



Lund University

School of Economics and Management
Department of Business Law

VAT treatment of financial leases in EU law

by

Igor Kochkodan

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Supervisor: Oskar Henkow

Examiner: Cécile Brokelind

Author's contact information:

i.kochkodan@gmail.com

+46 0725348489

Table of Contents

- Summary I
- Abbreviation list..... II
- 1. Introduction 1
 - 1.1. Background 1
 - 1.2. Subject and purpose..... 2
 - 1.3. Methods and materials 3
 - 1.4. Delimitation 3
 - 1.5. Outline 4
- 2. Key concepts and evolution of the VAT treatment of leases in case law of the CJEU 4
 - 2.1. Notion of lease..... 4
 - 2.2. Concept of “supply of goods” in CJEU case law 6
 - 2.3. Phenomenon of “double supply” (case of Centralan Property) 8
 - 2.4. Development of the views on the VAT nature of leasing in case law of the CJEU..... 10
- 3. VAT treatment of financial leases in current case law of the CJEU 12
 - 3.1. Criteria set out in case of Eon Asset Management: a step towards economic reality?..... 12
 - 3.2. Interpretation of Article 14(2)(b) of the VAT Directive in case law of the CJEU 15
 - 3.3. A right to deduct input VAT in respect of financial lease transactions 18
 - 3.4. Application of “Eon Asset test” in recent case law of the CJEU..... 19
 - 3.4.1. BCR Leasing 20
 - 3.4.2. BGZ Leasing 21
- 4. VAT treatment of financial leases and principle of fiscal neutrality 21
 - 4.1. Concept of ‘fiscal neutrality’ in CJEU case law..... 21
 - 4.2. Fiscal neutrality of criteria introduced in Eon Asset and possible impact of new accounting rules for leases..... 24
 - 4.3. VAT treatment of similar transactions in case law of the CJEU 28
 - 4.3.1. Transactions that must be treated as a lease for VAT purposes: granting of rights in rem..... 28
 - 4.3.2. Transactions similar to financial lease 30
- 5. Conclusions..... 31
- Bibliography..... III

Summary

Treatment of financial leases has always been a major problem of European VAT. Lack of clear rules in the VAT Directive combined with different approaches employed by the national laws of Member States resulted in a high degree of legal uncertainty and provided remarkable opportunities for abusive arrangements. Although significant part of this work is focused on current VAT treatment of financial leases in the case law of the CJEU, its purpose is a little bit broader. The main goal of the thesis is to reflect on the line of reasoning followed by the Court, to assess its advantages and shortcomings and to make some assumptions regarding its further development. In order to achieve this objective, the author addresses key underlying concepts, such as “supply of goods”, distinction between financial and operational leases; pays some attention to the VAT treatment of transactions similar to financial leases and notion of “similarity” in case law of the CJEU; shows the evolution of approach currently used by the Court in respect of financial leases. Possible impact of anticipated adoption of new IFRS for leases on the case law of the CJEU is also considered briefly in the paper.

Abbreviation list

2 nd Exposure Draft	Joint IASB and FASB Exposure Draft ED/2013/6 (May 2013)
AG	Advocate General
BV	<i>Besloten vennootschap met beperkte aansprakelijkheid</i> , Dutch limited liability company
CJEU; the Court	Court of Justice of the European Union
Eon Asset	Eon Aset Menidjmont
EU	European Union
FASB	Financial Accounting Standards Board
First Directive	Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
International Accounting Rules	IAS+IFRS
Second Directive	Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes - Structure and procedures for application of the common system of value added tax
Sixth Directive	Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value-added tax: uniform basis of assessment
VAT	Value Added Tax
VAT Directive	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax
VAT Directives	First, Second, Sixth and VAT Directive
UCITS Directive	Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities
UK	United Kingdom of Great Britain and Northern Ireland

1. Introduction

1.1. Background

Although foundations of European VAT have been laid down almost half a century ago¹, today it still may be considered as an evolving system. While some of its provisions have been profoundly elaborated in CJEU case law and academic literature, that allowed a straightforward and consistent application of these rules, there is also a limited number of ‘grey areas’ where lack of explicit regulations have been offset by some kind of silent consensus, based not solely on positivistic reasoning. These ‘grey areas’ often are also ‘areas of growth’ where new concepts, that later become generally applicable, are developed and tested.

VAT treatment of leases in EU law used to be one of these ‘grey areas’. This was not due to lack of academic interest. On the contrary, complex legal nature of lease, that comprises different elements of hire, sale and acquisition of financial services in a proportion specific for each particular contract, has become a subject of numerous researches². At the same time, in the VAT Directive (as well as in the Sixth Directive) the term “lease” appears only twice, in both cases in relation to the exemption of immovable property leases from VAT (Articles 135 and 137). No explicit guidance may be found in the VAT Directive regarding the VAT treatment of leases that does not fall within the scope of this exemption.

Case law of the CJEU as it stands now is also far from providing a comprehensive set of rules regarding the VAT treatment of leasing transactions. In the number of cases (*ARO Lease*³, *Lease Plan Luxembourg*⁴ and others) the Court treated leases of motor vehicles as supplies of services. However, since classification of leasing contracts was not the main issue in the aforementioned cases, no general statements had been delivered by the CJEU in this respect. As a result, some Member States treated leases differently for VAT purposes. For example, in Germany, whose legal system has been heavily influenced by the concept of ‘substance over form’, some leases have been considered as supplies of goods⁵. As it has been seen from the case of *RBS Deutschland*⁶, different rules on the VAT treatment of leasing transactions enshrined in the legislation of certain Member States open a broad field for tax-planning arrangements resulting in total non-payment of VAT. Although the CJEU took the view that tax authorities of the Member State cannot refuse a right to deduct input VAT paid in another Member State on the sole ground that output VAT had not been collected because of the manner in which a commercial transaction had been categorized under

¹ More precisely, on April 11, 1967, when First and Second Directives have been adopted.

² Brook, J., *Sales and Leases*, Wolter Kluwer Law & Business, New York, 2012; Clark, T., *Leasing*, McGraw-Hill, London, 1978; Duke, J. C.; Hsieh, S. J.; & Su, Y. Operating and synthetic leases: Exploiting financial benefits in the post-Enron era. *Advances in Accounting*, 2009, Vol. 25, No. 1, pp. 28-39; Martino, G. de., Considerations on the subject of lease accounting, *Advances in Accounting*, 2011, Vol. 27, pp. 355–365; Mehta, A., Tax Aspects of Cross-Border Leasing Transactions, *European Taxation*, December 2006, pp. 570-576; Mitua I., Tduora A.T., Pali-Pista S.F., Accounting for Leases: Differences between Romanian Regulations and IAS 17, *Procedia Economics and Finance*, 2014, Vol. 15, p. 1310-1315, and authors cited thereby.

³ Case C-190/95 *ARO Lease BV v Inspecteur van de Belastingdienst Grote Ondernemingen te Amsterdam*, 17 July 1997, ECLI:EU:C:1997:374

⁴ Case C-390/96 *Lease Plan Luxembourg v Belgische Staat*, 7 May 1998, ECLI:EU:C:1998:206

⁵ Lambion M., The influence of international accounting standards in the field of VAT: a recent ECJ judgment and its impact on VAT practice, *World Journal of VAT/GST Law*, 2012, Vol. 1, No. 2, p. 159.

⁶ Case C-277/09 *The Commissioners for Her Majesty's Revenue & Customs v RBS Deutschland Holdings*, 22 December 2010, ECLI:EU:C:2010:810

legislation of the former⁷, such outcome was clearly undesirable from the prospective of fiscal neutrality and coherence of European VAT system.

Taking into account the fact that the concepts of EU law should be given an autonomous meaning, as it has been reiterated by the CJEU in respect of, for example, insurance transactions (cases of *CPP*⁸, *Taksatorringen*⁹ and case law cited), the Court had been expected to suggest its own interpretation of the concept and legal nature of leasing, what it finally did in the case of *Eon Asset*¹⁰. The fact that the CJEU extended its considerations far beyond what had been actually required to respond to the questions referred confirms that it just took an opportunity to bring more coherence to the area where it was extremely required.

Although *Eon Asset* has become the first case where the CJEU described its view on the VAT treatment of leases in relatively consistent manner, it gave rise to a number of new questions. Recently decided cases of *BGZ Leasing*¹¹ and *BCR Leasing*¹² did not bring more clarity in this respect. Finally, new accounting rules for leases, jointly developed by IASB and FASB, introduced number of interesting concepts that may, in principle, have significant impact on the future case law of the CJEU.

1.2. Subject and purpose

The purpose of this paper is to outline current model of the VAT treatment of leasing transactions, to assess it from the viewpoint of fiscal neutrality and to capture the main trends in its further development with regard to the most recent case law of the CJEU and anticipated adoption of new IFRS for leases.

To achieve this goal, it is necessary to describe briefly economic nature of leasing, in order to understand the source of difficulties related to its VAT treatment. Then a short overview of previous CJEU case law relevant to the topic of this research is performed. The rulings delivered by the Court in *Eon Asset* case are addressed separately due to their heavy potential influence on the classification of leasing transactions as supplies of goods or services as well as deduction of input VAT. Next, it is important to assess their real impact in the light of cases recently decided by the CJEU. Finally, current VAT treatment of leases in CJEU case law is to be examined from the viewpoint of fiscal neutrality. In order to do so, concept of “similar transactions” has to be defined, and the main features of VAT treatment of transactions similar to leases must be considered. The question to what extent some conceptual changes introduced by IASB proposals may affect current situation, in particular, elimination of distinction between financial and operational leases, is also important in this context.

⁷ C-277/09 *RBS Deutschland*, para 42.

⁸ Case C-349/96 *Card Protection Plan v Commissioners of Customs & Excise*, 25 February 1999, ECLI:EU:C:1999:93, paras. 15-17.

⁹ Case C-8/01 *Taksatorringen (Assurandør-Societetet et v Skatteministeriet)*, 20 November 2003, ECLI:EU:C:2003:621, para 37.

¹⁰ Case C-118/11 *Eon Aset Menidjunt OOD v Direktor na Direktsia "Obzhalvane I upravlenie na izpalnenieto"*, 16 February 2012, ECLI:EU:C:2012:97.

¹¹ Case C-224/11 *BGŻ Leasing sp. z o.o. v Dyrektor Izby Skarbowej w Warszawie*, 17 January 2013, ECLI:EU:C:2013:15

¹² Case C-438/13 *BCR Leasing IFN SA v Agenția Națională de Administrare Fiscală*, 17 July 2014, ECLI:EU:C:2014:2093

1.3. Methods and materials

Present research is mostly based on the legal dogmatic method, reflecting the law how it stands now. Provisions of the VAT Directive and CJEU case law have been interpreted, where necessary, with regard to the context in which they appear and their objectives. However, the aim of this paper is to explain rather than to describe. It presents an attempt to reflect on the line of reasoning followed by the CJEU and disclose the reasons that have determined its choice in favor of current model. We share the view of Prof. Douma and cited authors that the purpose of legal science is looking for a “better” law, the law as it ought to be¹³. It would be completely impossible to reach this goal without considering certain underlying issues, such as economic substance of lease and similar transactions, differences between financial and operational lease, certain doctrinal concepts and new solutions developed by IASB etc.

Since provisions of the VAT Directive provide for a very limited field of analysis in the course of present research, case law of the CJEU has become the primary point of reference. A number of academic papers on the topic is also insignificant. Relevant sources are represented mostly by separate paragraphs in the papers concerning overall tax treatment of leases in national context¹⁴ and a few articles dealing with the outcomes of *Eon Asset* case¹⁵. Important source for present analysis has been provided by International Accounting Rules and proposals for lease accounting developed jointly by IASB and FASB and incorporated into 2nd Exposure Draft (delivered in May 2013). These rules, although not legally binding in the field of VAT, properly reflect economic reality and introduce new interesting approach to classification of leasing contracts.

1.4. Delimitation

This research does not cover all problematic issues related to leases of immovable property. Leases of immovable property are addressed in so far as the concepts, developed by the CJEU in respect of these transactions, are generally applicable, i.e. may apply to other types of leases. For example, some cases concerning exemption of “leases or letting of immovable property” from VAT have been recalled in order to define the scope of a term ‘lease’ in the VAT Directive. As it may be concluded from the case *Wojskowa Agencja*, concepts developed by the CJEU with regard to leases of movable property are applicable *mutatis mutandis* to contracts concerning immovable property¹⁶. In the author’s view, there is nothing to preclude this reasoning from working in another way as well.

Due to limited space, this paper cannot cover all the aspects of the VAT treatment of leases. The VAT treatment of transactions closely linked to leasing, such as provision of insurance coverage for the leased asset, remains outside the scope of current research. Leasing arrangements that present

¹³ Douma S., *Legal research in International and EU Tax Law*, Wolters Kluwer, 2014, p. 17.

