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VAT preferential treatments for small enterprises in Germany

Incidence and applicability

Introduction

Global economic development is not only driven and inspired by “big players”. Small and medium sized enterprises worldwide are also influential contributors to the value added creation and job market. They represent nearly 99,0% of all the businesses in the European Union and account for approximately 2/3 of European employment. In many cases they are specialized, supply goods and services tailored to the customers’ needs and satisfy their refined tastes and expectations. They are capable of creating more direct bonds with the clients than the large enterprises. Small and medium sized enterprises can expand and take over new markets as long as they are supported by appropriate government policy. For a long period of time German SMEs seemed more robust and resilient than their counterparts in other European Union member states and were treated as a model for European success. However countries’ attitude missteps followed by long term competitive pressure and recent COVID-19 crises may undermine or shake even the strongest. Assisting and promoting entrepreneurship is therefore one of the primary concerns of the European Union. Similarly some member states supporting entrepreneurship are coming up with more and more recent concepts to facilitate the functioning of this “backbone of the economy”.

Tax incentives are among the measures relatively suitable to achieve this objective which however leads to discrepancies in legislative provisions among different countries. That may also be observed in relation to the VAT – the tax whose harmonization was initiated as early as in the 1960-ties. Some margin of discretion for the member states when it comes to designing national VAT

law is allowed on the basis of selected principles included in the 2006/112/EC Directive providing framework for the common European Union legislation in this regard. National VAT acts are hence in many cases more detailed than the directive (Kristoffersson 2016: 30). Observed VAT discrepancies between member states may be divided into separate categories, namely these related to: provisions that are not compulsory to implement; exclusions from the VAT Directive that are allowed to be kept; exceptions due to the accession treaties; discordance in law interpretation (legal transplants, legal formants, differences in understanding of the European Union law) (Kristoffersson 2016: 34).

Considerable level of margin of discretion may be noticed in relation to the design of the provisions regulating special VAT schemes. These schemes in relation to taxation of small enterprises are usually grouped into three main types: those that provide for an exemption threshold, those that facilitate the calculation of tax liability and those that reduce the burden of accounting, filling or payment obligations (*Consumption Tax Trends* 2016: 74). As the first of these types was put into practice by most European Union member states on similar terms the others are less common and more diversified. Under the first of the mentioned schemes small enterprises are exempt from the obligation to register for VAT purposes, they do not account for output VAT and as a consequence are not entitled to deduct input tax on their acquisitions of goods and services.

Simplification of the VAT calculation may be obtained by application of the flat-rate or margin schemes. These are used by member states less frequently than the exemption scheme. Most of the European Union member states employ various methods aiming at simplification of certain obligations. It has to be however underlined that some of the regimes result in achieving more than one of the mentioned objectives at the same time. They are discussed in this article in relation to one of the earliest member states of the European Union – Germany.

Despite the economic crises of the recent years the sector of SMEs in Germany is continuously developing. Particular role is played by micro-sized businesses (employing up to 9 people) that according to the official statistics represented in 2022 approximately 83,9% of the businesses in question. Funds deficiency and insufficient possibilities of cash flow management are listed among the most common challenges faced by this group of entities. Appropriately designed, tailored and adopted tax reliefs may provide for a basis to face such challenges with success. Public support is considered as one of the main sources of resilience of SMEs in Germany (OECD SME, 2021, p. 3).

The purpose of the article is not only to portray the provisions governing the application of simplified VAT schemes for SMEs but also to examine their application into practice. The findings could be of benefit for both legislators and associations of small businesses promoting entrepreneurship in the European Union. A further international comparison may however be necessary in this regard to provide a more comprehensive approach and lead to harmonization of the support measures. On the other hand there are some limitations to this concept. Primarily comparative studies require sufficient data sets aggregated on the basis of the same methods and in the corresponding way. Such sets are currently hardly available in the taxation field. Secondly a consensus of all member states is required to implement uniform principles. Taking into account diversified structures of the SMEs sectors in different countries, harmonization measures should be adopted successively and with circumspection. The article includes therefore statistics of one country and applies predominantly methods of normative and conceptual research, including literature review of the analysis of regulations comprised in selected national acts. The empirical studies cover a period of 2017-2019, which is predominantly dictated by data availability.

