

VAT applies to loan under hire purchase agreement

On May 3, 2018, the Advocate General ('AG') at the Court of Justice of the European Union ('CJEU') issued his Opinion in the *Volkswagen Financial Services (UK) Limited* case (C-153/17). The AG concluded that the VAT exemption for the provision of credit cannot be applied to hire purchase transactions. The AG concluded that a hire purchase transaction is a single supply of a service or a good and the whole supply should be treated as taxable.

Where national VAT rules allow a hire purchase agreement to comprise two separate supplies, one being the sale of, for example, a car and the other being the provision of a loan, the provision of a loan would be exempt. However, in that case, there is a risk that no VAT recovery would be allowed on general costs.

1. The AG's Opinion

The taxpayer ('Volkswagen') offers customers a hire purchase agreement. The hire purchase agreement is broken down by Volkswagen into 1) the supply of a car and 2) the provision of a loan. The supply of the car is treated as taxable. The price for the supply of the car equals the price that Volkswagen pays to a dealer in order to buy the car. The provision of the loan is treated as exempt. Volkswagen's profits are derived from the provision of loans.

In dispute is whether Volkswagen should be allowed to recover input VAT on general costs. One of the issues in this particular case is that, while it is clear that these general overhead costs are used for the business as a whole, they are effectively part of the price of the loans for which no VAT recovery is available.

However, before arriving at an answer in relation to this issue, the AG noted that, while both parties seem to have very good arguments in support of their views, they "did not see the elephant in the room". The first question that the AG believes should be addressed concerns the qualification for tax purposes of hire purchase agreements. The AG believes that these should qualify as a single supply and therefore the full remuneration for that supply, including the interest elements, should be treated as subject to VAT. The AG refers to the CJEU *Stock '94* case to support his view, which is contrary to the earlier ruling of the CJEU in the *Muys' en De Winter's Bouw- en Aannemingsbedrijf* case.

The AG notes that for past situations Volkswagen would have been able to benefit from national legislation which permits exemption on the loans. In that case, no input VAT recovery would be allowed on general overhead costs. This is on the basis that, while some of these costs are used for the purposes of taxable transactions, all are a component of the price of the exempt transactions.

Alternatively, Volkswagen would be able to directly rely on the EU VAT Directive (Directive 2006/112/EC) and treat the hire purchase agreements as taxable. It is up to the referring court to ascertain whether that is possible.

2. Initial comments and practical consequences

The AG's Opinion is not in line with commercial practice in the Netherlands and may have a significant impact on companies that operate in the leasing industry. It remains to be seen whether the CJEU follows the AG's interpretation in this case. We doubt whether the reasoning of the AG based on the *Stock '94* case will be upheld by the CJEU. In that case an interest-bearing loan was granted by a supplier to a farmer *in advance*, with the obligation to use the loan to purchase goods and services from that supplier. In the *Muys' en De Winter's* case the court made an observation in relation to the situation where deferral of payment was granted by a supplier to a consumer in return for payment of interest, *after* a supply was made. It appears to us that a hire purchase transaction has more similarity with the latter as under such an arrangement the interest component relates to deferral of payment after a supply. Furthermore, the outcome as suggested by the AG would appear to contradict the CJEU judgement in the *Banco Mais* case.

Nevertheless, as hire purchase agreements and financial lease agreements are often entered into for a long term, and VAT may have a significant impact on the profitability of such arrangements, we recommend assessing the impact of this potential change.

Currently, based on a Dutch decree, the provision of loans as part of certain financial lease and hire purchase arrangements can be treated as VAT exempt. Until such time that this decree is amended, taxpayers should be able to rely on the current guidance in the Netherlands. This would result in input VAT recovery being blocked. The approach taken by the AG in relation to input VAT recovery, i.e. that overhead costs need to be a cost component of a taxable supply in order for them to be recoverable, appears to be stricter than the current commercial practice. Alternatively, a taxpayer may also choose to directly rely on the EU VAT Directive if that provides a more beneficial outcome, should the CJEU follow the Opinion of the AG.

The tax advisors of Meijburg & Co's Indirect Tax Financial Services Group would be pleased to help you identify the potential implications of this Opinion and the CJEU judgment that follows. Please feel free to contact one of them or your regular contact at Meijburg & Co.

Meijburg & Co
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