b Absatz 5, § 14c Abs. 2 und § 25b Abs. 2 geschuldete Steuer. In den Fällen des Satzes 1 finden die Vorschriften über die Steuerbefreiung innergemeinschaftlicher Lieferungen (§ 4 Nr. 1 Buchstabe b, § 6a), über den Verzicht auf Steuerbefreiungen (§ 9), über den gesonderten Ausweis der Steuer in einer Rechnung (§ 14 Abs. 4), über die Angabe der Umsatzsteuer-Identifikationsnummern in einer Rechnung (§ 14a Abs. 1, 3 und 7) und über den Vorsteuerabzug (§ 15) keine Anwendung.

(2) Der Unternehmer kann dem Finanzamt bis zur Unanfechtbarkeit der Steuerfestsetzung (§ 18 Abs. 3 und 4) erklären, dass er auf die Anwendung des Absatzes 1 verzichtet. Nach Eintritt der Unanfechtbarkeit der Steuerfestsetzung bindet die Erklärung den Unternehmer mindestens für fünf Kalenderjahre. Sie kann nur mit Wirkung von Beginn eines Kalenderjahres an widerrufen werden. Der Widerruf ist spätestens bis zur Unanfechtbarkeit der Steuerfestsetzung des Kalenderjahres, für das er gelten soll, zu erklären.

(3) Gesamtumsatz ist die Summe der vom Unternehmer ausgeführten steuerbaren Umsätze im Sinne des § 1 Abs. 1 Nr. 1 abzüglich folgender Umsätze:

1. der Umsätze, die nach § 4 Nr. 8 Buchstabe i, Nr. 9 Buchstabe b und Nr. 11 bis 28 steuerfrei sind;
2. der Umsätze, die nach § 4 Nr. 8 Buchstabe a bis h, Nr. 9 Buchstabe a und Nr. 10 steuerfrei sind, wenn sie Hilfsumsätze sind.

Soweit der Unternehmer die Steuer nach vereinnahmten Entgelten berechnet (§ 13 Abs. 1 Nr. 1 Buchstabe a Satz 4 oder § 20), ist auch der Gesamtumsatz nach diesen Entgelten zu berechnen. Hat der Unternehmer seine gewerbliche oder berufliche Tätigkeit nur in einem Teil des Kalenderjahres ausgeübt, so ist der tatsächliche Gesamtumsatz in einen Jahresgesamtumsatz umzurechnen. Angefangene Kalendermonate sind bei der Umrechnung als volle Kalendermonate zu behandeln, es sei denn, dass die Umrechnung nach Tagen zu einem niedrigeren Jahresgesamtumsatz führt.

(4) Absatz 1 gilt nicht für die innergemeinschaftlichen Lieferungen neuer Fahrzeuge. § 15 Abs. 4a ist entsprechend anzuwenden.

## **6) Umsatzsteuergesetz (UStG) § 24 Durchschnittssätze für land- und forstwirtschaftliche Betriebe**

(1) Für die im Rahmen eines land- und forstwirtschaftlichen Betriebs ausgeführten Umsätze wird die Steuer vorbehaltlich der Sätze 2 bis 4 wie folgt festgesetzt:

1. für die Lieferungen von forstwirtschaftlichen Erzeugnissen, ausgenommen Sägewerkserzeugnisse, auf 5,5 Prozent,
2. für die Lieferungen der in der Anlage 2 nicht aufgeführten Sägewerkserzeugnisse und Getränke sowie von alkoholischen Flüssigkeiten, ausgenommen die Lieferungen in das Ausland und die im Ausland bewirkten Umsätze, und für sonstige Leistungen, soweit in der Anlage 2 nicht aufgeführte Getränke abgegeben werden, auf 19 Prozent,
3. für die übrigen Umsätze im Sinne des § 1 Abs. 1 Nr. 1 auf 10,7 Prozent

der Bemessungsgrundlage. Die Befreiungen nach § 4 mit Ausnahme der Nummern 1 bis 7 bleiben unberührt; § 9 findet keine Anwendung. Die Vorsteuerbeträge werden, soweit sie den in Satz 1 Nr. 1 bezeichneten Umsätzen zuzurechnen sind, auf 5,5 Prozent, in den übrigen Fällen des Satzes 1 auf 10,7 Prozent der Bemessungsgrundlage für diese Umsätze festgesetzt. Ein weiterer Vorsteuerabzug entfällt. § 14 ist mit der Maßgabe anzuwenden, dass der für den Umsatz maßgebliche Durchschnittssatz in der Rechnung zusätzlich anzugeben ist.

