

VAT treatment of hire purchase likely to change (3/21/18)

The Court of Justice of the European Union (CJEU) published Attorney General (AG) Maciej Szpunar's findings relating to Case C-153/17 Volkswagen Financial Services (UK) Ltd on 3 May 2018. The case involves measuring the deductible portion of input tax on overall costs in companies that generate revenues from hire purchases. This article explores the AG's findings, which are likely to significantly affect the VAT treatment of those supplies and procedures for deducting input tax, if the CJEU upholds them.

Facts of the main proceedings

Volkswagen Financial Services (UK) Ltd delivers vehicles on hire purchase. The consideration for the supply is split into two parts:

1. the price of the vehicle equal to the price at which the company bought it from the seller; and
2. the price of the loan, which essentially comprises all of the company's expenses associated with the supply plus a profit margin. The loan portion of the consideration was not charged to VAT.

We note that under UK and Latvian rules a hire purchase comprises a taxable element (a taxable supply of goods) and an exempt element (an exempt supply – a consideration for lending).

The dispute arose over whether the company is allowed to deduct input tax on its overall costs. Not questioning the fact that the overall costs are incurred for making the two supplies, it is clear those costs are not included in the taxable amount but are fully covered out of revenues not charged to VAT.

The AG's findings

- This split is artificial because there are no grounds for splitting the hire purchase into two parts and treat each differently for VAT purposes.
- Separating the lending service as an exempt supply from the hire purchase exceeds the scope for exempting the lending service under article 135(1)(b) of the VAT directive and is not consistent with the purpose of this exemption, according to the AG.
- In the circumstances of the case, a hire purchase should be considered a single compound supply, and the entire amount of the supply is subject to VAT (with the right to deduct input tax).
- To qualify for input tax deduction, the costs of earlier supplies should be included in the value of onward taxable supplies.
- The right to deduct input tax should not be restricted in a company that theoretically makes taxable supplies, but exercising the right in this particular case would go against the core principles of VAT.
- To recognise the company's right to input tax deduction in the circumstances of the case would mean to subsidise the particular taxable person (or even the entire industry) with systematically deducted amounts of input tax, which would not be deductible because there is no VAT payable onwards. And this structure of supply is neither incidental nor temporary.

The implications

It is understood that the CJEU may still disagree with the AG's findings, but if the court upholds them, the industry is facing significant changes:

1. The Latvian VAT Act should be amended accordingly;

2. Companies making such supplies may have to revise their input tax deduction procedures in the light of the court ruling.

We will immediately let our MindLink subscribers know once the court ruling is out.