¹⁴ Flora, P.; Messi, M., *Tax Treatment of Leasing Agreements: Italy*, *Derivatives & Financial Instruments*, September/October 2007, pp. 159-167; Hartmann J., *Tax Treatment of Leasing Agreements in Germany*, *Derivatives & Financial Instruments*, November/December 2007, pp. 210-217.

¹⁵ Lambion M., *The influence of international accounting standards in the field of VAT*; Menon, P.; Narasimhan, P. *The curious ECJ case of Eon Asset Management and its impact on finance leasing in the United Kingdom*, [Electronic resource]: <http://www.whitecase.com/files/Publication/a1377e41-4bde-4c86-b34b-9c58216e4cf1/Presentation/PublicationAttachment/f004f48d-666e-40dd-80cb-a45bb775a019/article-ECJ-Eon-Asset-Management.pdf> [Accessed 13 May 2015]

¹⁶ Case C-42/14 *Minister Finansów v Wojskowa Agencja Mieszkaniowa w Warszawie*, 16 April 2015, ECLI:EU:C:2015:229, paras. 21-27.

some features of abusive practices, such as sale-leaseback or lease-sublease transactions, are also not dealt with in details.

1.5. Outline

In line with its purpose and research questions as described above, this paper consists of Introduction, three main chapters and Conclusions. Following introductory remarks, Chapter 2 defines fundamental concepts that are crucial for understanding current VAT treatment of leasing transactions and problems related thereto. Chapter 3 provides an overview of CJEU case law where it stands now. It analyses advantages and shortcomings of position that the CJEU took in *Eon Asset* and tracks the application of *Eon Asset* criteria in recently decided cases. It also draws special attention to interpretation of Article 14(2)(b) of the VAT Directive, which is extremely important in respect of the right to deduct input VAT, and considers other issues related to the deduction of input VAT in case of financial leasing arrangements. Chapter 4 presents an analysis of approaches described in Chapter 3 from the fiscal neutrality prospective and makes some assumptions with regard to further development of CJEU case law.

2. Key concepts and evolution of the VAT treatment of leases in case law of the CJEU

2.1. Notion of lease

A lease is probably one of the most discussed concepts in private law. Although its economic definition is pretty clear, the question remains, to what extent it may be used for legal purposes. As a result, from the tax law prospective leasing arrangements provide attractive possibilities for tax planning combined, however, with dangerous lack of clear rules. This was especially true regarding the system of European VAT after its creation in 1967. On the one hand, the concept of autonomous interpretation had been recognized soon as its important basis. On the other, there was no definition of lease in European law. Consequently, application of VAT Directives to leases (excluding leases of immovable property) had been left to the Member States. Probably, in 1967 it was a reasonable temporal solution declining the number of problematic issues that could have been expected if a single model had been adopted at the Community level. However, this system was inconsistent with the mere idea of uniformity and, as it usually happens, a lack of uniformity has created room for abuse.

This has been clearly demonstrated by the Court's decision in case of *RBS Deutschland*. In this case the CJEU considered leasing arrangements structured in such a way that, using differences in the VAT treatment of financial leases between Germany and UK, they resulted in total non-payment of VAT. Contrary to what had been expected, the CJEU refused to declare such kind of 'jurisdiction shopping' incompatible with the purposes of the VAT Directive¹⁷. This decision did not leave to CJEU another options than to come up with its own view on VAT nature of different types of leases in the nearest future.

Economic definition of lease can be found, inter alia, in the International Accounting Rules developed by IASB. Although their relevance to the purposes of current research will be discussed

¹⁷ C-277/09 *RBS Deutschland*, paras. 41-42.

later in details, these standards constitute a good point of reference when it is necessary to understand economic nature of lease. According to IAS 17 Leases, a lease is “an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time”¹⁸. Although IAS 17 is currently subject to fundamental re-deliberation and will be replaced soon by the newer standard, this definition, most probably, will not be changed. According to 2nd Exposure Draft, issued jointly by IASB and FASB in May 2013, a lease is defined as “a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration”¹⁹. This definition was finally approved at the last joint discussion meeting in April 2015²⁰.

However, and this is new comparing to IAS 17, 2nd Exposure Draft contains additional conditions required to classify a legal arrangement as a lease: 1) fulfillment of the contract must be linked to the use of an identified asset; 2) the contract must convey the right to control the use of an identified asset. The first condition is not fulfilled if the lessor has a substantive right to substitute an asset during the term of the contract. The right is not considered substantive when the consent of the customer is required, or there are certain economic barriers able to prevent a supplier from exercising this right. The right to control the use includes the right of the customer to direct the use (i.e. to decide when and how the asset should be used, safe for the limitations imposed by the contract) and derive economic benefits from the use. The right to derive economic benefits does not exist where, in order to benefit from the use of the asset, the customer has to acquire additional goods or services provided only in conjunction with the asset or if the asset is incidental to the delivery of services (in this case, a supply is considered a supply of services)²¹.

Definitions provided by IAS 17 and 2nd Exposure Draft are coherent with those that may be found in academic literature on the topic. It is, therefore, commonly admitted that, in the broadest terms, a lease is a granting of the right to use certain property in return for periodic payments²². The only reason why this definition cannot be adopted as a final one is because it does not take into account the difference between lease and simple rental contract. Indeed, short-term leases look similar to simple rentals and it is not easy to explain the difference between them in objective terms. However, it is important to note that the lease has a specific purpose to finance the user of the property²³. This is quite obvious when the economic ownership is effectively transferred to the lessee and a lease represents, in fact, a sale and a loan. But even if the lessor retains not only legal title, but also risks and rewards incidental to it, leasing payments include an interest element, although it is not always easy to capture it in real life.

With regard to the foregoing, it is possible to define a lease as a contract that conveys the right to use an asset, involving supply of finance (financial element), in exchange for consideration. CJEU

¹⁸ IAS 17. Leases. Regulation (EC) No 1126/2008 of 3 November 2008.

¹⁹ Leases. Joint IASB and FASB Exposure Draft ED/2013/6 (May 2013) [Electronic resource]: <http://www.ifrs.org/current-projects/iasb-projects/leases/exposure-draft-may-2013/documents/ed-leases-standard-may-2013.pdf>

²⁰ Leases. Joint Project of the FASB and the IASB. Summary of tentative decisions as of April 7, 2015 [Electronic resource]: http://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdatePage&cid=900000011123

²¹ Joint IASB and FASB Exposure Draft ED/2013/6.

²² Mundstock, G. The tax import of the FASB/IASB proposal on lease accounting, *Virginia Tax Review*, Vol. 32:46, pp. 461-462; Martino, G. de., Considerations on the subject of lease accounting, *Advances in Accounting*, 2011, Vol. 27, p. 356.

²³ Martino G. de., Considerations on the subject of lease accounting, p. 357.

case law added to this definition one more essential feature: a leasing contract transfers not only a right to use underlying asset, but also a right to prevent other persons from using it²⁴.

2.2. Concept of “supply of goods” in CJEU case law

According to Article 14(1) of the VAT Directive, “supply of goods” means the transfer of the right to dispose of tangible property as owner. Notion of “supply of goods” is closely linked to the concept of “ownership”²⁵. Under the general rule, there is no supply of goods without transfer of ownership. Transfer of certain rights belonging to the owner (e.g., a right of use) or certain interests in immovable property does not constitute supply of goods unless Member State exercised the option provided for by Article 15(2) of the VAT Directive.

The problem is that different Member States have different concepts of ownership. Under civil law model the concept of ownership has been developed from Roman *dominium*. It is understood as a special relation between a person and a thing (*rem*), based on absolute powers²⁶. These powers are in essence legal guarantees that allow physical control, economic exploitation of the property (including a right to use and a right to derive economic benefits) and a right to control legal title. Under UK common law the meaning of ownership is less formalized, which may be considered a historical heritage of English feudal system²⁷. Separate position belongs to Germany whose legal tradition has been significantly influenced by “substance over form” concept²⁸. Finally, besides of different legal definitions, national rules related to the transfer of property are not the same. In France, Italy and Belgium ownership is transferred by contract, while in Netherlands it is assigned by formal act of delivery²⁹.

In these circumstances, construction of separate concept of “ownership” based on the methodology and principles of European law and independent from domestic law of Member States has become the only efficient way to guarantee a uniform application of the VAT Directive. Such autonomous interpretation has been performed by the CJEU in *SAFE* case. Shipping and Forwarding Enterprise Safe BV (hereinafter - SAFE), a Dutch company, transferred to another Dutch entity, referred to as “Kats”, an unconditional right to the immovable property, free of mortgages or other rights in rem. Any risks (i.e., changes in the value of the property) and all profits were to be borne by Kats. SAFE undertook an obligation to transfer the legal title to the immovable property when required by Kats, but no later than 31 December 1982. Since Kats went into bankruptcy within a short time after concluding this agreement, SAFE transferred the legal title to the third party which acquired unconditional right to the property in the course of the liquidation procedure. Tax authorities qualified the transfer of the legal title as a transfer of ownership and, consequently, taxable supply

²⁴ Case C-358/97 *Commission of the European Communities v Ireland*, 12 September 2000, ECLI:EU:C:2000:425, paras. 52-57; Case C-326/99 *Stichting "Goed Wonen" v Staatssecretaris van Financiën*, 4 October 2001, ECLI:EU:C:2001:506, para 55; Case C-108/99 *Commissioners of Customs & Excise v Cantor Fitzgerald International*, 9 October 2001, ECLI:EU:C:2001:526, para 21.

²⁵ Case C-223/03 *University of Huddersfield Higher Education Corporation v Commissioners of Customs & Excise*, 21 February 2006, ECLI:EU:C:2006:124, para 42.

²⁶ Martino, G. de., Considerations on the subject of lease accounting, p. 356.

²⁷ *Ibid.*

²⁸ Lambion, M., The influence of international accounting standards in the field of VAT, p. 159.

²⁹ Terra, B.; Kajus, J., VAT Directive-recast, IBFD, pp. 381-382; Lambion, M., The influence of international accounting standards in the field of VAT, p. 160.

of goods³⁰. The CJEU pointed out that the notion of supply of goods “does not refer to the transfer of ownership in accordance with the procedures prescribed by the applicable national law but covers any transfer of tangible property by one party which empowers the other party actually to dispose of it as if he were the owner of the property”³¹. This reasoning has been cited by the CJEU in many more recent cases, including *Auto Lease Holland*³², *Centralan Property*³³ and *Eon Asset*³⁴.

SAFE, as well as the Court’s subsequent case law, demonstrated that the transfer of ownership in the view of the CJEU is not the same as transfer of legal title. However, the question remained whether a transfer of legal title may be completely ignored. Some scholars tend to respond to this question negatively, arguing that at this stage the VAT concept of property should not be confused with that of the transfer of economic property, or of ‘substance over form’³⁵. It is justified, first, by the fact that two countries applying the concept of economic property may still use it differently, so the goal of uniform interpretation will not be achieved and, second, that the CJEU began its judgment with a very legal approach, clearly indicating that its interpretation has been based on the text of the Sixth Directive³⁶.

In this respect it is interesting to consider the second question referred to the CJEU in *SAFE* case. Thereby the national court asked whether Dutch doctrine of ‘economic ownership’ could be applicable in order to determine which transactions constitute a supply of goods within the meaning of Article 5 of the Sixth Directive. The CJEU refused to give a clear answer due to formal reasons. It stated, however, that “an agreement to transfer ownership under civil law [...] does not necessarily seem to entail the transfer of actual power as indicated by Article 5(1) of the Sixth Directive” and “the actual placing of the property at the disposal of the other party [...] would normally point towards a finding that actual power has been transferred”³⁷. These statements, if interpreted literally, lead to the conclusion that it is not only possible for supply of goods to be made without transfer of legal ownership, but transfer of legal title does not always entails transfer of ownership. It seems that the Court could not manifest its loyalty to the economic approach more clearly.

Under both economic and legal approaches, the ownership is characterized as a bundle of rights/powers. If it is not possible to use criteria linked to the legal title in order to draw a line between an owner and a user, how many of these rights must be transferred in order to say that the acquirer can “dispose of a property as owner”? Does the transfer of all 100% of powers incidental to ownership is absolutely required to classify transaction as supply of goods?

This point of view had been supported by the Commission in *Centralan Property* case. It maintained that the grant of a 999-year lease is not a transfer of ownership since a freehold reversion³⁸ remained³⁹. In the present case freehold reversion was practically worthless because of,

³⁰ Case C-320/88 *Staatssecretaris van Financiën v Shipping and Forwarding Enterprise Safe BV*, 8 February 1990, ECLI:EU:C:1990:61, paras. 2-3.

³¹ C-320/88 *SAFE*, para 7.

³² Case C-185/01 *Auto Lease Holland BV v Bundesamt für Finanzen*, 6 February 2003, ECLI:EU:C:2003:73, para 32.

