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Case alert

Volkswagen Financial Services (UK) ltd (VWFS)

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Summary

The Court of Justice of the European Union (CJEU) has issued its judgment in this referral from the UK's Supreme Court.

The issue referred to the CJEU was relatively simple. VWFS supplies vehicles to customers on hire purchase terms. It buys the vehicle from a dealer and sells at cost to the customer. It also provides credit finance to the customer who repays the cost of the vehicle plus interest on deferred terms. As far as input tax is concerned, HMRC considered that, as the vehicles were sold at cost, there should be no allocation of any overhead costs to the taxable supply of the vehicle. Instead they must be attributable wholly to the interest received on the supply of credit. As the supply of credit is an exempt supply for VAT purposes, HMRC argued that no input VAT could be reclaimed.

The case has been through all of the UK's Tribunals and Courts and the Supreme Court decided to refer the matter to the CJEU.

The CJEU has ruled that, in the circumstances, an apportionment of overhead input tax should be made as this reflects the fact that there are two separate supplies.

Court of Justice of the European Union

The CJEU has released its judgment in the case of VWFS. Surprisingly, the Court's judgment – issued on 18 October 2018 – has ignored the earlier opinion of the Court's Advocate General (AG) and has ruled that, in the circumstances of the case, VWFS is entitled to reclaim a proportion of the Input VAT incurred on overheads.

Whether or not VWFS was entitled to recover this input tax was the thrust of the Supreme Court's referral. However, when considering the facts of the case, the AG went on something of a detour. He questioned the way that the UK dealt with Hire Purchase agreements from a VAT perspective. The AG argued that when goods are sold on HP terms, there is a single supply of the goods. However, the UK accepts that there are actually two supplies – a taxable supply of the vehicle and an exempt supply of finance. If the AG was correct, suppliers such as VWFS would be required to account for VAT on the full value received (ie including the interest charged to the customer) but, returning to the question referred to it, VWFS would be entitled to full recovery of the input VAT incurred on overheads. This opinion caused much consternation in the financial services sector.

Ignoring the AG's detour, the full Court has ruled that it is up to the national court to determine whether there are, in fact, two separate supplies of the goods and the finance. It was clear to the Court that, in this case, the UK courts had decided that to be the case. In the circumstances, therefore, VWFS made a taxable supply of the vehicle at cost and an exempt supply of finance.

That being the case, the CJEU also ruled that, under the terms of the VAT Directive, VWFS was entitled to apportion its overhead input VAT between the supply of the vehicle and the interest received. HMRC's argument that it should be, wholly allocated to the exempt supply of finance, because no profit was made on the sale of the vehicle must therefore be wrong. The fact that the business recovered its overhead costs wholly in the exempt supply of finance was irrelevant. On the basis that there were two distinct supplies and one of those supplies was taxable, the CJEU confirmed that the input tax on overheads related to the business as a whole (including the sale of the vehicles). The part attributable to the sale of the vehicles being recoverable.

The VAT Directive requires apportionment to be based on turnover values or a tax authority can allow other methods of apportionment but only if the other method provides a more accurate apportionment than one based on turnover.

Comment – VWFS had claimed that it should be entitled to recovery 50% of its overhead VAT on the basis that for each supply of a vehicle, there were two transactions. Whether or not the Supreme Court accepts that such a method is more accurate is open to debate. What is not open to debate, however, is the question of entitlement to an apportionment. This case represents another challenge to HMRC's approach to determining when expenses can be regarded as a cost component of a taxable supply.

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