Simplified procedures for small enterprises under the VAT Directive

The current European Union legislation provide for few special VAT schemes applicable in the particular sectors of the economy. They concern in particular the following groups of taxpayers: small enterprises; farmers; travel agents; suppliers of second-hand goods, works of art, collectors' items and antiques; suppliers of investment gold; and finally non-established taxable persons providing electronic services to non-taxable persons. As it is indicated by Nellen and co-authors the first three schemes are aimed at streamlining the levying of VAT for various special categories of taxable persons, the fourth and the fifth ones were implemented to remove potential difficulties related to specific supplies of goods and the last one was adopted to promote compliant behavior and simplify certain administrative provisions (Nellen *et al.* 2020: 591). Some of these schemes have mandatory character others (the schemes dedicated to small enterprises or the scheme for farmers) are treated by the legislator as an optional solution. They may or may not be introduced to the legal system by the member states and chosen to be applied by the taxpayers at their discretion.

In order to ease the tax burden imposed on small enterprises by minimizing VAT record keeping and reporting obligations the national legislators

are entitled to authorize certain simplified VAT procedures (Schenk, Oldman 2007: 178). Pursuant to the article 281 of the 2006/112/EC Directive they may be implemented by Member States which might encounter difficulties in applying the average VAT arrangements to small enterprises, by reason of the activities or structure of such enterprises. Conditions for their introduction may be set by these states after consulting the VAT Committee. Such special arrangements may include flat-rate schemes for charging and collecting VAT and be used provided that they do not lead to a reduction of VAT liability (Hybka 2013: 584).

Exemption scheme for small enterprises is one of these arrangements. To define eligibility for that particular scheme turnover is used as a criterion. It relies on the fact that almost every small enterprise knows the value of its total sales which makes the scheme relatively easy to monitor and comply with (*Taxation of SMEs*: 124). Under the contemporary rules supplies by small enterprises are exempt if their annual turnover does not exceed a given threshold, different in each Member State. This turnover consists of the amount derived from supplies of goods and services, including zero-rated transactions, real property transactions, financial services and insurance transactions, unless these transactions are ancillary (VAT exclusive). It must be underlined that disposals of tangible or intangible capital business assets may not be taken into account for the purposes of calculating this turnover, unless that disposal is an integral part of the usual business activities of the taxable person (Annacondia 2017: 475). In most of the cases small enterprises which are not domestic have no access to such an exemption. However, specific Member States also apply this exemption to non-resident small businesses. They include such states as: Bulgaria, Cyprus, Hungary, Portugal and Sweden (Annacondia 2017: 475).

Due to certain shortcomings of this system and to provide small businesses with an environment to promote growth and cross-border trade in relation to this scheme the European Union adopted new rules that are going to come into force on the 1st of January 2025 (VAT: Council 2020: 1). The revised rules rely on two thresholds for this exemption, namely:

- the national threshold – providing for an exemption status for small businesses with an annual turnover not exceeding the threshold defined by the Member State which should not be higher than 85,000 €;
- European Union threshold – providing for an exemption status for small businesses established in other Member State than the one in which the VAT is due. This status may be assigned to businesses with an annual turnover in this state (where they are not established) not

exceeding national threshold and with an annual turnover in the EU below 100,000 €.

This second rule is meant to prevent companies with large turnover to benefit from the exemption in the other Member States and at the same time minimizing registration formalities by allowing single registration window in their own Member State.

A different form of simplified VAT arrangements are flat rate schemes. As it is indicated in the report of the European Commission under this scheme several options are possible (*Special Schemes* 2017: 6):

- the enterprises account for VAT due based on a specific basis or a different taxable base than outgoing supplies (e.g. weight of the purchased merchandise),
- the enterprises account for VAT applying the special lower flat-rate,
- combination of both.

The flat rate schemes are often applied in sectors vulnerable to fraud. These schemes differ significantly in their design among countries and are targeted in most of the cases to specific sectors or are applicable on more general basis, however employ industry specific VAT rates.