³³ Case C-63/04 *Centralan Property Ltd v Commissioners of Customs & Excise*, 15 December 2005, ECLI:EU:C:2005:773, para 62.

³⁴ C-118/11 *Eon Asset*, para 39

³⁵ Lambion, M., The influence of international accounting standards in the field of VAT, p. 160.

³⁶ *Ibid.*

³⁷ C-320/88 *SAFE*, para 12.

³⁸ Freehold reversion under UK law is a right to occupy a property at the end of a lease and receive rental payments.

first, the term of the lease, and second, nominal amount of rental payments due pursuant to the leasing contract. Thus, it was a legal title rather than economic asset. The CJEU dismissed this submission pointing out that, while it is for the national court to determine in each individual case whether a given transaction results in the transfer of the right to dispose of the property as owner, each of these transactions (granting of a 999-year lease followed by transfer of freehold reversion) may, in principle, be regarded as a transfer of ownership⁴⁰. This judgment, although quite controversial (this is the reason why it will be discussed later in details), demonstrated that “to dispose of tangible property as owner” does not necessarily mean to have all the rights of the owner. According to the CJEU in *Centralan Property*, a person who physically controls the property, uses it and derives economic benefits from this use may at least be the co-owner of the property even when these rights are, in principle, limited in time and another person holds the legal title.

Following the Court’s reasoning in *SAFE* and *Centralan*, situations where transfer of legal title takes place without transfer of economic powers incidental to ownership must not be treated as supply of goods. Sale-leaseback arrangements might be a good example here. Sale with subsequent leaseback allows deduction of input VAT where initial owner does not have the full right to deduct and, therefore, defers VAT liability through the useful life of underlying asset. Initial owner continues to use the asset; a lessor is usually a lessee’s subsidiary and he never acquires powers to dispose of leased property as owner. The only power he has is to grant a leaseback; other rights constitute only a legal title deprived of economic substance. Under such circumstances, treatment of sale-leaseback arrangements as supply of goods followed by supply of services seems to be inconsistent with recently recalled case law. It is rather a single transaction, “granting of credit” within the meaning of Article 135(1)(b) of the VAT Directive⁴¹.

2.3. Phenomenon of “double supply” (case of *Centralan Property*)

The underlying issue in the case of *Centralan Property* was the VAT treatment of immovable property lease, therefore, it did not produce immediate changes in the treatment of equipment leases, most often examined by the CJEU. Nevertheless, it became a new significant step towards the concept of economic ownership that has been adopted as a general rule in *Eon Asset*.

As it has been shown in the previous section, concept of ownership comprises certain rights (or powers, from the economic viewpoint). These rights/powers may, in principle, be transferred gradually, one after another. If this is the case, the question is, which transaction constitutes a transfer of ownership (supply of goods): the last one or the one that transfers the biggest portion of rights (and, normally, the largest share of value)? In *Centralan Property* the Court finally delivered some important considerations in this respect.

It would be somehow expected if the CJEU classified as a supply of goods granting of lease and not a transfer of freehold reversion. This outcome would be totally consistent with the reasoning delivered in *SAFE*, since the latter transaction represented only transfer of legal title, deprived of real economic powers incidental to ownership. What was surprising is that the CJEU has admitted

³⁹ C-63/04 *Centralan Property*, para 44.

⁴⁰ *Ibid*, para 62-63.

⁴¹ Terra, B.; Kajus, J., *VAT Directive - Recast*, p. 391.

that ownership, i.e. a right to dispose of a property as an owner, may be transferred in installments, so two persons can be co-owners even if they hold different rights in respect of the same asset.

As the Commission reasonably pointed out, “it is difficult to accept that each of two different persons, having different rights over a property, has the right to dispose of it as owner”⁴². Replying to this argument, the CJEU referred to “various manifestations of the concept of co-ownership in the Member States’ legal systems” indicating that it is possible that more than one person to have the right to dispose of property as owner⁴³. However, a concept created by the CJEU in this case is something very different from classical co-ownership, where several persons hold shares in the same right(s). Following the reasoning of the Court, there is nothing to preclude, for example, granting of *rights in rem* to be regarded as creation of such co-ownership and not supply of services as it was stated few years before in *Goed Wonen*⁴⁴.

In the author’s view, the lessee should have been recognized as an economic owner of the building. Indeed, it was difficult to say that the University (holder of freehold reversion) borne any risks and rewards incidental to ownership when it would have had the right to repossess it only after the end of the 999-years term. What residual value would the building have at that time? Pursuant to the lease contract rental payments were purely nominal. No other rewards had been expected. It was doubtless that the lessee, upon payment of a lump sum almost equal to the market value of the building, received an unconditional right to use it and derive economic benefits through the whole duration of its useful life.

It is difficult to name exact reasons why the CJEU reasoning in *Centralan Property* could not be, in principle, applied to most leases. Without any doubts, such application would entail many questions. First, it would be necessary to determine the scope of the rule. It would be obviously unreasonable to apply it to the short-term leases without strong evidence that the purchase option will be exercised. Then, the question of apportionment arises. In order to prevent abuses, the price of transaction would have to correspond to real significance of transferred rights. At the same time, approach used in *Centralan Property*, better than that developed in *Eon Asset*, corresponds to the position of IASB and FASB, reflected in their proposals on lease accounting. Double accounting for VAT, as suggested by the concept of co-ownership, is very much in line with splitting up single asset into the right of use and residual assets, followed by their transfer to the lessee at the commencement of the lease and after its termination respectively (if purchase option is exercised), as suggested by 2nd Exposure Draft.

Since to date *Centralan Property* is the only leasing-related case where the concept of co-ownership has been employed by the CJEU, aforementioned reasoning is to large extent hypothetical. However, taking into account present uncertainty regarding further application of *Eon Asset* standard and the fact that the CJEU once followed an approach presented by IAS 17, which is now about to be changed, it is not possible to exclude completely new turn in CJEU case law.

⁴² C-63/04 *Centralan Property*, para 65.

⁴³ *Ibid.*, para. 66.

⁴⁴ C-326/99 *Goed Wonen*, para. 56.

2.4. Development of the views on the VAT nature of leasing in case law of the CJEU

The concept of the VAT nature of leasing arrangements employed by the CJEU has long-term tax consequences for all the parties involved. Treatment of lease as a supply of goods or supply of services has important outcomes in respect of a place of supply, chargeability of input VAT and a right to deduct. Therefore, it is not surprising that the CJEU, being usually quite reluctant to any kind of analysis that goes beyond the scope of what is necessary to provide a useful answer in each particular case, had nevertheless to express its own view on the classification of leasing arrangements each and every time dealing with them.

The purpose of this section is to describe a history of changes in the VAT treatment of leases before Eon Asset judgment has been delivered. This case has been chosen as a milestone since, although its real significance is still under harsh debate, it is very likely that the results of its application combined with enforcement of the recent IASB proposals on the reform of lease accounting will give rise to a rich case law on the topic, pretty much different from all the previous findings of the CJEU.

Starting from the very first lease-related cases, the CJEU usually made its choice in favour of a “service” concept although it was not always stated directly in the judgment. For example, in *Lubbock Fine* surrender of lease in return of money payment has been considered by the CJEU like supply of services, which obviously would not have been the case if the main supply had been treated differently⁴⁵. In *ARO Lease* the CJEU found that “the leasing of vehicles constitutes a supply of services within the meaning of Article 9 of the Sixth Directive”⁴⁶. Unfortunately, the CJEU did not reveal backgrounds of this explicit statement. Additional explanation was strongly desirable since such conclusion could be derived directly from the text of Article 9 of Sixth Directive only provided that the lease of cars fell by default within the scope of the term “hiring of means of transport”. In its judgment in *Lease Plan Luxembourg*, delivered soon after *ARO Lease*, the CJEU did not oppose to submission of the referring court which classified the lease of the motor vehicles under hire purchase agreement as a supply of services. However, it seems that the CJEU tried to avoid any statements regarding the VAT nature of lease in general and did not cite paragraph 11 of *ARO Lease*, simply referring to the previous case in all aspects related to classification of particular transactions at issue⁴⁷.

The same approach had been employed by the CJEU in cases *Cura Anlagen*⁴⁸, *Auto Lease Holland*⁴⁹, *Cookies World*⁵⁰ and *Part Service*⁵¹. In *Cura Anlagen* the CJEU, basing its reasoning on *ARO Lease*, has ruled that national legislation of a Member State prohibiting the use of motor vehicle leased from an undertaking established in another Member State and registered there in the name of the lessor without registration in the first Member State constitute a restriction on the

⁴⁵ Case C-63/92 *Lubbock Fine & Co. v Commissioners of Customs and Excise*, 15 December 1993, ECLI:EU:C:1993:929, paras. 8-10.

⁴⁶ C-190/95 *ARO Lease*, para 11.

⁴⁷ C-390/96 *Lease Plan Luxembourg*, paras. 22-26.

⁴⁸ Case C-451/99 *Cura Anlagen GmbH v Auto Service Leasing GmbH*, 21 March 2002, ECLI:EU:C:2002:195

⁴⁹ C-185/01 *Auto Lease Holland*, paras. 20, 24.

⁵⁰ Case C-155/01 *Cookies World Vertriebsgesellschaft mbH iL v Finanzlandesdirektion für Tirol*, 11 September 2003, ECLI:EU:C:2003:449, paras. 44-45.

⁵¹ Case C-425/06 *Ministero dell'Economia e delle Finanze v Part Service Srl.*, 21 February 2008, ECLI:EU:C:2008:108, para 61.

freedom to provide services⁵². This case is mostly interesting because of the reasoning of AG Jacobs subsequently recalled by the CJEU in paragraph 18 of the judgment: "... although it [lease] undoubtedly involves goods - the vehicles concerned - those goods are not themselves supplied by the lessor to the lessee; what is supplied is rather the use of the goods, which remain the property of the lessor, and supply of the use of goods is logically a service"⁵³. This argument is probably the best possible illustration to subsequent changes in the case law of the CJEU that came only few years later. Indeed, after decisions in *Centralan Property* and especially *Eon Asset* the argument that the lessor remains the owner of leased asset is insufficient without assessment of all the circumstances of the case.

Subsequently decided cases *Huddersfield*⁵⁴, *Nordania Finance*⁵⁵, *Weald Leasing*⁵⁶ etc. did not contribute significantly to the understanding of legal nature of leasing. Since CJEU judgments in *Huddersfield*, *Weald Leasing* and *RBS Deutschland* had significantly broadened a room for tax-planning arrangements, the importance of uniform treatment of leasing transactions increased dramatically. In fact, it was the case *Goed Wonen* where the CJEU for the first time referred to the concept of leasing as an autonomous concept of European Law. Considering the question whether a grant of usufructuary right and leasing can be subject to the same treatment for VAT purposes, it emphasized that the differences between these two concepts existing in civil law of Member States have no decisive influence on their treatment under the VAT Directive⁵⁷. Furthermore, the CJEU found that requirement of fiscal neutrality must constitute primary point of reference⁵⁸.

As regards the economic substance of lease, it had been reiterated by the CJEU that the core element of leasing arrangements is a granting of the right to use a tangible property without transferring a legal title (at least, at the moment when the goods are physically transferred to the lessor)⁵⁹, or, as it had been held in relation to immovable property, the right to occupy property for an agreed period and for payment as if that person (lessee) were the owner and to exclude any other person from enjoyment of such a right⁶⁰. But it was also clear that leasing arrangements comprise something else and that is the element which distinguishes lease from simple rent or, in case when the ownership is to be subsequently transferred to the lessee, from the sale of goods on deferred terms. In *Part Service* it was called "financing transaction" which, according to the CJEU, must be considered as essential component of a leasing contract⁶¹.

The foregoing analysis helps to see the point where case law of the CJEU stood when a judgment in *Eon Asset* has been delivered. To sum up, the following irregularities precluding uniform treatment of leasing arrangements existed.

⁵² C-451/99 *Cura Anlagen*, paras. 28-29.

⁵³ Opinion of AG Jacobs in case C-451/99 *Cura Anlagen* (delivered on 25 September 2001), para 30; see also: Case C-330/07 *Jobra Vermögensverwaltungs-Gesellschaft mbH v Finanzamt Amstetten Melk Scheibbs*, 4 December 2008, ECLI:EU:C:2008:685.

⁵⁴ Case C-223/03 *University of Huddersfield Higher Education Corporation v Commissioners of Customs & Excise*, 21 February 2006, ECLI:EU:C:2006:124

⁵⁵ Case C-98/07 *Nordania Finans A/S and BG Factoring A/S v Skatteministeriet*, 6 March 2008, ECLI:EU:C:2008:144

⁵⁶ Case C-103/09 *The Commissioners for Her Majesty's Revenue and Customs v Weald Leasing Ltd.*, 22 December 2010, ECLI:EU:C:2010:804

⁵⁷ C-326/99 *Goed Wonen*, para 58.

⁵⁸ *Ibid*, para 56.

