

VAT DUTIES & INDIRECT TAX LAW

WEALD LEASING ~ A CURATE'S EGG IS SENT BACK TO THE DOMESTIC COURTS

CASE C-103/09 WEALD LEASING

MELANIE HALL QC

First published in the Tax Journal, 13 January 2011

www.taxjournal.com

On 22 December the European Court of Justice delivered its long-awaited judgment in the Weald Leasing case concerning the interpretation of the concept of an 'abusive practice' as referred to in Case C 255/02 Halifax, Case C-425/06 Part Service and Case C-162/07 Amplisientifica.

The Court of Appeal made a reference for a preliminary ruling concerning a leasing structure entered into by the Churchill Group of companies. By the time the case had reached the High Court (although not at Tribunal level) it was accepted that the aim of the leasing structure under consideration was to divide and spread the payments made for assets used by the business in order to defer the VAT liability of the Churchill Group.

The Churchill Group of Companies predominantly supplies exempt insurance services. Churchill Management Ltd ('CML') and its subsidiaries, Churchill Accident Repair Centre ('CARC') and Weald Leasing, are members of the Churchill Group. The Churchill Group, CML and CARC have an input VAT recovery rate of about 1%.

Weald Leasing's only trading activity consisted of purchasing the assets in question and leasing them out to Suas Ltd which is not part of the Churchill Group but is owned by a VAT consultant to the Churchill Group and his wife. The only significant trading activity of Suas Ltd was leasing assets from Weald Leasing and then subleasing them to CML and CARC.

When CML or CARC needed new equipment, it was purchased by Weald Leasing, which leased it to Suas, which, in its turn, subleased it to CML or CARC.

By resorting to that series of transactions, CML and CARC avoided having to make an outright purchase of assets they needed or to pay the total amount of non-deductible VAT on those purchases in a single sum. CML and CARC were only immediately liable for the amount of rent relating to that equipment, spread over the term of the leasing agreements.

THE DISPUTE WITH THE COMMISSIONERS

The Commissioners raised VAT assessments disallowing the deduction by Weald Leasing of the input VAT paid on the ground that the transactions at issue were not economic activities and constituted an abuse of rights. Weald Leasing appealed against the assessments, arguing that those transactions had not been entered into solely to obtain tax advantages and that making taxable supplies of equipment by means of leasing agreements was not contrary to the purpose of the Sixth Directive.

After the judgment in *Halifax* was delivered, the Commissioners were compelled to abandon their argument that the leasing transactions at issue were not economic activities and argued instead that those transactions constituted an abusive practice.

THE COURSE OF THE LITIGATION

The VAT and Duties Tribunal held that the essential aim of the transactions was to obtain a tax advantage, consisting in the deferral of the Churchill Group's VAT liability through the conclusion of leasing agreements, but that the advantage was not contrary to the relevant provisions of the Sixth Directive. It also held that any abuse did not arise from the leases themselves, but from the level of rentals under the leases and from the arrangements to avoid an open market direction from the Commissioners under Schedule 6 to the VAT Act 1994 by reason of the connection between Weald and CML and CARC. The Commissioners lost their appeal to the High Court.

The Commissioners appealed to the Court of Appeal arguing that it would be contrary to the purpose of the Sixth Directive to allow a taxpayer to deduct input VAT secured as a result of transactions which had no genuine commercial purpose, which were not at arm's length, which did not carry the burdens and risks typically associated with such transactions and which had not taken place as part of the participants' normal commercial operations.

C-103/09 WEALD LEASING

THE REFERENCE MADE BY THE COURT OF APPEAL

By the time the case reached the Court of Appeal both parties agreed that a reference should be made to the ECJ. The particular cause for concern was that in *Ampliscientifica* the ECJ appeared to equate the concept of normal commercial operations with an abusive practice but made no mention of that concept in *Part Service*. The Court of Appeal accepted that the position with regard to normal commercial operations was unclear. However, the reference it decided to make was more far reaching.

