



Federal Ministry of Finance creates new avenues for public sector, nonprofit organizations, and holding companies

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1 Background

With its two letters of 1 April 2026, the German Federal Ministry of Finance (BMF) has provided important and long overdue clarifications. One of the letters addresses the non-taxability of internal supplies within a VAT group where such supplies relate to non-economic activities in the narrow sense. The other letter deals with the change in the ratio of use between taxable activities and non-economic activities in the narrow sense. The two letters are interconnected. With them, the BMF creates important room to manoeuvre for legal entities under public law and non-profit organisations. However, holding companies may also be affected.

Both BMF letters concern interactions between the different VAT-relevant spheres. Legal entities under public law, as well as non-profit organisations and holding companies, operate not only in an economic area (= taxable sphere) but also in a non-economic area (= non-taxable sphere). For legal entities under public law, the latter is the so-called sovereign sphere, whilst for non-profit organisations, it is referred to as the idealistic sphere. For holding companies, the non-taxable sphere arises from the mere holding of participations. In VAT terms, these non-taxable spheres are referred to as "non-economic activities in the narrow sense."

It is clear that input VAT deduction remains excluded for the procurement of goods or services solely related to non-economic activities in the narrow sense. In the case of a mixed procurement of goods or services, the taxable person can only claim the proportional input VAT deduction according to the so-called apportionment rule. Interesting options arise



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when the ratio of use changes at a later date or when supplies are passed on, within a VAT group, to the sphere of non-economic activities in the narrow sense.

2 BMF letter dated 1 April 2026 (input VAT deduction and supplies carried out free of charge)

In light of recent jurisprudence, the BMF has concluded that a subsequent change in the ratio of use of an asset always constitutes an adjustment of (the initial) input VAT deduction within the meaning of sec. 15a of the German VAT Act (provided the other requirements of sec. 15a of the German VAT Act are met). Until now, the tax authorities have made the correction through the chargeable event of a supply carried out free of charge. In most cases, the result will be the same.

However, the new perspective is relevant, for example, to the important issue of a legal entity under public law transferring staff from an operation of a commercial nature to its own sovereign sphere. Previously, this was only then not considered a supply carried out free of charge within the meaning of sec. 3 para. 9a no. 2 of the German VAT Act, when a clear and easily understandable separation between the operation of a commercial nature and the sovereign sphere could be made with regard to the assignment of personnel. In the future, however, this assignment of personnel will generally be outside the scope of VAT. This is an important message for all legal entities under public law.

3 BMF letter dated 1 April 2026 (VAT Group)

With its second letter, the BMF finally implements the Federal Fiscal Court's recent jurisprudence and even goes beyond it. You may recall: With its judgement dated 29 August 2024 (V R 14/24), the German Federal Fiscal Court, in light of the ECJ jurisprudence in the case *C-184/23, Finanzamt T II*, confirmed its consistent jurisprudence on the non-taxability of internal supplies (see KMLZ VAT Newsletter 31 | 2024). Furthermore, the German Federal Fiscal Court follows the ECJ in its view that supplies provided for consideration by a controlled company to its controlling company are not taxable, even if the controlling company uses these supplies for non-economic activities in the narrow sense. The BMF has now gone one step further by clarifying that supplies carried out by the controlling company to the non-taxable sphere of the controlled company are also not taxable (the German Federal Fiscal Court had explicitly left open the latter scenario).

This statement has opened up significant room to manoeuvre for many legal entities under public law, as well as non-profit organisations when forming a VAT group with their subsidiaries: The VAT group thus also encompasses the sovereign or idealistic sphere of both the controlling company and the controlled company. The same applies to holding companies, where the VAT group now also includes the non-economic sector. Regardless of whether supplies of services are provided to the controlling company for consideration or free of charge there will be no taxation from now on. The BMF has fully adopted recent jurisprudence.

In practice, this means: Personnel costs and profit markup can be passed on without VAT from the controlled company (perhaps with a more favourable collective agreement) to the parent company's non-economic sphere.