⁵⁹ C-451/99 *Cura Anlagen*, para 18; C-425/06 *Part Service*, paras. 25, 27.

⁶⁰ C-326/99 *Goed Wonen*, para 55.

⁶¹ C-425/06 *Part Service*, para 27.

First, although it had been established that the term ‘leasing’ for the purposes of application of VAT Directive should be given an autonomous meaning, it was neither defined in European Law nor extensively developed by the CJEU. Despite the fact it had become an established case law that the granting of a right to use a property under lease contracts had to be treated as a supply of services, there was still lack of certainty in respect of legal arrangements that provided for a transfer of legal title at the end of the lease. Second, a question about the scope of the services comprising a lease had been very little elaborated, especially before the judgment in *Part Service* came. However, this question is extremely important in respect of fiscal neutrality analysis that will be provided below. Third, no attention had been paid to application of Article 14 (2)(b) of the VAT Directive (and Article 5(4)(b) of Sixth Directive) to leasing contracts. Arguably, it could be interpreted as covering financial lease and it seems that this approach would have brought much more consistency to CJEU case law. However, no clear distinction between financial and operational lease had been drawn by the CJEU at that time.

3. VAT treatment of financial leases in current case law of the CJEU

3.1. Criteria set out in case of Eon Asset Management: a step towards economic reality?

Although it is probably too early to assess the final impact made by the case of *Eon Asset* on the VAT treatment of leasing agreements, this case has all the chances to become a milestone in the case law of the CJEU. It is important owing to clear approach to classification of leases presented by the Court in this decision. It was actually the first time when the CJEU explicitly stated that, under certain conditions, a lease may be regarded as a supply of goods for tax purposes. This recognition looks like a step towards uniformity between tax and accounting treatment of financial leases.

It is still unknown for sure whether *Eon Asset* has become just a very specific case without general implications on the case law as a whole or is it a beginning of the new trend, but anyway it should be examined more closely since it deals with number of questions which had been barely raised before, namely: 1) classification of lease agreements as a supply of goods or supply of services; 2) application of Art.14 (2)(b) of the VAT Directive to leasing structures and, finally, 3) application of International Accounting Standards in order to define VAT consequences of transaction.

Circumstances at issue in the main proceeding were quite unremarkable as well as the questions referred to the CJEU. *Eon Asset*, a company established in Bulgaria, concluded two separate leasing contracts in respect of two motor vehicles (financial and operational lease). These vehicles were used to provide a managing director of the company with transport between his home and his workplace. *Eon Asset* claimed a right to deduct in full input VAT due in respect of lease payments made pursuant to both contracts. Tax authorities refused deduction since, in their view, vehicles had not been used for the purposes of *Eon Asset*’s taxable activity. Seven questions have been asked by the referring court, but only two of them present interest in the context of current research, both concerning the right to deduct input VAT: 1) when the requirements of “direct link test” are to be satisfied and 2) how does the primary allocation of goods/services influence the right to deduct?

The CJEU extended its considerations beyond what was actually necessary to provide a useful answer in the present case. It looks like the Court just used a convenient opportunity to deliver its reasoning on the more general topic which is of much bigger interest for us than the outcome of this particular case, that is, VAT nature of financial lease. This is the reason why extensive “preliminary considerations” delivered by the CJEU constitute for us primary point of interest.

Following the line established in the previous case law, the CJEU reiterated that, since a leasing of a motor vehicle does not constitute a supply of goods, it must, according to the general rule, be categorized as a supply of services⁶². However, it has been admitted that “the lease of a motor vehicle under a financial leasing contract may, nonetheless, present features which are comparable to those of the acquisition of capital goods”⁶³. Thus, the CJEU constructed an exception from the general rule that must be interpreted strictly. It is therefore necessary to determine the scope of this exception, i.e. to define conditions under which lease should be classified as supply of goods. A notion of “financial lease” is especially important in this context.

Basing its reasoning on International Accounting Standards (IAS 17, adopted by Commission Regulation (EC) No 1126/2008 of 3 November 2008), the Court concluded that the principal characteristic of financial lease is that substantially all the risks and rewards of legal ownership are transferred to the lessee. A reference to IAS has become in itself major point of discussion after delivery of *Eon Asset* judgment. International Accounting Rules on the one hand and VAT Directive with related Regulations on the other have always been regarded as completely autonomous sets of rules with different scopes, so a question about their interaction did not even occur before⁶⁴. That was the reason why the judgment in *Eon Asset* gave rise to a far-going concern related to possible outcomes of the application of International Accounting Rules in European VAT law.

As it has been pointed out by M. Lambion, application of International Accounting Rules in VAT-related case has been discussed only once before *Eon Asset*⁶⁵. It was *Wollny* case, where the CJEU was asked to clarify the concept of “full costs” (Article 11(A)(1)(c) of Sixth Directive) in respect of construction costs of building used partially for private and partially for business purposes. The Commission held that apportionment of construction costs could, in principle, be effected on the basis of “objective accounting criteria, generally recognized and specific to VAT”⁶⁶. AG Leger rejected this argument on the ground that application of IAS would not have guaranteed uniform treatment since IAS authorized different methods of depreciation to be used at that time⁶⁷. The CJEU did not incorporate these considerations in the final text of judgment.

Despite the fact that reference to IAS was somehow unexpected, it seems that the view of the Court on the interaction between different sources of European Law is far from a formalistic one. For instance, it felt free to refer to International Accounting Rules in a number of other cases, non-related to VAT, or to interpret provisions of VAT Directive with regard to UCITS Directive 85/611,

⁶² C-118/11 *Eon Asset*, para 33.

⁶³ *Ibid.*, para 34.

⁶⁴ Lambion, M. The influence of international accounting standards in the field of VAT, p. 158.

⁶⁵ *Ibid.*, p. 164.

⁶⁶ Opinion of AG Leger in case C-72/05 *Wollny*, para 55.

⁶⁷ *Ibid.*, para 104.

adopted in 1985 and modified in 2002⁶⁸. The reality is that the CJEU enjoys considerable discretion in interpretation of VAT Directive and would have been able, in principle, to employ any other theoretical concept instead of this enshrined in IAS, if it were more relevant, in its view, to the purposes of teleological interpretation. Therefore, application of any concept from IAS does not entail automatic application of the whole set of rules.

Provisions of International Accounting Rules in the field of VAT must be binding only in so far as they are incorporated in CJEU case law, otherwise functioning of the harmonized system of VAT may face significant difficulties. Present judgment itself is a good example to assess potential threats. The CJEU has employed a definition of financial lease provided for by IAS 17 but later on took a step away defining criteria for assessment whether certain legal arrangement constitutes financial lease⁶⁹. Most probably, referring to IAS 17, the CJEU did not have an objective to establish new trend based on the re-assessment of the role of these rules in the harmonized system of VAT. It was rather an outcome of two already existing trends: 1) movement towards more economic concept of ownership and 2) increasing importance of economic reality. As follows from the reasoning in *Eon Asset*, if the economic purpose of transaction is to transfer an ownership, juridical form (a lease) should not be decisive for VAT treatment. In this respect IAS 17 has become a good point of reference since it provided for classification of the forms of lease based on the allocation of risks and rewards incidental to ownership of a leased asset between the lessor and the lessee. It also specially emphasized that whether a lease is a finance lease or an operational lease depends on the substance of the transaction rather than the form of the contract⁷⁰.

According to the CJEU, financial lease that must be treated as a supply of goods takes place where either 1) a transfer of ownership is provided for on the expiry of the contract or 2) the lessee possesses all the essential powers attaching to ownership, or 3) the value of the lease payments is practically identical to the market value of the property⁷¹. These criteria present selective interpretation of provisions incorporated into paragraphs 10-11 of IAS 17. Here we can see a big piece of work for the CJEU in the future since each of these criteria requires further interpretation.

First, as it stems from CJEU case law, the mere purchase option exercisable on lessee's discretion is not enough to say that transfer of ownership is provided for by the contract⁷². But what if lessee has significant economic incentive to exercise this option? This may be the case when lessee can benefit from a purchase price lower than market value of an asset at the end of a lease. Another example is a lease of specific equipment, when either there is no market of used equipment of such kind or lessor's substantial losses associated with termination of lease are to be borne by lessee. Under IAS 17 these situations constitute separate criteria of financial lease⁷³.

Second, "amount which is practically identical to the market value" is quite a vague concept since different approaches may be used for its interpretation. According to IAS 17, a lease must be categorized as financial when, *inter alia*, "at the inception of the lease the present value of the

⁶⁸ Lambion, M. The influence of international accounting standards in the field of VAT, pp.165-166.

⁶⁹ C-118/11 *Eon Asset*, paras. 38, 40; IAS 17. Leases, paras. 10-11.

⁷⁰ *Ibid*, para 10.

⁷¹ C-118/11 *Eon Asset*, paras. 37, 38, 40.

⁷² Such conclusion is derived from the fact that the Court has not applied Article 14(2)(b) of the VAT Directive in cases *Auto Lease Holland*, *Lease Plan Luxembourg*, *Part Service* etc.; see paragraph 3.2 for further explanations.

⁷³ IAS 17. Leases, paras. 10(e), 11(a).

minimum lease payments amounts to at least substantially all of the fair value of the leased asset”⁷⁴. It seems that the CJEU had an intention to set a little bit lower threshold, otherwise it would have been reasonable to employ the same wording. The possible explanation is that at the time when the case has been decided, IASB and FASB continued joint work on the new lease accounting rules. One of solutions discussed was to include in the project more precise criteria currently incorporated in US GAAP and known as “bright lines”. One of these criteria is a fixed 90% threshold. It is possible that the Court wanted to develop more flexible concept less vulnerable to future changes. However, in 2nd Exposure Draft current system has been preserved⁷⁵.

Finally, a concept of “essential powers” does not appear in IAS 17 at all. This criterion is sufficiently general to cover any leasing arrangement that provides for the transfer of substantially all risks and rewards incidental to ownership and does not fall within two other aforementioned categories. It may be also considered ‘a safety net’ created in order to cover situations where VAT treatment is clear enough taking into account all the circumstances of the case.

The question remains why the CJEU did not simply referred to certain provisions of IAS 17. This would make application of criteria used by the CJEU more consistent not only because rules of IAS 17 are more detailed, but also because certain practice of their application had been formed. There are two possible explanations: 1) the CJEU did not want to create a likelihood of direct applicability of IAS, taking into account long-term consequences it could produce; 2) it wanted to develop more universal and more stable concept with regard to anticipated reform of International Accounting Rules related to leases. The only thing we can say for sure that the concept of financial lease developed by the CJEU has been based on IAS 17 because the Court considered provisions of this document as properly reflecting economic reality. However, the concept, developed in *Eon Asset*, does not copy that enshrined in IAS 17. Once formulated by the Court, it has become autonomous notion which, in principle, may be applicable even after replacement of IAS 17 with new IFRS for leases.

3.2. Interpretation of Article 14(2)(b) of the VAT Directive in case law of the CJEU

In the light of criteria set out by the CJEU in *Eon Asset* it has become finally possible to determine when Article 14(2)(b) of the VAT Directive is applicable to financial leasing contracts. This question is of particular importance not only because it is decisive in respect of classification of leases as supplies of goods or supplies of services, but also taking into account Article 64(1) of the VAT Directive which determines chargeable event and chargeability and, therefore, a moment when a right to deduct arises, for supplies giving rise to successive payments. As it will be shown below, as long as leasing contract falls outside the scope of Article 14(2)(b), in respect of chargeability and a right to deduct it should be subject to the same rules as a simple hire of goods (supply of services) despite the fact that it may still constitute supply of goods under Article 14(1) of the VAT Directive.

Provision currently incorporated into Article 14(2)(b) of the VAT Directive has a long history. It first appeared in Art. 5(2)(a) of Second Directive. According to it, “the actual handing over of goods, under a contract which provides for the hiring of goods for a certain period, or the sale on

⁷⁴ IAS 17. Leases, para 10 (d).

⁷⁵ Joint IASB and FASB Exposure Draft ED/2013/6.

deferred terms of goods, in both cases subject to a clause to the effect that ownership shall pass at the latest upon payment of the final installment due” were to be considered a supply of goods. A special clarification has been given to this provision in the Annex A to Second Directive. It was stated that “the contract referred to in Article 5(2)(a) must not be subdivided into part hire and part sale, but shall be regarded, as soon as concluded, as a contract involving a taxable supply [supply of goods]”⁷⁶. This provision had been expelled from the text of Sixth Directive.

Wording of Article 5(2)(a) of Second Directive was slightly different from that that had been implemented in Article 5(4)(b) of Sixth Directive and later transposed into the VAT Directive without any changes. The only substantial amendment was that the ownership is to pass “in the normal course of events”. At a first glance, this introduced the lower standard comparing to initial wording of Second Directive, where stronger construction “shall pass” had been employed without any exceptions. However, as it is demonstrated below, the Court’s interpretation of provisions at issue is not consistent enough to make certain conclusions in this respect.

