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ARO LEASE BV v INSPECTEUR DER BELATINGDIENST GROTE ONDERNEMINGEN, AMSTERDAM[1]

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Introduction

Is this a case that we have been waiting for or not? In 1994, UK accountancy firms started to promote cross border leasing of motor cars as a VAT efficient way of acquiring cars. Why? Because in the UK, VAT could not be recovered if you bought a company car[3] nor if you leased it. What was even worse was that if you leased company cars, whilst you had to charge VAT on the rental you still could not recover VAT on the car! In contrast our European neighbours allowed leasing businesses to recover VAT and consuming businesses to recover all or some of their VAT. It all seemed like too much of an opportunity to miss. It is the concept of cross-border leasing being taxed in the country of the lessor which the European Court of Justice ("ECJ") has now upheld. However, HM Customs & Excise (the UK authority responsible for VAT) were strongly of the view that the law did not allow this and issued a public statement to this effect.[4] Given that this authority's view on what is and is not permissable VAT avoidance, is a matter of considerable debate at the moment, this historical note only serves to demonstrate that their view even negates the law. At least the case was arguable.

The decision is proving unpopular for a number of reasons which I will discuss below; but let us first look at what the decision said.

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1 Case C-190/95 [1997] I ECR 4383.

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3 In this article a company car is used to mean a typical company car, i.e.one provided by an employer to an employee for business purposes but which the employee may also use for his or her private business.

4 Business Brief 14/94 dated 6th July 1994.

Judgment of the ECJ

ARO Lease BV is a Dutch leasing company. It leases cars. Although it has no offices, storage facilities or staff in Belgium, it does have Belgian customers. These are referred to it by independent intermediaries. It took the view that it was providing a lease of a form of transport and that the place of its supply was the Netherlands. The Belgian tax authorities, maintaining that ARO had a 'fixed establishment' in Belgium, maintained that Belgian VAT was due. ARO did not mind either way until the Dutch authorities refused to repay the VAT paid to them by ARO on the basis that ARO had no Belgian establishment. Hence, the case against the Amsterdam tax inspector.

VAT is charged on a taxable supply by a taxable person. Which member state is entitled to VAT is determined by the place of supply.

Leasing is a supply of services.[5] The general rule is that services are supplied at the place at which the supplier belongs. A supplier belongs at his fixed place of business but if he has more than one and they are in different member states, then the place of supply is the establishment with which the supply is most closely connected.[6] Given the facts above then unless the independent agents could be regarded as an establishment of ARO then ARO could only have a place of supply in the Netherlands.

For completeness one should also mention Article 9(2)e which provides that the leasing of movable property is supplied in the member state of the customer. This article applies to all movable property *except forms of transport*. No one argued that this article applied.

The judgment harks back to the case of *Berkholz*[7] which stated that a fixed establishment needed human and technical resources of the organisation to be capable of being regarded as such. Independent agents i.e. human and technical resources of someone else, was not a fixed establishment.

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5 Article 6 Sixth Directive EC/77/388. It is understood that initially the Belgian tax authorities argued that the supply was a supply of goods in Belgium but rapidly abandoned that view for the one argued in court.

6 Article 9(1) Sixth Directive.

7 *Berkholz v Finanzamt Hamburg-Mitte-Aldstadt* [1985] ECR 2251.

One issue not addressed although touched on elsewhere in another context[8] is to what extent, if at all, a third party can be regarded as a fixed establishment of some one else.

Given the facts, ARO was established only in the Netherlands so, if I lease a car from ARO Lease BV then I pay Dutch VAT and not UK VAT. If I am a taxable person I can recover that VAT pursuant to the Eighth VAT Directive.[9] Given that VAT reclaimed under the Eighth Directive takes some time to recover, naturally I would prefer to pay UK VAT and recover it through my VAT return. Indeed for means of transport, the recovery of input tax on which is not blocked e.g. lorries, the ARO decision can cause significant cash flow costs. Others wanted ARO to lose for other reasons.

Do I not like that!