CONTRARY TO PURPOSE – A FACTUAL MATTER FOR THE DOMESTIC COURTS

The essence of the first and second questions was whether, in the circumstances of the leasing scheme under consideration it was an abusive practice to enter into leasing transactions involving an intermediate third party company if that undertaking does not engage in leasing transactions in the context of its normal commercial operations.

It is a common misconception that the issue in *Weald* was whether the mere fact of leasing as opposed to purchasing would render any tax advantage thereby generated contrary to the purpose of the VAT Directive. Readers should therefore be cautious about that part of the judgment which confirms that a taxable person cannot be criticised for choosing to lease when he could have purchased outright. As the court records, that much was common ground. To hail the judgment as a victory for *Weald* or other taxpayers engaged in leasing transaction would therefore be to misunderstand the essence of the case.

The Commissioners' argument was that it would be contrary to purpose to retain a tax advantage generated by agreements which were commercially hollow, not at arm's length, and which would not be recognised in any open market. The Court accepted that there may be features of the Churchill transactions which could render their particular leasing arrangements contrary to purpose. This is the nub of the case. In that context, the Court bounced the key factual issues back to the domestic arena.

The first key issue is whether the *contractual terms* of the leasing transactions are contrary to purpose. The Court found that that would particularly be the case if the rentals were set at levels which were unusually low or did not reflect any economic reality because they did not correspond to arm's length terms. This is a factual issue, the outcome of which will depend upon a close forensic examination of the particular terms and conditions adopted in *Weald*. If it is found on further argument that the rents were unusually low or did not reflect arm's

length terms, then the domestic courts would be bound to conclude that the arrangements are contrary to purpose.

The second key issue which has been left to the domestic courts to determine is whether the involvement of Suas, an intermediate third party company was such as to preclude the issue of an open market value direction. The court rejected the argument that the principle of abusive practices does not apply to this purely domestic provision which was adopted on the basis of Article 27 of the Sixth Directive and forms part of the national implementing legislation.

NORMAL COMMERCIAL OPERATIONS – AN IRRELEVANCE

The Court concluded that this was an irrelevant consideration. The correct approach is to identify the object and effects of the transactions under consideration, as well as their purpose. Although the Court did not expressly adopt the Advocate General's opinion that the analysis is objective and not subjective, it is to my mind inconceivable that by referring to the purpose and the objects of a series of transactions the Court was endorsing a subjective approach – a proposition which was emphatically rejected by the Advocate General.

RE-DEFINITION – A FACTUAL MATTER FOR THE DOMESTIC COURTS

The Court was asked how the leasing transactions should be redefined, if they or any part of them constituted an abusive practice. Once again, it bounced this issue back to the domestic arena concluding that it was a matter for the referring court to determine, on the basis of the guidance provided in reply to the first and second questions, whether certain elements of the leasing transactions constituted an abusive practice. If that were the case, it would also be for that court to redefine those transactions so as to re-establish the situation that would have prevailed in the absence of the elements constituting that abusive practice. This too is an issue whose outcome will depend upon a forensic examination of the particular facts in *Weald* since the scope of the abuse determines the scope of the appropriate remedy. The Court identified two possible outcomes, which were by no means exhaustive. The first is to disregard the existence of Suas, the intervening third party. The second is to vary or to disapply the contractual terms which were contrary to purpose by reason of the Court's answer to the first and second questions.

OVERALL ASSESSMENT

For those seeking clarity with regard to the status of leasing arrangements in the field of abusive practices, the judgment in *Weald* is a curate's egg. The Court has clarified that the concept of normal commercial operations is not relevant. It has also made clear that it is the manner in which assets are leased that will determine whether the arrangements are abusive. However, as far as the outcome of the key factual issues is concerned, the saga continues.

Melanie Hall QC and Raymond Hill represented the Commissioners