It may seem that when some provision exists for a long time without being interpreted by the CJEU, then it is clear enough and interpretation is just not necessary. This is definitely not the case as regards to Article 14(2)(b) of the VAT Directive, but it looks like the CJEU has been avoiding references to it in lease-related cases. To date, the CJEU has decided significant number of cases where leases of motor vehicles were at issue in the main proceedings (*ARO Lease*, *Lease Plan Luxembourg*, *Part Service*, *BCR Leasing* etc.). Classification of leases as supplies of goods or supplies of services was not the issue of primary importance in some of these cases (while extremely important in others, for instance, in *Lease Plan Luxembourg* in order to determine place of supply). Nevertheless, the CJEU had to express its point of view implicitly every time referring to specific provisions of EU law. In all these cases the Court considered leasing transactions as supplies of services, without referring to Article 5(4)(b) of Sixth Directive or Article 14(2)(b) of the VAT Directive. In *ARO Lease*, *Lease Plan Luxembourg* and similar cases it probably could be explained by the fact that simple option to purchase leased vehicle at the end of the contract does not qualify for requirement that ownership is to be transferred “in the normal course of events”. The situation was different in *Part Service*, where, although the contract only provided for purchase option exercisable on lessee’s discretion, total sum of lease payments was practically equal to market value of the car; therefore, it was absolutely clear that this option, in the normal course of events, will be exercised⁷⁷. Even more curious is the recent case of *BCR Leasing*, decided after *Eon Asset* (discussed in the next paragraph). Therefore, today *Eon Asset* remains the main case that shed some light on the application of Article 14 (2)(b) to lease arrangements.

Unfortunately, the Court’s reasoning in respect of Article 14(2)(b) delivered in *Eon Asset* may be subject to different interpretations. From preliminary considerations it is not clear whether Article 14(2)(b) should apply to financial lease contracts or do they fall within the scope of Article 14(1) of the VAT Directive⁷⁸. At a first glance it may seem that the CJEU considered Article 14(2)(b) inapplicable in the present case. Indeed, if the assumption that the Court employed interpreted notion of “ownership” in Article 14(2)(b) as a legal one (as described below) is true, at least some of arrangements classified as financial leases in the light of *Eon Asset* are not covered by Article

⁷⁶ Second Directive, Annex A, para 4.

⁷⁷ C-425/06 *Part Service*, para 57.

⁷⁸ C-118/11 *Eon Asset*, paras. 36-40.

14(2)(b). On the other hand, the CJEU recognized that, in case of acquisition of capital goods under financial leasing contract, lessee might be entitled to deduct input VAT immediately⁷⁹. It means that exception provided by Article 64(1) for contracts covered by Article 14(2)(b) may, in principle, apply to financial leases.

Further interpretation of Article 14(2)(b) of the VAT Directive by the CJEU is much desirable since this provision raises number of problematic issues. First of all, the scope of Article 14(2)(b) is limited to “contracts for the hire of goods for certain periods or for the sale of goods on deferred terms”. A question arises whether lease contracts fall within the scope of this definition. In many Member States lease, hire purchase and sale on deferred terms constitute three different types of contracts⁸⁰. However, due to principles of fiscal neutrality and economic reality, when a lease actually results in the transfer of economic ownership, application of Article 14(2)(b) cannot be excluded on this sole ground. This has become especially clear after *Goed Wonen* case, where the CJEU entitled granting of *rights in rem* to the same VAT treatment as lease stating that “the fundamental characteristic of such a transaction, which it has in common with leasing, lies in conferring on the person concerned, for an agreed period and for payment, the right to occupy property as if that person were the owner and to exclude any other person from enjoyment of such a right”⁸¹. Following this reasoning, financial lease must be treated in the same way as hire purchase or sale of goods on deferred terms, since economic substance of these transactions is the same.

Second, the notion of “ownership” in Article 14 (2)(b) is somehow unclear. If it were used in the same meaning as in Article 14(1), i.e., economic ownership, then the question whether legal title had been transferred would be of little importance as regards the application of article 14(2)(b). However, reasoning of the CJEU in *Eon Asset* presented a strong argument in favour of legal meaning. Pointing out that “in case of a financial leasing contract, there is not necessarily any acquisition of the goods since such a contract may provide that the lessee has the option of not acquiring those goods at the end of the lease period”⁸², the CJEU clearly referred to the transfer of legal title. If the economic concept has been applied here, the opposite would be true: in case of financial lease, qualified as such according to criteria set out by the Court, there is always a transfer of right to dispose of goods as owner, i.e. acquisition of goods. Moreover, the Court admitted that transfer of ownership within the meaning of Article 14(1) of the VAT Directive takes place when “substantially all the risks and rewards of legal ownership are transferred to the lessee”⁸³, i.e. at the commencement, not at the end of the lease.

Regarding application of Article 14(2)(b) in *Eon Asset* it has been noted that “the proviso that in the normal course of events ownership is to pass at the latest upon payment of the final installment is no longer the sole criterion of treating the hire of goods or the sale of goods on deferred terms as a supply of goods (at the moment of the actual handing over)”⁸⁴. This is true in relation to legal ownership, but it seems that economic interpretation, consistent with Article 14(1), is more appropriate in this context. In order to preserve neutrality of treatment, Article 14(2)(b) must cover

⁷⁹ C-118/11 *Eon Asset*, para 62.

⁸⁰ Lambion, M., *The influence of international accounting standards in the field of VAT*, p. 159; Menon, P.; Narasimhan, P. *The curious ECJ case of Eon Asset Management and its impact on finance leasing in the United Kingdom*, p. 1.

⁸¹ C-326/99 *Goed Wonen*, para. 55.

⁸² C-118/11 *Eon Asset*, para 37.

⁸³ C-118/11 *Eon Asset*, paras. 38-40.

⁸⁴ Terra, B.; Kajus, J. *Commentary to the Case C-118/11 Eon Asset Management*, IBFD, 2015.

all financial leases that, according to criteria set out in *Eon Asset*, constitute supply of goods. Otherwise, pursuant to Article 64(1) of the VAT Directive, some of them would fall within the scope of exception provided for contracts covered by Article 14(2)(b) and others would not, with the result that the latter would be entitled to benefit from the deferral of their VAT liability. Therefore, in our view, the concept of ownership enshrined in Article 14(2)(b) must be interpreted in the same way as in Article 14(1) - that is, as transfer of right to dispose of the property as owner rather than transfer of legal title.

3.3. A right to deduct input VAT in respect of financial lease transactions

As the CJEU has continuously pointed out, the deduction system is intended to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities⁸⁵. In principle, deduction is allowed when: 1) there is a direct and immediate link between the costs incurred and taxed output transactions; 2) these costs form a part of the overheads relating to a clearly defined part of a taxable person's economic activities; 3) the costs can be regarded as forming part of the taxable person's "general costs" and, as such, are included in the prices of the goods or services that the taxable person supplies⁸⁶. These requirements are essentially the same for all costs incurred by the taxpayers in the course of their economic activity, regardless to whether goods or services have been acquired. However, deductions of input VAT in respect of capital goods present some particular features. As it was shown by the CJEU in *Charles Tijmens*, the taxpayer acquiring capital goods has a choice, for the purposes of VAT, of 1) allocating those goods wholly to the assets of his business, 2) retaining them wholly within his private assets, thereby excluding them entirely from the system of VAT, or 3) integrating them into his business only to the extent to which they are actually used for business purposes⁸⁷. If capital goods are allocated to the business assets, input VAT will be, generally, fully and immediately deductible⁸⁸. Immediate use of these goods for taxable supplies does not in itself constitute a condition for deduction⁸⁹. Subsequent use of these goods for private purposes constitutes a ground for adjustments.

That was the background the CJEU recalled extensively in *Eon Asset*⁹⁰. Therefore, paragraph 44 of this judgment, where it observed that "the criterion relating to the use of the goods or services for the purposes of transactions within the scope of the undertaking's economic activity varies according to whether a service or capital goods are being acquired"⁹¹, must be interpreted as referring to the criterion of primary assessment (allocation of capital goods) rather than determination of direct and immediate link with taxable activity. Regarding the latter, the CJEU cited its judgment in *AB SKF* case, according to which the existence of direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to entitlement to deduct is, in principle, necessary before the taxable person is entitled to deduct

⁸⁵ Case C-268/83 *D.A. Rompelman and E.A. Rompelman-Van Deelen v Minister van Financiën*, 14 February 1985, ECLI:EU:C:1985:74, para 19; Case C-29/08 *SKF*, para 56 and case law cited.

⁸⁶ Doesum, A.; Norden, G-J. van. The Right To Deduct under EU VAT. *International VAT Monitor*, Vol. 22, No. 5, pp. 324-325.

⁸⁷ Case C-434/03 *P. Charles and T. S. Charles-Tijmens v Staatssecretaris van Financiën*, 14 July 2005, ECLI:EU:C:2005:463, para 26 and case law cited.

⁸⁸ *Ibid*, para 24; Case C-97/90 *Hansgeorg Lennartz v Finanzamt München III*, 11 July 1991, ECLI:EU:C:1991:315, para 26.

⁸⁹ C-97/90 *Lennartz*, paras. 14-15.

⁹⁰ C-118/11 *Eon Asset*, paras. 53-58.

⁹¹ *Ibid*, para 44.

input VAT and in order to determine the extent of such entitlement⁹². It is also allowed to deduct the costs of the services that constitute a part of the general costs of the undertaking and do have, as such, a direct and immediate link with the taxable person's economic activity as a whole⁹³. Therefore, in respect of entitlement to deduction and, in particular, the scope of direct link test, the Court has not added much to the previous case law. It just brought leasing arrangements corresponding to the aforementioned criteria set out to determine financial lease within the scope of rules on VAT treatment of capital goods that had been developed in previous case law.

This is not the case as regards to the Court's findings on the moment when taxpayer can deduct input VAT. Under Article 167 of the VAT Directive, the right to deduct VAT arises at the time when the tax becomes chargeable. Referring to the Article 64 of the VAT Directive, CJEU has stated that, in case of operational lease which can be classified as a supply of services giving rise to successive payments, the time when the right to deduct input VAT arises and when requirements of direct link test are to be satisfied is on the expiry of the period to which each of those payments relates⁹⁴. However, the CJEU did not apply Article 64(1) in respect of acquisition of capital goods under financial leasing contracts. This should imply that, in the Court's point of view, financial lease that satisfies conditions set out in paragraphs 38 and 40 of the judgment falls within the scope of Article 14(2)(b) of the VAT Directive since this is the only exception provided for by Article 64(1). Therefore, the Court concluded that VAT payable in respect of acquisition of capital goods leased under financial leasing contract that gives a rise to successive payments is fully and immediately deductible, and any use of these goods for the taxable person's private purposes or for the purposes other than those of his undertaking must be treated as a supply of services carried out for consideration⁹⁵.

3.4. Application of "Eon Asset test" in recent case law of the CJEU

At the time when it was delivered a judgment in *Eon Asset* had all the chances to take a spot in the line of "big" cases producing a great influence on subsequent CJEU case law. However, even today, three years after the Court's decision, it is difficult to assess its final outcomes. *Eon Asset* presented a point of view very different from previous case law, too different to be accepted at once without any hesitation. It is characterized as "creating considerable uncertainty"⁹⁶ rather than providing for necessary answers. Furthermore, authority of *Eon Asset* decision has been significantly undermined by some recently decided cases where the CJEU did not apply approach developed in *Eon Asset* without any special explanation. These are the reasons why all the players involved do not rely too much on this judgment. For instance, United Kingdom, which used to treat financial leases as supply of services⁹⁷ and was required to change its national practice after *Eon Asset*⁹⁸, still neither implemented any amendments to 1994 VAT Act⁹⁹ nor, to the best of our knowledge, issued any

⁹² C-118/11 *Eon Asset*, para 47; C-29/08 *SKF*, para 57 and case law cited.

⁹³ C-118/11 *Eon Asset*, para 48; C-29/08 *SKF*, para 58.

⁹⁴ C-118/11 *Eon Asset*, para 62.

⁹⁵ *Ibid.*, para 63; C-434/03 *Charles Tijmens*, para 24.

⁹⁶ Ryder G. VAT on finance leases, [Electronic resource]: http://www.moorestephens.co.uk/vat_on_finance_leases.aspx

⁹⁷ C-277/09 *RBS Deutschland*, para. 20.

⁹⁸ Menon, P.; Narasimhan, P. The curious ECJ case of *Eon Asset Management* and its impact on finance leasing in the United Kingdom, p. 4.

⁹⁹ UK Value Added Tax Act 1994. Schedule 4: Matters to be treated as supply of goods or services, para 1(2)(b). [Electronic resource]: <http://www.legislation.gov.uk/ukpga/1994/23/schedule/4>

appropriate guidance bringing position of national tax authorities in line with reasoning of the CJEU¹⁰⁰.

