



## Mercedes-Benz Financial Services (MBFS) (C-164/16) CJEU Judgment released

### Opportunity or Risk?

The Court of Justice of the European Union (CJEU) has released its judgment in a case involving the VAT treatment of a common type of hire purchase (HP) contract. For background to the case, as previously provided on release of the AGO in June, please see below.

#### **MBFS CJEU**

This is a case which concerns whether a hire purchase contract falls to be treated as a supply of goods or services for VAT purposes.

The relevant EU legislation is Article 14(2)(b), of the VAT Directive which deems there to be a supply of goods in the event of *“the actual handing over of goods pursuant to a contract for the hire of goods for a certain period, or for the sale of goods on deferred terms, which provides **that in the normal course of events** ownership is to pass at the latest upon payment of the final instalment.”* (emphasis added).

As a preliminary point, the CJEU has noted that the label attached to a specific agreement for the hiring of a motor vehicle with an option to purchase (e.g. ‘finance lease’ or ‘hire purchase’) is not determinative as to whether the supply is one of goods or services.

The CJEU goes on to set the tests to determine whether a supply falls to be treated as goods under Article 14(2)(b) as being:

- the contract must include a clause expressly relating to the transfer of ownership of the goods; and
- objectively assessed, ownership of the goods will pass automatically through the normal performance, over the full term, of the contract.

In a contract where the first of the above tests is met but where the transfer of ownership of the goods is not automatic and is one of a number of options available to the customer (other options being for example to return the goods or extend the hire period), the second test above will not be met. Thus the contract will not fall within Article 14(2)(b). However, as an exception to this in regard to the second test, the contract will fall within Article 14(2)(b), where:

- the contractual instalments correspond to the market value of the goods including financing; and
- the customer will not be required to pay a substantial additional fee in order to exercise the option to purchase.

While the CJEU has provided clear guidance, as normal, it is ultimately for the national courts to determine the answer on a case-by-case basis in light of all the facts.

#### **KPMG’s view**

In KPMG’s view the application of the CJEU’s guidance when applied to MBFS’s Agility agreements will mean that these contracts should be classified as falling outside Article 14(2)(b) and therefore treated as services.

## Previously provided background information

Readers will probably be aware that HP contracts are a common method of financing the purchase of new and used cars in the UK. Therefore, this case potentially has wide ramifications for the automotive retail and finance sectors.

## Background

Traditional HP contracts have been used to finance the purchase of expensive consumer goods since the 19th century. Under a HP arrangement the customer takes possession of the goods and pays for them in equal instalments (weekly or monthly) over an agreed period. On payment of the final instalment ownership in the goods is transferred to the customer. Typically, each instalment will include an amount of capital and finance.

Since the introduction of VAT in the UK in 1973, these contracts have been treated as a taxable supply of goods and an exempt supply of finance. During the mid-1990s, Personal Contract Plans (a form of HP) evolved in the automotive retail sector. Under these contracts, a customer pays lower monthly instalments resulting in a higher final payment (often referred to as a balloon payment). These have also been treated as a taxable supply of goods and an exempt supply of finance for UK VAT purposes.

It is worth noting that by virtue of the Consumer Credit Act 1974, a consumer has the right to voluntarily terminate a HP type contract and hand possession of the goods back to the finance company once he/she has paid instalments equal to 50 percent of the total amount payable under the contract. Consequently, in a significant proportion of PCP contracts involving car sales, ownership of the vehicle will not pass to the customer.

In recent years, it is these PCP arrangements which have largely fuelled the high level of UK new car sales. As a result, the FCA is considering more stringent regulations which would usher in strict affordability checks in a bid to avoid a PCP-prompted financial crisis.

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## MBFS ‘Agility’ Contract

The MBFS Agility finance arrangement was aimed at customers who did not know at the outset of the arrangements whether they would ultimately want to purchase the vehicle or hand it back. Thus the HP contract used largely reflected the form of a PCP. However, specifically the final balloon payment was marketed as being entirely optional for the customer (which was then reflected in the form of the contract).

MBFS therefore maintained that its Agility PCP contract should be treated as supplies of services, rather than goods. The effect of treating the PCP contract as one of taxable services is that VAT is payable based on each monthly instalment rather than on the full vehicle value at the inception of the contract. Such treatment gives rise to a significant working capital improvement for the finance company.

## Contacts

If you have any questions about this case and the implications for your business, please contact one of the contacts below or your usual KPMG VAT adviser.

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