The Court's decision has not been popular. This has been mainly for domestic budgetary reasons. However, whilst having regard to these, what I would like to do is examine where we stand and where might we go in the context of private use of business assets and, in particular, cars.

This raises the following issues:

- is the *Berkholz/ARO* test for a fixed establishment the right one? (particularly bearing in mind that the ECJ is not bound by its own decisions and could change its view in the future);
- how do the views or wishes of the various member states impact upon the likelihood of the origin system coming into effect?
- the VAT treatment of company cars in the EU is far from harmonised which, given the size of the European company market, is a significant economic issue to be addressed.

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8 See *Customs & Excise v DFDS A/S* Case C-260/95 [1997] STC 384 in the context of the tour operators margin scheme.

9 Directive 79/1072. The Dutch authorities are however more generous than UK authorities in the proportion of VAT they will repay.

Fixed establishment

In ARO the French, Belgian and German governments and the Commission all made submissions to the effect that ARO did have an establishment in Belgium and ought to be taxed there. The reasons for this were variously:

- that the mere presence of a significant amount of assets (800 cars in this case) generating income must be capable of being a fixed establishment. Personally, I cannot see how 800 very mobile chattels could ever be regarded as fixed; and

- that VAT, being a tax on consumption, should be taxed at the place of consumption, and that Article 9(1) ought to be construed so as to achieve this result.

However, VAT is not the only product of the European legal system. There are many other directives, e.g. those which regulate the financial services industry which also use a fixed establishment/branch/agency test. Are these tests to be regarded as internally consistent or are they all independent, such that whilst one can be required to register for one purpose one might not be required to register for another? Would this not make commercial life extremely complicated and allow those who wished to abuse the various tests to do so?

I think that there is no way in which it could rightly be said that ARO had, or should have been regarded as having, a business establishment in Belgium. To do so would divorce the tax from economic reality and commercial sense.

The origin system

The introduction of VAT was seen as a necessary pre-requisite to the completion of the single market: the fulfilment of the aim of the Treaty of Rome to create a single economic area free from distortion of competition. If the EC is successful, then surely the logical consequence is free trade all over Europe. Hence, one should expect Dutch leasing companies to lease cars in the UK, Sweden, Italy and Austria and for no one to be in the least surprised.

The problem for the various member states is that they believe that *their* citizens should pay taxes to *them* and not to another member state. This is where the debate really becomes potentially interesting because as you will already be aware the origin system will be based on taxing by reference to the place of the supplier and not of consumption. If there is this much opposition in the context of very mobile items such as cars, what hope is there for everything else? Indeed, if Economic and Monetary Union brings in a single currency in some member states, making retail prices directly comparable (rather than working out if FF10 is more or less than DM3 you can compare 4 Euro with 3 Euro) then the mobility of

consumer spending can only increase thus increasing the likelihood of similar issues arising.

VAT treatment of cars and other private use items

Article 17(6) of the Sixth Directive provides that VAT cannot be recovered on items which are not strictly business expenditure, and to give us a clue as to what this means, the article then lists luxuries, amusements and entertaining. Hence, on the face of it, a company car should attract full VAT recovery on the basis that it is either used for business purposes or, when it is not, forms part of the remuneration package of the employee which is also a business purpose. Whilst remuneration is not consideration for a supply,[10] Article 6(2)(a) states that the use of an asset of the business for the private use of staff is deemed to be a supply of services.[11] However, this charge on a deemed supply can only arise if input tax has been recovered on the acquisition of the asset and has not been blocked by Article 17(6). What is or is not covered by Article 17(6) is supposed to have been agreed between the member states and indeed a draft Twelfth Directive was published but has now been withdrawn.

The current position is that the treatment of the private use of cars and other assets is far from uniform. Given the future advent of a single currency and the current freedom of movement of workers, such distinctions remain ripe for exploitation. The answer is not to try and stretch the existing law but to start and face the consequences of a developing economic and political European system.

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10 Article 4(4) Sixth Directive.

11 See, for example, *Lennartz v Finanzamt Munchenn III* [1995] STC 514.