Unfortunately, only two decisions that may give some idea about further application of *Eon Asset* criteria have been delivered by the Court to date. Both of these decisions relate to financial leases of motor vehicles, a classical example of leasing agreements non-related to immovable property.

3.4.1. BCR Leasing

At the first glance, this case may be regarded as a step away from *Eon Asset* or, alternatively, an attempt to limit its scope. BCR Leasing, an applicant in the main proceeding, acquired cars from different suppliers and leased them to its customers, natural or legal persons. The structure used by BCR Leasing was very similar to that at issue in simultaneously decided *GMAC* case (see paragraph 6.3.2). Consequently, there were reasonable grounds to assume that legal title will be finally transferred to the lessee. The question, referred to the CJEU, was whether termination of lease contract, in case of breach on the part of a customer, with subsequent impossibility for a leasing company of recovering leased assets may be treated as a supply of goods for consideration for the purposes of Articles 16 and 18 of the VAT Directive¹⁰¹.

Classification of leasing contracts at issue was, in principle, not necessary in order to answer the question referred. However, Romanian tax authorities, arguing that non-recovery of goods in the present case constitutes a self-supply, took the view that “financial lease must be treated, for the duration of the contract, as a supply of services that may be followed by a supply of goods upon the expiry of the contract, depending on whether or not the lessee exercises the option to purchase”¹⁰². The CJEU did not oppose to this submission; moreover, it seems that it has been adopted for the purposes of present case. If the Court had found that the contract at issue corresponded to *Eon Asset* criteria and provided for a transfer of ownership, Article 16 of the VAT Directive would have been declared inapplicable *a priori* since an asset that have been already sold cannot constitute a part of undertaking’s business assets. Finally, the Court came to the same conclusion, but through different reasoning¹⁰³.

Furthermore, in *BCR Leasing* the CJEU cited a provision of Romanian Law, intended to transpose Article 14(2)(b) of the VAT Directive, which explicitly excluded leasing contracts from its scope¹⁰⁴. Such interpretation of Article 14(2)(b) was clearly inconsistent with the Court’s reasoning in *Eon Asset*. However, in the present case the Court neither delivered any comments regarding to this questionable interpretation, nor made any references to *Eon Asset*.

In our view, the only explanation that allows preserving a likelihood of consistency is that VAT nature of leasing contracts concluded between *BCR Leasing* and its customers did not constitute issue of primary importance in this case. The CJEU had not been asked to assess their VAT consequences; the only thing it had to do was to decide whether self-supply of goods took place, and this task could be accomplished in different ways. In fact, approach followed by the CJEU was

¹⁰⁰ Ryder, G., VAT on finance leases

¹⁰¹ C-438/13 *BCR Leasing*, para 22.

¹⁰² *Ibid.*, para 17.

¹⁰³ C-438/13 *BCR Leasing*, paras. 25-27.

¹⁰⁴ *Ibid.*, para 9.

even more beneficial since it resulted in a number of generally applicable criteria¹⁰⁵. Nevertheless, the fact that the CJEU retained silence in respect of how Article 14(2)(b) of the VAT Directive had been transposed into Romanian Law is really difficult to explain.

Probably, the present case may be interpreted as demonstrating that rules introduced in *Eon Asset* constitute an exception from the general rule. It seems that the CJEU is about to construct a rebuttable presumption, according to which financial lease must be considered supply of services and not supply of goods until it is proven that substantially all the risks and rewards incidental to ownership have been transferred to the lessee (using *Eon Asset* criteria). Obviously, such analysis will not be performed where it is not absolutely necessary to give a useful answer to the questions referred to the CJEU.

3.4.2. *BGZ Leasing*

The main issue in this case was VAT treatment of insurance for the leased asset supplied by a third party and re-invoiced by the lessor to the lessee. The CJEU recalled extensively *Eon Asset*, re-affirming that, as a general rule, leasing agreements do not provide for a transfer of ownership in the leased item, therefore, they must be categorized as a supply of services¹⁰⁶. However, it remains unclear whether the same reasoning is applicable to financial lease, or, vice versa, the latter assumes transfer of ownership for the purposes of VAT Directive. In the light of *BCR Leasing* it seems that the Court tends to give preference to the first alternative.

Furthermore, it has been seen from *BGZ Leasing* that the CJEU leaves the application of criteria set out in *Eon Asset* to the national courts¹⁰⁷. Taking into account, first, significant room for judicial discretions, enshrined in the wording of these criteria, and second, the fact that even now, three years after decision in *Eon Asset* had been delivered, this case remains the only example of successful application of this test, consistent interpretation is very unlikely to be achieved without further guidelines.

4. VAT treatment of financial leases and principle of fiscal neutrality

4.1. Concept of 'fiscal neutrality' in CJEU case law

It is well known that there are different ways to transfer a right to dispose of a property as owner. It may be transferred through simple sale, hire purchase, financial lease agreement; sale of shares in the company that holds the property; taking a loan and granting a mortgage in return and so forth. At the end of the day, the economic outcomes of these transactions are the same. Should the juridical form of the transaction be decisive for VAT treatment then?

In order to preclude different VAT treatment of transactions with the same economic essence a concept of fiscal neutrality has been developed. As the CJEU pointed out in *Zimmerman*, which may be regarded as a summary of all previous findings on that topic (see also *NCC Construction*

¹⁰⁵ *Ibid.*, para. 25.

¹⁰⁶ C-224/11 *BGZ Leasing*, para 37.

¹⁰⁷ *Ibid.*, para 37.

*Danmark*¹⁰⁸, *Marks&Spencer*¹⁰⁹, *Rank Group*¹¹⁰ and case law cited), supplies of goods or services which are similar, and which are accordingly in competition with each other, may not be treated differently for VAT purposes¹¹¹. As it was already mentioned before, this principle has been applied in *Goed Wonen*, where the CJEU allowed the same VAT treatment of lease and granting of usufructuary right. The main question, which usually arises in this respect, is which transactions must be regarded as similar. Unfortunately, case law of the CJEU as it stands now does not give a straightforward answer to this question.

As the CJEU has stated in a number of cases, in order to determine VAT consequences of supply, it is necessary to take into account objective character of transaction in question¹¹². The intentions of a taxable person, i.e. the reasons why he/she/it undertook this action, are not relevant. What is relevant, is what the parties agreed to (and what they actually put in the contract)¹¹³. This, however, does not mean that legal form of transaction is decisive. As it may be seen from *SKF*, the CJEU looks through the legal form and pays significant attention to economic substance. In this case the Court ruled that “in so far as the disposal of shares is equivalent to the transfer of a totality of assets or part thereof of an undertaking” it may entail application of Article 5(8) of Sixth Directive and, since Sweden (the Member State at issue) exercised an option provided by this Article, it did not constitute an economic activity subject to VAT¹¹⁴. Therefore, similar transactions may have different legal form, but the same economic outcome, from the viewpoint of impartial observer taking into consideration not what the parties wanted to do, but what they actually did.

Principle of fiscal neutrality also has its limits. According to CJEU decision in *Cantor Fitzgerald*, “the principle of the neutrality of VAT does not mean that a taxable person faced with a choice between two transactions (one exempt and one taxed) may choose one of them and avail himself of the effects of the other”¹¹⁵. It is commonly accepted that “EU legislation must be certain and its application foreseeable by those subject to it. It is settled CJEU case law that the requirements of legal certainty must be observed even more strictly in the case of rules that entail financial consequences, in order that those concerned may know precisely the extent of the obligations which they impose on them”¹¹⁶

In order to understand what limits are imposed on application of the principle of fiscal neutrality by current case law of the CJEU, it is necessary to examine *Cantor Fitzgerald* case more carefully. This is a remarkable case, which has become an attempt to find a compromise between economic reality and legal certainty. The facts at issue in the main proceeding were the following. According to agreement, concluded between Prudential Assurance Co. Ltd (owner of the property) and Wako

¹⁰⁸ Case C-174/08 *NCC Construction Danmark A/S v Skatteministeriet*, 29 October 2009, ECLI:EU:C:2009:669, para. 44.

¹⁰⁹ Case C-309/06 *Marks & Spencer plc v Commissioners of Customs & Excise*, 10 April 2008, ECLI:EU:C:2008:211, para 52.

¹¹⁰ Joined cases C-259/10, C-260-10 *Commissioners for Her Majesty's Revenue and Customs v The Rank Group plc.*, 10 November 2011, ECLI:EU:C:2011:719, para. 34.

¹¹¹ Case C-174/11 *Finanzamt Steglitz v Ines Zimmermann*, 15 November 2012, ECLI:EU:C:2012:716, paras. 46-48.

¹¹² Case C-4/94 *BLP Group plc v Commissioners of Customs & Excise*, 6 April 1995, ECLI:EU:C:1995:107, para. 24; Case C-259/11 *DTZ Zadelhoff vof v Staatssecretaris van Financiën*, 5 July 2012, ECLI:EU:C:2012:423, para 25.

¹¹³ Doesum, A. van., What looks like a duck is a duck: economic purpose and legal reality in EU VAT Law, *World Journal of VAT/GST Law*, 2012, Vol. 1, No. 2, pp. 203-204.

¹¹⁴ C-29/08 *SKF*, para 41.

¹¹⁵ Doesum, A. van. What looks like a duck is a duck: economic purpose and legal reality in EU VAT Law, p. 202.

¹¹⁶ *Ibid.*, p. 203.

International Limited (hereinafter - 'Wako'), the latter was granted a 15-year lease of the part of office building in London. Five years later Wako, with the landlord's consent, assigned this lease to CFI. CFI, which became the new tenant, undertook to perform Wako's obligations under the lease and to indemnify Wako for any losses or liabilities incurred by reason of the lease. In return, Wako paid to CFI a sum of GBP 1.5 million. CFI was required to pay VAT in respect of supply made to Wako. Objecting to decision of tax authorities, CFI submitted that this supply is exempt in line with CJEU ruling in *Lubbock Fine*. In this case it has stated that the term 'letting of immovable property' covers the case where a tenant surrenders his lease and returns the immovable property to his immediate landlord with the result that consideration paid by one party to the other in connection with the surrender of the lease is exempt, where the rent paid under the lease was exempt from VAT¹¹⁷. CFI argued that if it were CFI which had made a payment to Wako in consideration for the assignment of the lease, it would be undoubtedly exempt. Further, it noted that whether the payment is made by the assignor or the assignee is simply a reflection of market conditions and does not justify different VAT treatment of transaction¹¹⁸.

The CJEU did not oppose to this submission. Instead, it stated that "letting of immovable property" for the purposes of Article 13B(b) of the Sixth Directive is a contractual relationship between landlord and tenant, whereby the former supplies to the latter a right to occupy his property in return for rent. In the Court's view, transaction at issue did not fulfill these requirements since it was not a supply made by Wako to CFI, but supply, made by CFI to Wako; consequently, it was not a supply of the right to use an asset¹¹⁹. The CJEU has specially emphasized that Article 13B(b) of the Sixth Directive provides for exemption from general rule, so it must be interpreted narrowly¹²⁰.

As regards to conclusion made by the CJEU that principle of fiscal neutrality cannot eliminate consequences of taxpayer's choice between two types of transactions subject to different VAT treatment, it was an answer to the argument submitted by the Commission, that Wako could have achieved the same economic result by making a payment to the landlord so that the latter would reduce the rent for the new tenant, or, alternatively, sub-letting the property to CFI and paying the difference to the landlord on its own¹²¹. The CJEU admitted that these options would have comparable economic impact¹²². However, in its view, that was not sufficient justification for interpreting Article 13B(b) of the Sixth Directive so as if it was also applicable to supply of services that did not include transfer of a right to occupy property¹²³.

If we see it correctly, conclusion derived from *Cantor Fitzgerald* is that, in order for certain transaction to be entitled to the same VAT treatment as provided for in respect of similar transaction pursuant to principle of fiscal neutrality, it must have not only the same economic outcome, but also similar economic substance. It seems that economic substance is considered "similar" by the CJEU when the same asset constitutes an object of both contracts. This is why granting of usufructuary right and operational lease, on the one hand, or financial lease and hire purchase agreement, on the other, are similar transactions: they provide for the transfer of a right to use an asset and, in the latter case, some other rights and powers incidental to ownership to the comparable extent.

¹¹⁷ C-63/92 *Lubbock Fine*, paras. 10, 13.

¹¹⁸ C-108/99 *Cantor Fitzgerald*, para 13.

¹¹⁹ *Ibid.*, paras 21-23.

¹²⁰ *Ibid.*, para 25.

¹²¹ *Ibid.*, para 16.

¹²² C-108/99 *Cantor Fitzgerald*, para 16.

¹²³ *Ibid.*, para 32.

Meanwhile, supply of a right to use an asset (sublease) and indemnifying lessee for any liabilities incurred by virtue of lease contract in return for consideration are not considered as such (at least where provision at issue requires strict interpretation).

