Vehicle Finance Agreements: A Supply of Goods or Services?

We would wish to draw member's attention to the following VAT case, which your MILS lawyers have been following closely and which has important implications for all franchised dealers.

Summary. The Upper Tribunal has held that a car hire contract containing an option for the customer to buy the car at the end of the term was a supply of services.

Background. Under a supply of services, VAT is chargeable each time the customer is liable to make a payment under the agreement.

An agreement for the sale of goods on deferred terms, where in the normal course of events, ownership is to pass at the latest on payment of the final instalment, is a supply of goods *(Article 14(2)(b), Council Directive 2006/112/EC)* (Article 14(2)(b)).

The facts of the case are as follows:

Mercedes-Benz Financial Services UK Limited (M) entered into a particular type of motor vehicle finance agreement with its customers, which contained an option to buy the vehicle at the end of the three-year hire period (the agreement). There was a cash flow advantage for Mercedes if the agreement was classified as a supply of services but, with a supply of goods, VAT would be chargeable at the start of the agreement.

The First-tier Tribunal held that the agreement was a supply of goods and Mercedes appealed.

The tribunal decided to allow the appeal.

The issue of whether the agreement constituted a supply of goods or services depended on whether, in the normal course of events, ownership of the car would transfer to the customer. The purpose of Article 14(2)(b) is to ensure that where the economic reality of a transaction is that it is a sale, the transaction is taxed as a sale. For the agreement to be a sale of goods under Article 14(2)(b), the normal outcome of the agreement would be for ownership to the car to pass. This is to be judged objectively at the time that the agreement was entered into. A mere option to acquire title is not sufficient to meet this test.

Mercedes' argument that the First-tier Tribunal acted in a procedurally unfair way by describing the agreement as a contract for the sale of goods failed; this description was interpreted as referring to the economic reality of the agreement rather than its legal characterisation.

To succeed, Mercedes would have had to show that the First-tier Tribunal's finding of fact that the sole realistic option for the customer was to purchase the car, and to do this it had to show that the First-tier Tribunal reached their conclusion without any evidence or on a view of the facts that could not be reasonably entertained.

The tribunal held that the agreement could be characterised as a contract for the sale of the vehicles and that, as such, was merely a contract that might lead to the sale of a car and so could not be a supply of goods.

Comment. This is an important decision for members as it is understood that many manufacturers have entered into similar financing arrangements. The decision provides a helpful clarification of the meaning of "in the normal course of events" and when Article 14(2)(b) will apply. It confirms the importance of looking not just at the wording of the agreement but also at the wider circumstances: the economic reality.

Case: Mercedes-Benz Financial Services UK Limited and The Commissioners for Her Majesty's Revenue & Customs [2014] UKUT 0200 (TCC).

MILS Solicitors t/a Motor Industry Legal Services

27b The Mansions, 252 Old Brompton Road, London SW3 9HW

Tel: 020 7244 6790 Fax: 0207 244 7139 DX: 132857 West Kensington 3 Email: legal@mils.co.uk Website: www.mils.co.uk

Offices also at: Canonteign House, Lower Ashton, Nr Exeter, Devon EX6 7RH. DX 8326 Exeter

Partners: Andrew Reeves, LLB (Hons), BSc; Henry Knill, MA (Cantab), Amanda Senitt LLB (Hons), Kirsty Swan LLB (Hons)