

Economic stimulus package 2020 - temporary reduction of VAT rates

Background

On 3 June 2020, the Federal Government (Coalition Committee) adopted the 2020 economic stimulus package. One of the most important measures is the temporary reduction of VAT rates, namely the reduction of the standard VAT rate from 19% to 16% and the reduced VAT rate from 7% to 5%. This measure is (initially) applicable from 1 July 2020 to 31 December 2020. This measure is said to cost the government around EUR 20 billion, and is by far the largest measure adopted.

Which companies are affected?

The planned VAT rate cut does not provide for any exceptions. All companies and all sectors are affected.

What opportunities will arise?

On the input side, the planned measure may provide relief in particular for companies that are not, or only partially, entitled to deduct input VAT, provided that net prices have been agreed for the purchase of services, as the services purchased will become cheaper. In particular companies in the financial, real estate, health as well as companies from the third sector and the public sector will benefit from this measure. In order to save costs, any planned investments should be postponed, and effected during the period from 1 July to 31 December 2020.

On the output side, contractors who have agreed gross prices for supplies to their customers will benefit most, since less VAT is payable to the state for the same remuneration. Depending on the sector, companies will let their clients participate in additional price reductions. Companies of the retail sector have already announced this.

What does the planned reduction in VAT rates mean?

In principle, VAT is incurred when the service is rendered, i.e. irrespective of when the invoice is issued or the remuneration is received (exceptions include e.g. services from abroad). The applicable VAT rate depends on the time at which the VAT arises. If an incorrect VAT rate is reported for a domestic service, this entails a risk both for the entrepreneur providing the service and the recipient of the service (who is entitled to deduct input VAT). According to § 14c paragraph 1 German VAT Act, a taxable person providing the service owes the VAT stated in the invoice (even if a lower VAT rate would actually be applicable). The recipient of the service on the other hand is only entitled to deduct input VAT from this invoice to the amount of the (lower) VAT legally owed. For companies it is now important to duly prepare for the planned reduction in VAT rates and thus prevent neutralizing the desired relief by errors made in the adjustment of the ERP-system/accounting system which result in increased administrative expenditure due to the necessary invoice corrections.

1 July 2020 has consequently become a key date in terms of invoicing. In practice, particular attention must be paid to all transactions that take place over a period of time before and after this cut-off date, especially in the cases listed below:

- In general, for any (net) price agreements agreed to before 1 July 2020, but relating to supplies which will be executed after 1 July 2020 (until 31 December 2020) the lower VAT rate must be applied.
- If advance payments or payments on account are invoiced before 1 July 2020, but the total service is only provided in full after this date (and before 31 December 2020), this must be corrected in the final invoice and the lower VAT rate must be applied overall. This must also be taken into account when reviewing invoices on the input side for the

purposes of input VAT deductions.

- In the case of services which are rendered in sections or parts (e.g. construction projects, letting services, all services for which interim acceptance, partial steps or the like have been agreed), it depends on whether part of the service is rendered between 1 July and 31 December 2020, in which case the lower VAT rate is to be applied.
- One must also check when ongoing/recurring services (rentals, maintenance contracts, etc.) are provided. If, for example, they relate to the entire year, the VAT rate on the agreed date applies. If they relate to individual months or quarters and are only settled annually, the remuneration must be divided accordingly.
- Even without the change in the VAT rate, the correct mapping of transactions associated with a change in the VAT assessment base is a challenge for all companies involved, both for the VAT to be paid and for the input VAT deduction. This includes in particular:
 - The subsequent granting of discounts and rebates (especially annual rebates, refunds, bonuses, cashback systems, etc.)
 - The issue and redemption of vouchers
 - Allocations and settlements within a group of companies (e.g. intercompany adjustments from agency agreements for the provision of IT services, the granting of licenses and other administrative services)

In individual cases, it depends on when the adjustments take place and the period of time to which they relate (time of supply). It is to be expected that the tax authorities will issue transitional and simplification rules in this regard.

What do we have to pay particular attention to in practice?

In order to ensure that invoices are issued correctly and that transactions are correctly declared in the preliminary VAT returns, the ERP-systems/accounting systems must be adapted accordingly. We therefore recommend that you check whether any old tax codes for 16% are still available and can be reactivated, and how new tax codes for 16% and 5% can be set up on a transitional basis. You must ensure that these are correctly linked to all relevant VAT accounts. It is recommended that all services rendered up to 30 June 2020 are invoiced as of this date, if possible, in order to ensure the correct application of the (new) tax codes and proper invoicing.

This measure also poses a practical challenge for the conversion of the cash register systems, because the lower VAT rates have to be incorporated at short notice and on a transitional basis. On the other hand, restaurants and catering businesses will already benefit from the announced application of the reduced VAT rate to the delivery of food, which also needs to be implemented in the cash register systems.

In addition, more checks should be carried out on incoming invoices for the deduction of input VAT, especially with regard to the indication of the time of supply and the correct VAT rate.

If long-term contracts have been concluded and these are also regarded as invoices, we recommend that you check whether these agreements require a supplement. This is especially the case if the contracts mention the concrete applicable VAT rate (19% or 7%) rather than wording referring to the legally owed VAT.

It is currently unclear how sales from 1 July 2020 onwards must be reflected in the preliminary VAT returns. We assume that there will be new form templates on a transitional basis, or that there will be an indication of whether sales are to be shown in the existing fields (19% and 7% or sales at other VAT rates). This will mainly affect the interfaces between the accounting systems and the systems for creating preliminary VAT returns.

How can you prepare for these adjustments

In some cases, it is not yet clear how the changes will affect the practical side of things (e.g. with regard to the forms for VAT returns). In some cases, however, it is already possible to start preparing for the changeover announced at short notice, in particular by taking the following measures:

- Auditing of the ERP-systems/accounting systems in order to
 - prepare the adjusted tax codes and
 - adapt the invoice layout
- Checking whether any adjustments or additions to long-term contracts, which are regarded as invoices, are necessary
- Preparation of the invoicing of the services rendered until 30 June 2020 (as far as possible) in order to facilitate the change of tax codes

- Examination of existing agreements to determine whether a gross or net agreement has been reached
- Preparing the responsible employees for the change (What should be taken into account when booking? How are the incoming invoices to be checked? etc.)
- Identification of the business transactions most affected in your own company using the cases shown above

What happens next?

We will keep you informed about the status of the legal implementation of the planned measures of the economic stimulus package and inform you about corresponding statements and information from the tax authorities. It is to be expected that the tax authorities will react in the same way as they did with the last change to the VAT rate (increase from 16% to 19% as of 1 January 2007) (cf. BMF letter of 11 August 2006). At that time, simplification and transitional provisions were provided for the following areas, in particular:

- Supplies of goods and services which are provided in instalments
- Ongoing services such as rentals, leasing, maintenance, monitoring, ongoing financial and payroll accounting, etc.
- Changes in the basis of assessment (especially vouchers, annual refunds and annual bonuses, refund of deposit amounts)
- Services provided by utility companies (electricity, gas, heat)
- Passenger transport companies

Additional notes

The reduction of the VAT rates also applies to import VAT. At the same time, the economic stimulus package provides for the due date of the import turnover tax to be postponed to the 26th of the following month in order to provide companies with a liquidity advantage.

The insurance tax rate will not be reduced and will remain at 19%. This has no effect on VAT because insurance services are generally exempt from VAT (§ 4 No. 10, 11 GVATA).

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