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Conflict of definition with no collection of VAT does not preclude input tax deduction

The ECJ has held that a conflict of definition leading to cross-border car leasing being taxable in neither country does not preclude the right to deduct input tax.

A Scottish bank arranged for its UK customers to lease their cars from its German subsidiary. This subsidiary had a UK VAT registration but no UK establishment, its leasing and other business being managed from Germany. At the time, car leasing was seen under UK law as a service taxable in the country of establishment, whereas German law saw it as a delivery of goods taxable in the country of supply. Thus, neither country saw itself as entitled to collect the VAT on the lease payments. This led the UK authorities to disallow the input tax deduction on the grounds that the cars had been purchased for the purpose of performing tax-exempt turnover. The lessor subsidiary challenged this conclusion before the courts.

The ECJ has now held that the output transactions were not, as such, exempt. Thus output exemption was not a ground for refusing an input tax deduction. Input tax was deductible wherever the outputs were taxable or would have been taxable, had the service been performed in the same country. Had UK law deemed the leasing to be taxable in the UK, the input tax would have been deductible without question. Under the laws of both countries, the output transactions were taxable. The conflict was not "whether", but "where". Failure to resolve it did not render the outputs exempt. They were merely not, in fact, taxed.

The ECJ went on to examine the question of abuse. Had the transactions been wholly artificial for the sole purpose of obtaining a tax advantage, they would have been abusive and the tax authorities would have been right to refuse an input tax deduction. However, the leasing subsidiary had been carrying on a genuine business with unrelated lessees. A taxpayer had the right to arrange his affairs with a view to limiting his tax burdens. In the present case the arrangements did not go beyond the legitimate.

It should be noted that this case is no longer directly applicable as it stands to current transactions, following a January 1, 2010 change in the VAT Directive rendering services to a business customer taxable in his country. (AM)

The ECJ case reference is C-277/09 RBS Deutschland judgment of December 22, 2010.

Keywords

car leasing, collection of VAT, conflict of definition, cross-border leasing, input tax deduction, place of taxation