

Tax & Legal Weekly Alert

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Proposal to amend VAT treatment in case of leasing transactions

During the Government meeting on the 12th of June 2019, it was duly noted the proposal to amend the Tax Code in order to bring national legislation in line with the Court of Justice of the European Union's (CJEU) decision in Case C-164/16 Mercedes-Benz, according to which (financial) leasing operations constitute supplies of goods.

Draft law on public procurement and concessions

The National Public Procurement Agency has proposed a draft law with respect to the public procurement and concessions legislation.



Proposal to amend VAT treatment in case of leasing transactions

Through the memorandum presented at the Government meeting on June 12, 2019, the Ministry of Public Finance proposed to the Government the amendment of the national VAT legislation in order to qualify the financial leasing operations as supplies of goods.

This measure comes as a result of the judgment in case C-164/16 Mercedes Benz UK of 4 October 2017 decided at the Court of Justice of the European Union (CJEU), according to which, under certain conditions, financial leases should be considered supplies of goods and not services, a decision with which national legislation in the matter is not aligned.

The amendment was proposed with the aim of avoiding a potential infringement procedure against Romania for not complying with the EU VAT law and considering that the other EU member states were already following the VAT principles stated in the Mercedes-Benz case (as implemented through their national legislations).

Summary of the case

In the case brought before the CJEU, Mercedes Benz UK offers three types of vehicle financing contracts:

- **a standard lease agreement called "Leasing"**, which explicitly excludes the transfer of ownership and sets a maximum mileage that the user can use (without penalties). This contract is treated as a service provision (not disputed by the authorities);
- **a "Hire-Purchase" agreement**, stipulating a transfer of ownership (in theory, optional) and monthly rates that sum up to approximately equal to the sale value of the good (including the financing cost), a modest amount being paid at the end of the contract ("the option fee"). This contract is treated as a supply of goods (not disputed by the authorities);
- **a lease with a purchase option named "Agility"**, stipulating a transfer of ownership (optional), the monthly rates being lower than under the "Hire-Purchase" agreement and the value of "the option fee" being significantly higher (estimated 40% of the sale price of the good). Approximately half of all the lessees choose to buy the good. In this case, the UK tax authorities had a different interpretation from that of Mercedes Benz (which considers the agreement a supply of services) so that the case in question reached the CJEU.

Consequently, the CJEU had to rule on the interpretation of the phrase "*contract for hire which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment*" provided by art. 14 par. (2) lit. (b) of the VAT Directive in the Mercedes Benz UK case.

The Court concluded that in order to consider such agreement supply of goods it is necessary that:

- 1) The agreement should contain *an express clause on the transfer of ownership* (i.e. the transfer of ownership) - a condition considered to be fulfilled, for example, in the case of a purchasing option;

- 2) It must be clear from the terms of the contract, as objectively assessed at the time when it is signed, that *the ownership of the goods is intended to be acquired automatically by the lessee if performance of the contract proceeds normally, over the full term of the contract*. Such case arises when - even in the presence of a "purchase option" (formal option) - it appears in fact that the option to acquire the goods, given the financial terms of the agreement, *seems to be the only economically rational choice the lessee can make* (for example, if at the date of exercise option, the amount of the paid rates is approximately equal to the market value of the good, including the cost of financing it).

Therefore, under certain conditions, the leasing contracts for the use of the goods should be seen as a supply of goods (with payment in instalments) from a VAT perspective.

National VAT law implications

Nowadays, the Romanian tax legislation qualifies all leasing as supply of services, the VAT being due on a gradual basis at each contractual date for the payment of each instalment for the entire period of the contract.

Only at the end of the leasing period, depending on the lessee's option, if the ownership of the good is transferred to the lessee, the transaction is considered supply of goods, the VAT base for the supply being the amount at which the transfer is performed.

Moreover, national law distinguishes between leasing operations (which are considered supplies of services) and supplies of goods in instalments, establishing for these transactions different moment when the VAT payment obligation arises.

With the amendment of the legislation to qualify the financial leases as supply of goods (provided the criteria stated by the CJEU is met), *the companies performing financial leasing transactions will be required to collect and pay to the state budget the VAT on the full value of the good subject to the contract as of the date of making the good available to the lessee*. This action will have an important cash flow impact and an additional burden for the clients who will pay a higher advance.

Unfortunately, the memorandum submitted to the Government does not address the query of the ongoing lease contracts, respectively transitory measures proposals, in order for the leasing companies' activity to be as little as possible disturbed. From our perspective, at the moment when the law will be amended, the option with the least implications would be to maintain for the ongoing contracts the VAT treatment applicable when their signing took place (i.e. leasing as a supply of service).

To the extent that the alignment of national legislation with the Community law regarding leasing operations will be decided, companies in this sector will have to analyze in detail the types of contracts and, depending on the characteristics of each, decide whether to classify them as supplies of goods with instalments or supplies of services (based on the guidelines issued by the CJEU).

The retroactive effect of the decision

One of the memorandum's mentions is that the taxpayer's right to prevail on the VAT principles of the CJEU in front of the tax authority in order to compensate for an incurred loss.

In this case, we wish to mention that the reverse effect is not possible. More precisely, in case of a tax audit, the tax inspectors cannot re-classify the VAT treatment applied by the leasing companies during the audited period, since a member state cannot avail on its own different application of community law provisions into national law against the taxpayer (i.e. of the additional mention from the Romanian law stating that leasing transactions are considered supplies of services).

For further questions regarding the aspects mentioned in this alert, please contact us.



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Draft law on public procurement and concessions

The National Public Procurement Agency has proposed at the end of May 2019 a draft law with the purpose of amending and complementing the public procurement and concessions legislation in Romania. Such draft law is currently undergoing the public debate stage.

The legislative project concerns various provisions under Law no. 98/2016 on public procurement, Law no. 99/2016 on sectorial public procurement and Law no. 100/2016 on concessions of works and services, aimed at improving the transposition of the European Directives into the national legislation.

The National Public Procurement Agency's initiative comes as result of the infringement procedure launched by the European Commission against several European countries for failure to transpose in a proper manner the European Directives on public procurement and concessions.

Main topics covered by the draft law refer to measures addressing the protection of competition and clarification of the substantial modification of public procurement and concession contracts.

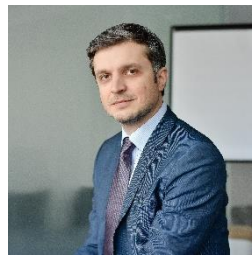
To this end, the draft law provides:

- The possibility of the candidates who were involved in the preparation of the awarding procedure to prove, prior to their exclusion from the procedure, that their involvement cannot affect the competition;
- The obligation of the contracting authorities to evaluate the measures taken by the economic operators for avoidance of their exclusion from the procedure, taking into account the importance and particular circumstances of the criminal offence or misconduct considered reasons for exclusion;
- A complete alignment with the European directives on public procurement regarding the substantial amendment of the public procurement contracts during their term;
- As regards Law no. 100/2016 on work concessions and services concessions, a new provision was introduced with the purpose of expressly regulating the fact that the awarding criteria should be provided in a way that does not allow contracting authorities an unrestricted freedom of evaluation.

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