

Value added tax application in hire purchase (lease) transactions 3/16/25

In practice, the application of VAT to hire-purchase transactions (lease/finance lease) still leads to confusion, as a recent ruling by the Senate suggests (the ruling of 6 December 2024 in case A420225819, SKA-38/2024).

Circumstances of the case

- SIA "TKB LIZINGS" (lessor) transferred several vehicles to SIA "PANWAY LOGISTICS" (lessee) based on financial lease agreements. The vehicles were registered in the name of the lessor, with the lessee designated as the object holder (user). Subsequently, based on a contract for novation of financial lease contracts, SIA "TRANSIMPEKS TERMINAL" replaced SIA "PANWAY LOGISTICS", taking over all rights and obligations arising from the lease contracts;
- SIA "TRANSIMPEKS TERMINAL" failed to fulfil its obligations under the lease agreement;
- SIA "TKB LIZINGS" entered into a sale agreement with SIA "LIDER INVEST", which further entered into a sale agreement with SIA "VKG CAPITAL" (in the applicant's case), as a result of which SIA "VKG CAPITAL" acquired the claim rights arising from financial lease novation agreements against SIA "TRANSIMPEKS TERMINAL", including ownership rights to vehicles;
- SIA "VKG CAPITAL" agreed with SIA "TRANSIMPEKS TERMINAL" that, in partial payment of the liabilities, SIA "TRANSIMPEKS TERMINAL" will return all vehicles (lease objects) to the creditor;
- The transfer of vehicles to SIA "TRANSIMPEKS TERMINAL" was made out with a bill of lading - an invoice, applying VAT to the transaction. VAT on the invoice of SIA "VKG CAPITAL" was deducted as input tax;
- SRS did not consider that there was a supply transaction between SIA "VKG CAPITAL" and SIA "TRANSIMPEKS TERMINAL" and that SIA "VKG CAPITAL" had the right to deduct input tax.

Assessment of the situation by the Senate

Application of VAT to a lease transaction

The supply of goods is a transaction consisting of the transfer of ownership of a thing to another person so that the latter may dispose of the thing¹. A hire-purchase is a supply of goods in which the supplier of the goods, under the hire-purchase contract concluded, supplies a specific item which becomes the property of the recipient of the goods within the period specified in the contract after all payments specified in the contract have been made².

On the other hand, the moment of delivery of the goods is the moment when the goods are delivered, but not later than the moment when the goods are received by the consignee³. In a hire purchase transaction, the taxable value shall be the remuneration specified in the contract for the subject of the hire purchase on the day of entering into the contract, as well as all additional payments specified in the contract, except for credit interest⁴.

Consequently, a hire purchase (financial lease) is a supply of goods, although the transfer of ownership of the goods is postponed until the end of the contract. The lessor is obliged to issue a VAT invoice, enter it in the VAT return and pay it into the budget, while the lessee is entitled to input tax. VAT must be invoiced and VAT applied to the whole transaction value when the lessee is transferred for use, regardless of whether payment will be made in later periods. The right to deduct input tax arises not from the moment

of transfer of the right of ownership, but from the actual moment of transfer of the object of lease, with the lessor issuing a bill of lading on the value of the object of lease together with VAT.

How to correctly account for the return of the assets for VAT purposes

Although in the case of a hire purchase agreement, the obligation to calculate VAT and the right to deduct input tax arise from the actual transfer of the goods to the lessee, ownership of the leased property remains with the lessor. Ownership rights shall be transferred only after the expiry of the contract, fulfilling the conditions of the contract. SIA "TRANSIMPEKS TERMINAL" is a lessee who failed to fulfil the obligations. SIA "VKG CAPITAL" has taken over the claim rights against SIA "TRANSIMPEKS TERMINAL" from the lessor based on the assignment agreement. Under this agreement, SIA "VKG CAPITAL" acquired ownership of the vehicles. Upon termination of the lease contracts, SIA "TRANSIMPEKS TERMINAL" returned the lease object to SIA "VKG CAPITAL".

Since the SIA "TRANSIMPEKS TERMINAL" was not the owner of those vehicles, but only the holder, the return of the goods to their owner does not constitute a supply of goods. First of all, the legal relationship resulting from the lease agreement must be terminated. From the point of view of the lessee, nothing has changed: it remains bound to return the lease object to the lessee and, in such circumstances, the lessee can't supply the goods instead. On the contrary, the lessee must return the lessee to the lessor. Consequently, in the specific circumstances, the SIA "TRANSIMPEKS TERMINAL" was not required to draw up a VAT invoice. Consequently, SIA "VKG CAPITAL" did not have the right to deduct input tax.

¹ VAT Law, Section 1, clause 20

² VAT Law, Section 1, clause 13

³ VAT Law, Section 31, part one

⁴ VAT Law, Section 34, part eight