4.2. Fiscal neutrality of criteria introduced in Eon Asset and possible impact of new accounting rules for leases

In order to determine whether VAT treatment of financial lease fulfill the requirements of fiscal neutrality comparison should be made in two respects: 1) neutrality of VAT treatment of different types of leases; 2) treatment of financial leases and similar transactions.

Judgment in *Eon Asset*, while introduced more neutral treatment of financial leases comparing to hire purchase agreements and sale on deferred terms, raised major issues in respect of the first question. Due to the criteria employed in order to distinguish financial and operational leases, a borderline between them has become very ambiguous. At the same time, outcomes of this classification are enormous¹²⁴. For instance, exclusion of financial lease from the scope of Article 64(1) of the VAT Directive results in a requirement to account for VAT upfront. This clearly imposes additional burden on the taxpayer.

As it follows from *Marks and Spencer*, different treatment of similar transactions is neutral as long as differentiation is objectively justified¹²⁵. Doubtless, there is such kind of justification for different VAT treatment of operational lease, which constitute a supply of services, and financial lease, classified as a supply of goods. However, when it comes to comparison between two individual transactions, difference may be slightly visible. In case of leasing arrangements distinction is especially complicated. While, from the viewpoint of economic reality, financial lease prevails, companies struggle to structure their lease terms in a different way to obtain operating lease accounting¹²⁶. It follows that, in order to ensure that similar transactions are treated in the same way, unambiguous criterion for distinction is absolutely necessary.

Regarding VAT treatment of other transactions leading to the same economic result, a number of questions raised by the case law of CJEU as it stands now far exceeds a number of answers provided. After *Part Service* it has become clear that supply of financing (“financing transaction”) must be treated as an essential element of leasing and is therefore subject to the same VAT treatment¹²⁷. But what if financing is purchased separately from an unrelated party? Are there certain conditions when supply of financing would be exempt? Unfortunately, neither *Eon Asset* nor later case law did not shed more light on the VAT treatment of similar transaction, such as, for example, hire purchase agreements in UK law¹²⁸. Do they all constitute a lease for the purposes of VAT Directive following *Goed Wonen* reasoning¹²⁹? If no, does the provision of financing

¹²⁴ Menon, P.; Narasimhan, P. The curious ECJ case of Eon Asset Management and its impact on finance leasing in the United Kingdom, p. 5.

¹²⁵ C-309/06 *Marks and Spencer*, para 52.

¹²⁶ Altamuro, J; Johnston, R.; Pandit Sh.; Zhang, H. Operating Leasing and Credit Assessments, *Contemporary Accounting Research*, Vol. 31, No. 2, p. 551.

¹²⁷ C-425/06 *Part Service*, para 27.

¹²⁸ Menon, P.; Narasimhan, P. The curious ECJ case of Eon Asset Management and its impact on finance leasing in the United Kingdom, p. 2.

¹²⁹ C-326/99 *Goed Wonen*, paras 42, 56.

constitute an essential element of these transactions or may it be considered a separate supply? CJEU case law in its present state does not provide clear answers to these questions.

Another reason for concern is anticipated adoption of new accounting standards. According to IAS 17 (currently in force), two different models of accounting apply for financial and operational leases. In case of financial lease it is assumed that the leased item is under the lessee's control. Consequently, it is recorded in full as an asset in his possession (*whole asset model*). Under operating lease, the rights granted to the lessee depend on payment of rentals and, *vice versa*, lessee's obligation to pay rent to the lessor is conditional upon the lessor making the asset available to him during the lease period. Operational lease does not create any assets or liabilities for lessor or lessee. Rental payments are recognized as expenses incurred by the lessee and as income on the part of the lessor; the latter continues to record the full value of the leased item on his balance sheet and depreciates an asset. This is called "*executory contract model*"¹³⁰.

Since operational leases are not shown on the balance sheet, they are widely used by the companies in order to hide assets and liabilities. Results of empirical research (2009) indicate that by reporting operating leases, the 366 companies included in the sample (contained in the 2003 S&P 500 index) have concealed 11% of total liabilities and 4% of total assets¹³¹. One of the most fabulous examples was a case of Enron, a major US energetic corporation. By means of off-balance sheet financing instruments it overstated its equity-to-debt ratio by more than \$1.2 billion¹³². Enron's bankruptcy in 2001, followed by a grand scandal, has become one of the reasons why in 2006 IASB and FASB initiated a joint project to revise leasing accounting rules. Its main purpose was to subject majority of leases to single accounting model, better reflecting economic reality¹³³.

IASB and FASB, having issued 2nd Exposure Draft in May 2013, suggested a *right of use model* as a uniform basis for accounting for both operational and financial leases, excluding short-term leases (up to twelve month). This proposal is based on the assumption that, although the scope of rights granted to the lessee regarding the leased item through the lease contract is different from those deriving from full ownership of the item, their nature is similar to those acquired when the asset is purchased¹³⁴. Therefore, all leases are required to be capitalized, i.e. entails recognition of assets and liabilities both for a lessor and a lessee.

2nd Exposure Draft introduced new classification of leases under two categories: Type A and Type B leases. A lease of assets other than immovable property must be classified as Type A lease unless either 1) the lease term is for an insignificant part of the total economic life of the underlying asset; or 2) the present value of the lease payments is insignificant relative to the fair value of the underlying asset at the commencement date. Leases of immovable property fall within Type B category unless either 1) the lease term is for the major part of the remaining economic life of the underlying asset; or 2) the present value of the lease payments accounts for substantially all of the fair value of the underlying asset at the commencement date. If any of these conditions is satisfied,

¹³⁰ Martino, G. de. Considerations on the subject of lease accounting, p. 360; Mundstock, G. The tax import of the FASB/IASB proposal on lease accounting, p. 465.

¹³¹ Duke, J. C., Hsieh, S. J., & Su, Y. Operating and synthetic leases: Exploiting financial benefits in the post-Enron era. *Advances in Accounting*, 2009, Vol. 25, No. 1, p. 38.

¹³² Baker, C.R.; Hayes, R., Reflecting form over substance: the case of Enron Corp., *Critical Perspectives on Accounting*, 2004, Vol. 15, No. 6-7, pp. 768.

¹³³ DiSalvio, J.; Dorata, N.T., Lease Accounting Change: It's Not Over Yet, *Review of Business*, 2014, p. 16.

¹³⁴ Martino, G. de., Considerations on the subject of lease accounting, p. 360.

a contract falls within another category¹³⁵. The actual effect of these provisions is that all leases currently classified as financial would become Type A lease, while Type B would cover most operational leases. In order for the contract to be classified as Type A lease the lessee must be “expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset”¹³⁶. This is significantly lower standard that currently applicable to financial leases both under IAS 17 and criteria set out in *Eon Asset*; therefore, some operational leases would also qualify as Type A leases.

Despite this distinction and unlike currently applicable rules, accounting for Type A and Type B leases under 2nd Exposure Draft is pretty much the same. In both cases, at the beginning of a lease a lessee would recognize a liability equal to the present value of all future lease payments and an asset of equal amount that represents the lessee’s “right of use” in the leased property¹³⁷. A right to use asset would be subject to depreciation in the same way as wholly owned asset¹³⁸. On the part of a lessor, in case of Type A lease, previously recognized asset would be split into two parts: receivable lease payments and residual asset, representing the rights the lessor retains relating to the underlying asset (most commonly – a right to economic exploitation of property after termination of the contract). This scheme is also known as “receivable and residual approach”. In case of Type B lease a lessor would continue to account for underlying asset on its balance sheet and would recognize lease payment as income¹³⁹.

Although 2nd Exposure Draft received many critical feedbacks and has been subjected to re-deliberation procedure, a summary of tentative decisions reached by IASB and FASB to date (as of April 7, 2015) demonstrates that both bodies do not consider any alternatives to the right of use model. Classification of leases presented in 2nd Exposure Draft is also very likely to appear in the final document. Though exact criteria to distinguish Type A and Type B leases, as well as some minor issues regarding accounting for interest expenses on the part of the lessee, are still open to discussion, it is clear that the system introduced in 2nd Exposure draft will not be changed profoundly¹⁴⁰.

Therefore, it is appropriate to consider possible impact of International Accounting Rules similar to those analyzed before. It is argued that if the CJEU follows the line drawn in *Eon Asset*, it will have to assign most leases to the same treatment as that currently applicable in respect of financial leases. According to M. Lambion, in this case most leases will be considered “not supplies of services but supplies of goods – the acquired good being not the leased asset but the right to use this very asset”¹⁴¹. This reasoning may seem quite confusing since the fact that a right to use an asset is considered an asset itself under IASB/FASB proposals does not make it ‘a good’ within the meaning of the VAT Directive. From the viewpoint of the CJEU, a lease may be treated as supply of goods in so far as the transfer of rights pursuant to the contract, that are, if considered separately, intangible assets and, therefore, which constitute supply of services for the purposes of VAT, entails

¹³⁵ Joint IASB and FASB Exposure Draft ED/2013/6.

¹³⁶ *Ibid.*

¹³⁷ Mundstock, G. The tax import of the FASB/IASB proposal on lease accounting, p. 464.

¹³⁸ Martino, G. de., Considerations on the subject of lease accounting, p. 360.

¹³⁹ Joint IASB and FASB Exposure Draft ED/2013/6.

¹⁴⁰ Leases. Joint Project of the FASB and the IASB. Summary of tentative decisions as of April 7, 2015. [Electronic resource]: http://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdatePage&cid=900000011123 [Accessed 13 May 2015]

¹⁴¹ Lambion, M., The influence of international accounting standards in the field of VAT, p. 173.

transfer of substantially all rewards and risks incidental to ownership and have, consequently, the same economic outcome as supply of goods itself. It is not important in this respect whether a right of use is capitalized or not; what really matters, is the correlation between receivable and residual assets. Where most economic powers are transferred to the lessee and their value, converted into lease payments, significantly exceeds value of residual asset, it may be reasonably assumed that supply of goods takes place.

With regards to the foregoing, it is clear that new International Accounting Standards, if introduced, would not have a big influence on CJEU case law. Main idea of the new rules – recognition of assets and liabilities on lessee’s balance sheet – does not affect the Court’s criteria based on considerations of economic reality. It is important to keep in mind that, while the purpose of the proposal is to introduce single model for most leases, principle of fiscal neutrality requires the CJEU to treat differently leases similar to sale (financial or Type A leases) those transferring only a right to use without transfer of economic ownership (operational or Type B leases). Any model that does not take a proper account of this distinction would be vulnerable to abusive practices aimed at deferral of VAT liability in respect of transactions similar to sale of goods. Moreover, it is difficult to think of another uniform model than those providing for splitting single lease into sale and hire components – approach that had been precluded by the Second Directive.

While it is true that the 2nd Exposure Draft subject substantially all leases to the rules currently applicable to financial leases it would be too much to say that Type B leases would be treated similarly to supply of goods, since the latter one would remain on the balance sheet of the lessor. Situation is different in respect of Type A leases where leased asset (equipment or immovable property) would disappear from accounting prospective, being split into receivable and residual assets. Receivable asset, amounting to the total value of lease payments, constitutes a consideration for the supply that, under general rules, must be considered supply of services from the VAT prospective. However, where the value of residual asset is very low comparing to initial market value of the underlying asset, as it would normally be in case of Type A leases, it is clear that substantially all economic benefits incidental to ownership has been transferred to the lessee.

The main question, which is to be considered therefore in respect of IASB/FASB proposals is whether classification of leases introduced by them may substitute currently existing one that is based on the distinction between financial and operational leases. We submit that it is very unlikely in present course of events. The threshold of the underlying asset’s value that is to be transferred by Type A lease under 2nd Exposure Draft (“more than insignificant part”) is too low in order to consider all Type A leases similar to sales without distortion of economic reality. If the threshold is increased in the final document, this approach may, in principle, be adopted. However, it is important to keep in mind that classification of leases under 2nd Exposure Draft has another purpose.

In the author’s view, approach developed by the CJEU in *Eon Asset* will not be undermined if IASB/FASB proposals are finally adopted. Moreover, even hypothetically, these proposals do not suggest better solutions than those employed in *Eon Asset*. It was, therefore, a good idea not to link the concepts of financial/operational leases in the case law of the CJEU to the provisions of IAS 17. These concepts are sufficiently independent in order to be developed autonomously in the future, regardless to any subsequent changes in financial accounting rules where they initially came from.

However, the CJEU retains a freedom to implement any solutions suggested by IASB if it considers them appropriate.