According to the article 63 of the 2006/112/EC Directive the chargeable event for VAT purposes occurs and tax becomes chargeable when the goods or the services are supplied. As such, VAT systems are usually accrual based, requiring that VAT be remitted on taxable sales where the cash has not yet been received (Taxation of SMEs, 2015, p. 110). However for certain categories of taxpayers or in respect of certain transactions Member States are entitled, by the way of derogation, to adapt provisions defining different moments of the VAT chargeability. In that case, VAT becomes chargeable at one of the following times (article 66 of the 2006/112/EC Directive):

- no later than the time the invoice is issued,
- no later than the time the payment is received,
- where an invoice is not issued or is issued late, within a specified period from the date of the chargeable event.

Certain Member States made use of this provision and implemented different rules concerning chargeability of VAT in respect to transactions carried out by small enterprises. As a result these enterprises are allowed to apply the so called optional cash accounting scheme. This derogation delays the right of deduction for these taxable persons in this scheme until the payment is made to their suppliers, provided they are allowed to delay the moment when the tax is due until receipt of payment (Terra, Kajus 2019: 1001).

VAT schemes for small enterprises in Germany

All the member states of the European Union adopted the provisions of the 2006/112/EC Directive that are outlined in the second chapter of this paper and granted small enterprises a right to VAT exemption. In Germany, pursuant to the §19 of the VAT Act, entrepreneurs are eligible for such an exemption (*Kleinunternehmerregelung*) if their turnover (tax included) in the calendar year preceding the current year did not exceed 22,000 euro (17,500 euro until the end of 2019) and in the current calendar year will presumably not exceed 50,000 euro (Steuern 2019: 132). Small enterprises commencing economic activity have an option to make use of this exemption if their turnover in the first year of their activity does not exceed 22,000 euro.

Table 1

Flat input VAT rates for selected sectors of the economy in Germany until 2022

| Type of economic activity | Sector of the economy | Flat rate |
|---------------------------|---------------------------------------|-----------|
| Retail trade | flowers and plants | 5.7% |
| | entertainment journals and newspapers | 6.3% |
| | health and beauty products | 10.9% |
| | textile products and overgarments | 12.3% |
| Skilled labour | painting, decorating, varnishing | 3.7% |
| | shoemaking | 6.5% |
| | stone carving and stonemasonry | 8.4% |
| | millinery | 12.2% |
| Liberal professions | writers | 2.6% |
| | university teachers | 2.9% |
| | journalists | 4.8% |
| | sculptors | 7.0% |

Source: Anlage zu den §§ 69 – 70, Umsatzsteuer-Durchführungsverordnung 2005.

It must be underlined that exempt businesses are not entitled to deduct the input tax on their purchases (Weimann, Lang 2019: 1470). Similar rule exists in the other European Union member states (Annacondia 2017: 475). Businesses fulfilling the conditions for VAT exemption that notwithstanding the above-mentioned right decide to be a taxable person are obliged to pay VAT on their taxable transactions for the period of the consecutive five years. Taking into account the international comparison this threshold for exemption is in

Germany relatively low. The ceilings for exemption in the European countries range from 2845 euro (Sweden) to 94,741 euro (the United Kingdom).

Tax compliance costs imposed on small enterprises may, according to certain provisions of the VAT Directive, be cut down by applying flat (fixed) rates to deduct the input or (and) output VAT. This type of simplified procedure was available to German enterprises in line with the §23 of the VAT Act (*Allgemeine Durchschnittsätze*) until the end of 2022. Flat rate scheme for VAT purposes used to have many advantages, such as facilitating record keeping, improving management of cash flow, and reducing tax burden (under certain conditions and for certain groups of taxpayers).

It was of particular benefit for entrepreneurs incurring relatively low costs while conducting their business activity. There was however only predefined group of businesses that could have adopted the scheme (Kurz et al. 2022: 523). This group included entrepreneurs that were not legally obliged to keep books and to prepare regular financial statements on the basis of annual inventories, in other words – taxpayers who computed the income tax base by using the so called net income method (*Einnahmen-Überschuss-Rechnung*). The provisions of the Tax Ordinance (§141 Abgabenordnung 2002) impose that particular obligation, namely – to keep books and to prepare regular financial statements on the basis of annual inventories on businesses that meet one of the following conditions:

- the company's turnover in a calendar year exceeds 600 thousand euro or
- the company's profit in a calendar year exceeds 60 thousand euro.