(2) Als land- und forstwirtschaftlicher Betrieb gelten

1. die Landwirtschaft, die Forstwirtschaft, der Wein-, Garten-, Obst- und Gemüsebau, die Baumschulen, alle Betriebe, die Pflanzen und Pflanzenteile mit Hilfe der Naturkräfte gewinnen, die Binnenfischerei, die Teichwirtschaft, die Fischzucht für die Binnenfischerei und Teichwirtschaft, die Imkerei, die Wanderschäfferei sowie die Saatzucht;
2. Tierzucht- und Tierhaltungsbetriebe, soweit ihre Tierbestände nach den §§ 51 und 51a des Bewertungsgesetzes zur landwirtschaftlichen Nutzung gehören.

Zum land- und forstwirtschaftlichen Betrieb gehören auch die Nebenbetriebe, die dem land- und forstwirtschaftlichen Betrieb zu dienen bestimmt sind. Ein Gewerbebetrieb kraft Rechtsform gilt auch dann nicht als land- und forstwirtschaftlicher Betrieb, wenn im Übrigen die Merkmale eines land- und forstwirtschaftlichen Betriebs vorliegen.

(3) Führt der Unternehmer neben den in Absatz 1 bezeichneten Umsätzen auch andere Umsätze aus, so ist der land- und forstwirtschaftliche Betrieb als ein in der Gliederung des Unternehmens gesondert geführter Betrieb zu behandeln.

(4) Der Unternehmer kann spätestens bis zum 10. Tag eines Kalenderjahres gegenüber dem Finanzamt erklären, dass seine Umsätze vom Beginn des vorangegangenen Kalenderjahres an nicht nach den Absätzen 1 bis 3, sondern nach den allgemeinen Vorschriften dieses Gesetzes besteuert werden sollen. Die Erklärung bindet den Unternehmer mindestens für fünf Kalenderjahre; im Falle der Geschäftsveräußerung ist der Erwerber an diese Frist gebunden. Sie kann mit Wirkung vom Beginn eines Kalenderjahres an widerrufen werden. Der Widerruf ist spätestens bis zum 10. Tag nach Beginn dieses Kalenderjahres zu erklären. Die Frist nach Satz 4 kann verlängert werden. Ist die Frist bereits abgelaufen, so kann sie rückwirkend verlängert werden, wenn es unbillig wäre, die durch den Fristablauf eingetretenen Rechtsfolgen bestehen zu lassen.

## 7) Thresholds for the exemption for small enterprises in the EU on January 2016

Source: European Commission, 'Annex 1: VAT Thresholds (January 2016)' <[http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/vat/traders/vat\\_community/vat\\_in\\_ec\\_annexi.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/traders/vat_community/vat_in_ec_annexi.pdf)> accessed 18 April 2016

Member State	Threshold(s) for exemption for small enterprises		Euro equivalent on 15 April 2015		
	National Currency				
Belgium			15.000		EUR
Bulgaria	50.000	BGN	25.265		EUR
Croatia	230.000	HRK	30.344		EUR
Czech Republic	1.000.000	CZK	36.476		EUR
Denmark	50.000	DKK	6.696		EUR
Germany			17.500		EUR
Estonia			16.000		EUR
Ireland			37.500	75.000	EUR
Greece			10.000		EUR
Spain					EUR
France			32.900	42.600	82.200
Italy			15.000	20.000	35.000
Cyprus			15.600		EUR
Lativa			50.000		EUR
Lithuania			45.000		EUR
Luxembourg			25.000		EUR
Hungary	6.000.000	HUF	20.144		EUR
Malta			14.000	24.000	35.000
Netherlands					EUR
Austria			30.000		EUR
Poland	150.000	PLN	37.333		EUR
Portugal			10.000	12.500	EUR
Romania	220.000	RON	49.780		EUR
Slovenia			50.000		EUR

Slovakia			49.790		EUR
Finland			8.500		EUR
Sweden	(proposal: 30.000)	SEK			
United Kingdom	82.000	GBP	114.397		EUR

Average lowest threshold:

30.489,00 EUR

Average highest threshold:

35.701,00 EUR

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