4.3. VAT treatment of similar transactions in case law of the CJEU

4.3.1. Transactions that must be treated as a lease for VAT purposes: granting of rights in rem

As the CJEU had observed before in relation to immovable property, there was nothing in the wording of the Sixth Directive that would shed any light on the scope of the term ‘leasing’¹⁴². Although the Sixth Directive did not define a term “leasing” (nor does the VAT Directive), it also did not refer to relevant definitions adopted in the legal orders of the Member States (as it did, for example, in respect of a term “building land”); therefore, it had to be regarded as constituting independent concept of the EU law¹⁴³. In *Goed Wonen* the CJEU pointed out that this concept may be interpreted broadly. In its view, concept of leasing under the Sixth Directive was broader than that existing in the various national laws¹⁴⁴.

Although fifteen years have passed after delivery of judgment in *Goed Wonen*, so far CJEU has been explicitly extending the notion of lease in order to cover only one category of transactions, namely granting of rights in rem. This trend has been set out by CJEU in *Goed Wonen* and continued in number of other cases, among which the case of *Walderdorff* is of greater interest.

In *Goed Wonen* the CJEU considered a situation where a usufructuary right in respect of newly-built housing complexes with dwellings had been granted for a term of 10 years in return for a sum lower than the cost price of those dwellings. Both transferor and transferee were Dutch companies, and housing complexes were also located in Netherlands. According to Article 3(2) of Dutch VAT Law, “the grant, transfer, modification, waiver or termination of limited rights over immovable property [...] must also be viewed as a supply of goods, save where the total consideration plus turnover tax amounts to less than the economic value of those rights”¹⁴⁵.

Since transaction at issue did not fall within the scope of this provision due to low transfer value, Dutch tax authorities took the view that it must be classified as “leasing or letting of immovable property”, exempt from VAT. *Goed Wonen*, an applicant in the main proceeding, contended that the grant of the usufruct was a supply of goods since the transferee acquired the power to dispose of the dwellings in question as owner, in line with criterion established in *SAFE* case¹⁴⁶. The Commission supported this reasoning and pointed out that “leasing and letting, on the one hand, and usufruct, on the other, are significantly different in the civil law systems originating in Roman law, such as those existing in the majority of the Member States”¹⁴⁷. Moreover, their economic purpose is different: while letting or leasing generally makes the property in question available to the tenant to live in, usufruct transfers a right to derive economic benefits from its use¹⁴⁸.

¹⁴² Case C-358/97 *Commission of the European Communities v Ireland*, 12 September 2000, ECLI:EU:C:2000:425, para 53.

¹⁴³ C-326/99 *Goed Wonen*, paras. 44-47.

¹⁴⁴ *Ibid.*, para 49; C-358/97 *Commission v. Ireland*, para 54.

¹⁴⁵ C-326/99 *Goed Wonen*, para 9.

¹⁴⁶ C-326/99 *Goed Wonen*, para 27.

¹⁴⁷ *Ibid.*, para 42.

¹⁴⁸ *Ibid.*

Replying to these arguments, the CJEU has held that approach suggested by the Commission would ignore significant differences existing between the legal systems of the Member States¹⁴⁹. Findings of AG Jacobs are especially interested in this context. He pointed out that, although usufruct has characteristics which distinguish it from leasing or letting, these differences are not relevant to the determination of the present case. Particularities in question, arising from the fact that these legal institutions belong to distinct legal categories, must be regarded as secondary comparing to the fact that, economically, usufructuary right such as in question in the present case and leasing have essential common characteristic and present conferring on the person concerned, for an agreed period and for payment, the right to occupy property as if that person were the owner and to exclude any other person from enjoyment of such a right¹⁵⁰.

In *Walderdorff* the CJEU made further clarifications in respect of this reasoning. According to circumstances of the case, Ms Walderdorff, an applicant in the main proceeding, granted, for 10-years term and in return of consideration, a right to fish in two ponds located within Ms Walderdorff's land holding and in publicly owned fishing waters where Ms Walderdorff has fishing rights registered in the Fisheries register. Ms Walderdorff did not account for VAT in respect of this transaction. Tax authorities, however, refused to classify supply at issue as exempt and issued notice of assessment requiring to pay VAT at a standard rate¹⁵¹.

The first question, which had been considered by AG Sharpston, was whether a contract granting access to and enjoyment of actual immovable property for the sole purpose of fishing can be regarded as a lease or letting. Contrary to submission of Austrian tax authorities¹⁵², she found that granting access to the property in order to enjoy fishing rights may be classified as lease since it is not "not unusual for a lease to specify that the property concerned is to be used, or is not to be used, for one or more particular purposes"¹⁵³. However, in order to be classified as such each particular contract must include two essential elements reflecting the economic substance of lease, i.e. to be structured in such a way that: 1) it assigns the right to occupy the property, and 2) it excludes other persons from it. According to AG's conclusions, concept of lease cannot cover arrangements whereby "the owner of the property assigns the right to use it for a specific purpose but retains the right to use the property himself, or to authorise others to use it, for the same purpose or for other purposes"¹⁵⁴. The CJEU supported these findings having concluded that transaction at issue did not constitute lease or letting for VAT purposes in so far as it did not confer on the holder of usufruct a right to exclude other persons from enjoying the same property¹⁵⁵.

On the basis of the foregoing it is possible to construct rough guidelines on how granting of *rights in rem*, including usufruct, must be treated for VAT purposes. Where *rights in rem* confer on the transferee a right to occupy a property and to exclude any other person from enjoying it, this transaction should be entitled to the same treatment as that assigned to lease. Where, pursuant to the contract, these rights are transferred for significant part of the economic life of the property or their value is comparable to the market value of the latter, it may constitute financial lease, which is to be determined according to general rules. Where the scope of these rights is not sufficient in order to

¹⁴⁹ *Ibid.*, para 49.

¹⁵⁰ Opinion of AG Jacobs in case C-326/99 *Goed Wonen*, paras. 86-91; *Goed Wonen*, paras. 55, 58.

¹⁵¹ Case C-451/06 *Gabriele Walderdorff v Finanzamt Waldviertel*, 6 December 2007, ECLI:EU:C:2007:761, paras. 8-10

¹⁵² *Ibid.*, para 9.

¹⁵³ Opinion of AG Sharpston in case C-451/06 *Walderdorff*, para 25.

¹⁵⁴ *Ibid.*, para 36.

¹⁵⁵ C-451/06 *Walderdorff*, para 24.

effectively exclude other persons from use of the same property, granting of *rights in rem* constitute supply of services other than lease or letting. This test is applicable if the Member State concerned has not opted for treatment of *rights in rem* as tangible property pursuant to Article 15(2) of the VAT Directive.

4.3.2. Transactions similar to financial lease

National law of most Member States distinguishes hire purchase, sale on deferred terms and financial lease¹⁵⁶. Their economic substance is the same and comprises transfer of ownership and provision of financing necessary for that purpose. The CJEU makes no distinction between terms “hire purchase” and “sale on deferred terms”, using them interchangeably¹⁵⁷. The only difference comparing to financial lease is that hire purchase, as well as installment sale, provides for the transfer of ownership occurring upon payment of final installment, while financial lease usually offers only purchase option¹⁵⁸. Consequently, hire purchase agreements and sale on deferred terms have always been considered supply of goods under Article 14(2)(b) of the VAT Directive. After this provision has been applied to financial leases in *Eon Asset* case the difference between them became slightly visible.

Classical example of hire purchase contract concluded under UK law had been under examination in recently decided *GMAC* case. GMAC was a hire purchase company that structured its business as follows. First, a consumer had to choose a vehicle from a dealer and requested an individual financing arrangement. Then he was directed to GMAC. Upon conclusion of agreement between the three parties, the dealer sold the car to GMAC and then the latter supplied the car, under hire purchase contract, to the final consumer¹⁵⁹.

Looking beyond legal title, it is completely impossible to distinguish this scheme from financial lease. Essentially, it also presents a sale and acquisition of financing, in economic terms. If a purchase option had been put into hire purchase contract, transforming it into financial lease, the outcome of transaction would have been the same since it was clear that final transfer of ownership would take place anyway. Actually, this is exactly what had happened in *BCR Leasing* (see paragraph 3.4). In our view, these two types of legal arrangements should be assigned to the same treatment.

As regards financial element of transactions, they equally fall under the scope of *Muys & De Winter* case, where the CJEU has stated that the expression ‘the granting and the negotiation of credit’ in the Sixth Directive is sufficiently broad to include credit granted by a supplier of goods in the form of deferral of payment¹⁶⁰. The Court especially emphasized that principle of fiscal neutrality would

¹⁵⁶ Lambion, M., The influence of international accounting standards in the field of VAT, p.167; Ryder. G. VAT on finance leases. URL: http://www.moorestephens.co.uk/vat_on_finance_leases.aspx

¹⁵⁷ Case C-589/12 *Commissioners for Her Majesty's Revenue & Customs v GMAC UK PLC.*, 3 September 2014, ECLI:EU:C:2014:2131, paras. 16-17.

¹⁵⁸ Lambion, M., The influence of international accounting standards in the field of VAT, p. 167.

¹⁵⁹ C-589/12 *GMAC*, para 17.

¹⁶⁰ Case C-281/91 *Muys' en De Winter's Bouw- en Aannemingsbedrijf BV v Staatssecretaris van Financiën*, 27 October 1993, ECLI:EU:C:1993:855, para 13.

be disregarded “if a purchaser were to be taxed on credit granted by his supplier, whereas a purchaser seeking credit from a bank or another lender received an exempted credit”¹⁶¹.

Therefore, if the concept of lease in EU law is wide enough to cover granting of *rights in rem*, as it has been stated in *Goed Wonen*, different VAT treatment of hire purchase agreements and financial leases would seem completely inconsistent.

5. Conclusions

In the broad terms it is possible to define a lease as a contract that conveys the right to use an asset and the right to exclude other persons from using it, involving supply of finance (financial element), in exchange for periodic payments. It is important to keep in mind that, although both financial and operational leases fall under this definition, their economic substance is different. While financial lease does not necessarily provide for the transfer of legal title at the end of the lease, this type of contract is usually concluded when the parties have initial intention to transfer a right to dispose of underlying asset as owner. Consequently, it either creates or implies certain economic incentives for the parties to exercise purchase option. Financial lease, in essence, presents acquisition of goods combined with supply of financing. Unlike to it, operational lease is similar to a simple rent, with financial element that is not easy to capture in the structure of lease payments.

The difference existing between financial and operational leases precludes them from being treated in the same way for VAT purposes. The same treatment would be incompatible with the principle of fiscal neutrality and would open a broad field for tax-planning arrangements, distorting economic reality. At the same time, different treatment requires clear distinction between these two types of leasing agreements in order to preserve consistency. Lack of universal criteria applicable in this context has become one of the reasons why IASB decided to abandon current classification and introduced a new one in its proposals relating to the reform of accounting rules for leases.

Unfortunately, the VAT Directive, like the Sixth Directive before, does not provide for any rules in respect of the VAT treatment of leasing agreements, except those exempting leases of immovable property from VAT. As a result, the CJEU retains wide discretions in this field. Within long period of time the CJEU had been treated all leases as supplies of services since, in its view, it was uncertain whether ownership would be finally transferred. However, after economic interpretation of ownership has become a part of CJEU well-established case law, this reasoning is no longer valid.

Pursuant to criteria set out by the CJEU in *Eon Asset*, if financial lease provides for the transfer of substantially all risks and rewards, incidental to ownership, to the lessee, it constitutes a supply of goods for VAT purposes. However, significance of this judgment, huge at a first glance, should not be overestimated. At the present stage its outcome looks like “illusion of certainty”: despite the fact that distinction between the VAT treatment of operational and financial leases has been drawn, the application of the test proposed by the CJEU may be quite difficult without further interpretation even in the context of ordinary car lease, as it could be seen from *BCR Leasing*. It seems that future case law of the CJEU will impose strict limits on the application of *Eon Asset* ruling.

¹⁶¹ *Ibid.*, para 14.

Significant concern is being raised now regarding the right to deduct input VAT in respect of financial lease transactions. Approach that has been developed in *Eon Asset*, allowing deductions of input VAT to be made upfront, is consistent with previous CJEU case law, but its application is possible only provided that financial lease, together with hire purchase and installment sale agreements, falls within the scope of Article 14(2)(b) of the VAT Directive. To date, case of *Eon Asset* remains the only example of application of this provision to a leasing contract, and it is difficult to make any general conclusions in this respect. As it seems from recently decided cases of *BCR Leasing* and *BGZ Leasing*, position expressed by the CJEU in *Eon Asset* constitutes exception rather than general rule.

We submit that the VAT treatment of financial and operational leases based on *Eon Asset* ruling corresponds to the requirements of fiscal neutrality. In particular, having compared financial lease to similar transactions, such as hire purchase or sale on deferred terms, it is possible to conclude that their different treatment cannot be justified by any objective reason. Interest incurred in respect of these transactions must be also assigned to the same treatment. With regards to anticipated adoption of new IFRS for leases, it seems that independent model of the VAT treatment, such as that constructed in *Eon Asset*, is the best possible solution. On the one hand, it takes proper account of economic reality, on the other, addresses specific needs of the uniform system of European VAT in the most efficient manner.

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