Enterprises from that group had an entitlement to apply fixed rates while deducting input VAT if their turnover in the previous tax year did not exceed 61 356 euro (§ 69 Umsatzsteuer-Durchführungsverordnung 2005). The calculation of this turnover did not take into account the value of intra-Community transactions and the importation of goods and services. Fixed rates varied depending on the type of a business (for selected categories of taxpayers they are presented in Table 1). They amounted from 1.5% (for lawyers and notaries) to 12.5% of the turnover (for retail businesses that were primarily selling fuels).

Due to administrative reasons chargeability of VAT, also in Germany, generally occurs when goods and services are delivered or when the invoice is issued (Klenk 2019, p. 570). German legislator made however use of the article 63 of the 2006/112/EC Directive and adopted for certain groups of taxpayers the provisions derogating from the basic rule governing VAT chargeability (*Berechnung der Steuer nach vereinnahmten Entgelten*). Such a cash accounting scheme reduces cash flow pressure of the enterprises. In the cash accounting scheme, the application of provisions dealing with non-payments does not

seem to be necessary, which reduces not only compliance but also administration costs. Hence the customer does not pay, the VAT does not become chargeable and consequently, the supplier cannot be held to pay the VAT to the tax authorities (Doesum 2023, pp. 61-62). It allows the supplier to declare the VAT in the tax period in which the payment for the supplies of goods or services is received or made (Pato, Marques 2014, p. 222). Relaxation of its conditions, as it was indicated by the OECD, may in the times following the economic crises be adequate measure to alleviate the problems of payment delays and payment defaults which are still increasing in many member states of the European Union (*Consumption Tax Trends 2022*: 19-20).

In Germany cash accounting scheme for VAT purposes may be chosen by the enterprises that meet the following conditions (§ 20 Umsatzsteuergesetz 2005):

- their total turnover in the previous calendar year did not exceed 600 thousand euro or
- they are exempt from the obligation to keep books and to prepare regular financial statements pursuant to § 148 of the Tax Ordinance or
- they are carrying out a liberal profession within the meaning of the § 18 Abs. 1 Nr. 1 of the Personal Income Tax Act (Einkommensteuergesetz, 2009).

In the case of the supply of goods and provision of services by these taxpayers, VAT becomes chargeable upon receipt of the payment or partial payment (Lippross 2022: 1265). The additional requirement however is that a taxpayer submits an official form informing the competent tax office about the choice of that scheme (Istbesteuerung 2019: 792).

Applying simplified VAT schemes for small enterprises in Germany

Germany is among the member states of the European Union where the VAT exemption scheme was implemented only in relation to supplies of goods and services carried out by taxable persons who are established in the country. Restricting this scheme to domestic enterprises is a principle applied by the majority of the countries (22 member states). Contrary to some member states, small enterprises making use of this exemption in Germany are obliged to register with a competent tax office. Such an obligation is not imposed on small companies inter alia in Austria, Bulgaria, Cyprus, Denmark, Estonia, Finland, France, Croatia, Ireland, Lithuania, Latvia, Poland, Portugal, Romania, Slovenia, Slovakia and Sweden (*Special Schemes 2017*: 4).

Table 2
Simplified VAT schemes in Germany in the years 2017-2019 (general overview)

| Type of the scheme | Year | Taxpayers | | Turnover | | VAT due | |
|--------------------|------|-----------|-------|--------------------|------------|--------------------|-------------|
| | | Number | % * | Amount (1000 euro) | Average ** | Amount (1000 euro) | Average *** |
| Flat rate | 2017 | 3163 | 0,10 | 135 000 | 42 681 | 12 423 | 3928 |
| | 2018 | 3110 | 0,09 | 135 482 | 43 563 | 12 483 | 4014 |
| | 2019 | 3097 | 0,09 | 132 907 | 42 915 | 12 193 | 3937 |
| Cash accounting | 2017 | 966 692 | 29,59 | 139 077 378 | 143 869 | 11 852 533 | 12 261 |
| | 2018 | 982 555 | 29,96 | 145 097 471 | 147 674 | 12 667 269 | 12 892 |
| | 2019 | 1 008 827 | 30,68 | 152 964 448 | 151 626 | 13 508 657 | 13 390 |

