

# PCP finance agreements – VAT

## Could your business benefit from a VAT cashflow advantage?

In the UK the Upper Tribunal has recently delivered its judgment in the VAT case of Mercedes-Benz Financial Services UK Ltd. The Tribunal concluded that under a Personal Contract Purchase (PCP) agreement title to the goods would not pass in the normal course of events. The appropriate VAT analysis would be to treat the sale as a supply of services with output VAT due on receipt of each monthly payment as opposed to upfront VAT at the start of the agreement.

While this is a UK decision which has been appealed by the UK tax authorities, it does offer some guidance on the interpretation of the equivalent Irish VAT legislation.

### Background

Traditionally, when financing a new vehicle purchase, a hire purchase agreement is structured with the total price of the vehicle spread over the life of the agreement. The finance is therefore amortised to nil at the end of the agreement, with the customer acquiring all the equity in the vehicle. Under this arrangement, it makes no sense for customers not to make the final payment.

Under a PCP, the customer makes relatively low monthly instalments and the finance company sets an expected residual value to be paid at the end of the agreement. This is only payable if the customer exercises an option to purchase the vehicle. PCP finance deals have become one of the most popular financing options in Ireland. In less than two years PCP finance options make up more than half of the finance deals provided by some leading car manufacturers.

### Technical analysis

Current Irish VAT legislation provides that the renting of goods for a certain period, subject to a condition that ownership of the goods shall be transferred to the person on a date not later than the date of payment of the final sum under the agreement, is a supply of goods with VAT payable upfront at the start of the agreement. This legislation must be construed in conformity with the EU VAT Directive.

Article 14.2(b) of Council Directive 2006/112/EC deems that an agreement for the sale of goods on deferred terms, which provides that in the normal course of events ownership is to pass, at the latest upon payment of the final instalment is a supply of goods.

Therefore under Irish legislation for a supply of goods to occur, the condition that ownership of the goods is transferred to the person not later than the date of payment of the final sum under the agreement must be expressed plainly in the terms and fulfilled. It has been established in the UK that in the majority of cases the option to purchase the vehicle is not taken under PCP. The fundamental point for EU law is whether, in the normal course of events, title will pass to the customer. Again in PCP agreements, it is more likely than not that the customers will choose to return the vehicle or take a replacement vehicle. In most cases, therefore, title in the vehicle does not pass and as a consequence, the supply is not a supply of goods but is a supply of services.

### Mercedes-Benz Financial Services (MBFS)

In the UK, MBFS argued that the correct VAT treatment of the 'Agility' product was a supply of services, chargeable to output VAT each time the

customer was liable to make a payment. The UK tax authorities however argued that the output VAT was chargeable at the commencement of the agreement on the basis that UK legislation requires only the possibility that the title of the goods would pass, not inevitability. The Upper Tribunal has agreed with MBFS concluding that the agreement is a contract which may well lead to a sale of the vehicle but, equally, may not and therefore is a supply of services.

### Key considerations

In light of this decision, a business should review the fact pattern in its PCP book to examine if this supports a claim for potentially overpaid output VAT.

A key concern is whether the finance charge under this analysis can remain exempt from VAT. If not, that may outweigh the cash-flow benefits of the MBFS-type analysis.

If the facts support a claim, and the finance charge can remain exempt, a four-year claim should be submitted to protect the potential claim value. As outlined above this is a UK case which is persuasive but not binding on Irish courts.

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