

VAT treatment of hire purchase (2/46/18)

In this article you can find out whether the Court of Justice of the European Union (CJEU) agrees with its Attorney General's earlier opinion that a hire purchase is a single composite supply covered by a single VAT treatment, or whether the CJEU finds that a hire purchase consists of two independent supplies, and how a taxable person can deduct input tax on administrative overheads that are included only in the price of exempt supplies.

In our earlier [Flash News](#), we informed MindLink subscribers about CJEU Attorney General Maciej Szpunar's findings in a dispute between Volkswagen Financial Services (UK) Ltd ("VWFS") and the UK tax authority over the VAT treatment of a hire purchase and input tax deduction rights (case C-153/17). The CJEU issued a ruling on 18 October 2018.

Background

VWFS is part of the Volkswagen AG group that manufactures and distributes multiple brands of motor vehicles. VWFS offers various services, including a hire purchase (finance lease) that involves a vehicle supply and a lending service. After entering into a hire purchase agreement, VWFS buys a vehicle from the distributor and delivers it to the customer for use, stating that ownership will not pass until the customer has made all the agreed payments.

In the UK, a hire purchase for VAT purposes consists of two supplies: a taxable supply of goods and an exempt supply of lending services. VWFS makes a profit on the exempt lending service, but the supply of goods brings no profit, i.e. the selling price is identical to the acquisition cost (overhead costs associated with daily administration are not included in the price of goods). VWFS's expenses are associated only with taxable supplies or only with exempt supplies, or with both types of supplies. The costs mainly related to both types of supplies are administrative overheads. The dispute between VWFS and the tax authority arose over the method of deducting input tax on costs related to both taxable and exempt supplies.

The CJEU's arguments

Contrary to the Attorney General's earlier findings, the CJEU supported the opinion that a hire purchase may consist of two independent supplies: a taxable supply of goods and an exempt lending service if the interest payment represents a lending fee and is not part of the payment for the supply of goods or services.

The CJEU ruled that the right to deduct input tax arises when it is established that the acquired goods or services have been used for making taxable supplies. If administrative overheads in fact have a direct and immediate link to all VWFS activities rather than to only some of them, the link remains unaffected by VWFS's practice of including those overheads only in the price of exempt supplies. The result of a taxable person's business activity cannot affect the right to deduct input tax. The CJEU also said that where a taxable person has only a partial input tax deduction right, the main method to be used for measuring the deductible portion of input tax is the turnover method. A different method should be used only if it helps you measure the deductible input tax more accurately.