* Share of the number of taxpayers applying the scheme in the total number of taxpayers

** Average value of turnover per taxpayer

*** Average value of tax due per taxpayer

Source: Author's compilation based on Finanzen und Steuern 2019-2021: 9-36.

Table 3
Simplified VAT schemes in Germany by sectors of the economy in 2019

| Sector of the economy | Type of the scheme | | | |
|--|--------------------|---------------------|-----------------|---------------------|
| | Flat rate | | Cash accounting | |
| | Taxpayers | VAT due (1000 euro) | Taxpayers | VAT due (1000 euro) |
| Agriculture, hunting and forestry | 65 | 260 | 24 743 | 49 693 |
| Manufacturing | 46 | 181 | 43 830 | 465 456 |
| Electricity, gas and water supply | 5 | 27 | 37 542 | 199 425 |
| Construction | 51 | 139 | 128 142 | 1 319 556 |
| Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods | 41 | 154 | 149 303 | 1 333 321 |
| Hotels and restaurants | 108 | 340 | 92 142 | 947 563 |
| Transport, storage and communication | 75 | 269 | 76 981 | 1 012 002 |
| Real estate, renting and business activities | 12 | 60 | 64 049 | 575 238 |
| Education | 67 | 290 | 15 839 | 212 664 |
| Health and social work | 21 | 118 | 12 195 | 130 772 |
| Liberal professions | 601 | 3760 | 257 720 | 6 141 691 |
| Art, entertainment and recreation | 1816 | 5570 | 27 654 | 247 607 |
| Others | 189 | 1025 | 78 687 | 873 669 |
| Total | 3097 | 12 193 | 1 008 827 | 13 508 657 |

Source: Source: Finanzen und Steuern 2019-2021: 9-36.

Table 2 illustrates also the popularity of the cash accounting scheme in Germany. Such countries as Germany, Ireland, the Netherlands and Lithuania apply the cash accounting scheme only to the extent that it relates to output tax. Enterprises in these countries may recover input tax in accordance with the general rules – it means on an accruals basis. Other countries using the scheme implemented the so called combined cash accounting which means that it covers both input and output tax. In most of the countries application of this scheme requires ex ante notification of the tax authorities (exception is provided only for small businesses in Finland and Italy).

The number of taxpayers profiting from the cash accounting scheme was in Germany increasing in the years 2017-2019 (table 2). Nearly 30,7% of all VAT registered businesses decided to apply this scheme in 2019. Cash accounting scheme is particularly favored by taxpayers in such sectors of the economy as: liberal professions, wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods and construction. Taxpayers from these sectors account for nearly 53,1% of the taxpayers that opted for this scheme in 2019.

Taking into account the relation of the number of taxpayers using the scheme to the total number of VAT registered businesses leads to the conclusion that this scheme is especially appealing to entrepreneurs in the sector of hotels and restaurants where it was selected by approximately 41,4% of all taxpayers. It is also popular among entrepreneurs exercising liberal professions and companies operating in the sector of electricity, gas and water supply and construction sector. These are also the sectors of the economy with the highest total amount of VAT due to be paid to the state budget in 2019 (table 3).

Conclusions

Simplified VAT schemes in relation to small enterprises enjoy certain level of popularity among European Union member states. Many countries implemented two or more of such schemes according to the provisions of the 2006/112/EC Directive. They are optional in all of EU countries allowing the enterprises a relatively wide margin of flexibility and providing for the possibility to opt out of the scheme when application of the general rules is potentially more beneficial. The requirements and principles of the usage of these schemes differ significantly in their design among jurisdictions. Special VAT schemes were predominantly enforced in relation to domestic enterprises which led to an unequal treatment of international businesses. They still face some limita-

tions owing to the fact that they are prone to fraud and abuse as some enterprises may be tempted to underreport turnover in order to reduce their tax burden. In addition they need adaptation to the recent developments and EU proposals in the field of e-commerce.

German VAT act allows small enterprises fulfilling certain conditions to opt for VAT exemption or cash accounting. The legislator repealed since 1 January 2023 the provisions for flat rate scheme which were targeted to specific sectors of the economy and based on industry specific VAT rates. This abolition was substantiated by the legislator with the low usefulness of the schemes for practice and may be relatively intelligible considering the fact that it was usually opted for by less than 0.1% of VAT taxpayers annually. On the other hand it may also elicit skepticism as the scheme was relatively favorable for some liberal professions, retail traders and skilled labour. Other schemes still available in the VAT system have more uniform and general character and provide support to a wider and more diversified group of enterprises. Cash accounting scheme in Germany seemed to be definitely more popular among taxpayers than the flat rate scheme. It may be explained by the restrictions of the usage of the latter. All the schemes limiting the number of enterprises that may profit from them by imposing a turnover ceiling may disincentive businesses to broaden the scope of their activities and open the opportunities for fraud. Such schemes are prevailing in the EU member states. That is why they should be adopted with caution and supervised on a continuous basis by the tax authorities. For most of such schemes, as it is indicated by C. Crawford and J. Freedman (2010: 1083), the take up rate is relatively low, which is due to their complexity. Such schemes are used as a substitute to simplifying the whole tax system. Many small enterprises seems to value general stability more than simplification due to selected measures derogating from general provisions.

Alleviation of tax obligations as well as reduction of both the tax burden and compliance costs imposed on taxpayers is considered to be pivotal for the survival of certain groups of enterprises in some sectors of the economy. For that reason such schemes should be popularized and endorsed rather than abolished. Many countries are introducing diversified tax measures to support the sector of small and medium sized businesses. Some of these, like *inter alia* tax rate cuts or tax exemptions, are related to VAT. Deferring VAT payment or simplifying the calculation of VAT due may also be considered as an effective and straightforward method in this regard. Recently proposed initiative by the European Union may for small enterprises alleviate the problem of some income tax discrepancies among member states. A new Head Office Tax System for SMEs would probably give this group of businesses the option to interact with only one tax adminis-

tration which can be very preferential for these entrepreneurs that conduct their business on the global scale. When it comes to turnover taxation a new VAT scheme for small businesses will include the internationally active ones and open the VAT exemption to these established in other member states. It forms a component of the entire package aimed at combating late payments and clarify and streamline the process of tax registration and reporting.

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ABSTRACT

Value Added Tax has been to a large extent harmonized in the European Union since the 1960s. As a result, most of the general provisions concerning its design are applicable in all Member States. However, there are some variances in how specific categories of taxpayers are taxed. Member States that face challenges in applying universal VAT norms to specific categories of entrepreneurs due to the structure and nature of their activity are permitted to adopt simplified procedures for calculating and collecting the tax. These procedures typically take the shape of flat-rate schemes, tax exemptions, tax reductions or specific provisions concerning VAT chargeability.

This paper aims to assess the implementation of these schemes in Germany with regard to small businesses. The study provides a multi-level insight into the legal framework that underpins the design and actual implementation of these VAT schemes. It is primarily conceptual in nature. The paper's objective is achieved through the use of selected socio-legal research combined with certain quantitative methods. To determine the demand reported by entities for the procedures in question, as well as the scale of their application, statistical data from the Federal Statistical Office of Germany were used.

For many years, Germany was among the member states that implemented all the simplified VAT schemes outlined in the 2006/112/EC Directive to reduce the tax burden imposed on firms. However, these schemes were and continue to be applicable only to a limited extent. They are an example of legal concepts that are diversely understood depending on the legal systems, despite the advanced harmonization process of VAT. Studies and publications addressing the problem of the application of simplified VAT schemes are therefore extremely rare. The issue covers both the legal and economic aspects of VAT design. The present paper uses one country as an example, but a comparative study was also conducted to juxtapose the provisions adopted at the European Union level and those implemented at the national level.