Case C-103/09

The Commissioners for Her Majesty's Revenue and Customs

v

Weald Leasing Ltd

(Reference for a preliminary ruling from the

Court of Appeal (England and Wales) (Civil Division) (United Kingdom))

(Sixth VAT Directive – Concept of 'abusive practice' – Leasing transactions effected by a group of undertakings to spread the payment of non-deductible VAT)

Summary of the Judgment

1. *Tax provisions – Harmonisation of laws – Turnover taxes – Common system of value added tax – Sixth Directive – Transactions constituting an abusive practice – Meaning*

(Council Directive 77/388)

2. *Tax provisions – Harmonisation of laws – Turnover taxes – Common system of value added tax – Sixth Directive – Transactions constituting an abusive practice*

(Council Directive 77/388)

1. The tax advantage accruing from an undertaking's recourse to asset leasing transactions, instead of the outright purchase of those assets, does not constitute a tax advantage the grant of which would be contrary to the purpose of the relevant provisions of Sixth Directive 77/388 on the harmonisation of the laws of the Member States relating to turnover taxes, as amended by Directive 95/7, and of the national legislation transposing it, provided that the contractual terms of those transactions, particularly those concerned with setting the level of rentals, correspond to arm's length terms and that the involvement of an intermediate third party company in those transactions is not such as to preclude the application of those provisions, a matter which it is for the national court to determine.

The fact that the undertaking does not engage in leasing transactions in the context of its normal commercial operations is irrelevant in that regard. A finding that there was an abusive practice is inferred, not from the nature of the commercial operations usually engaged in by the party which made the transactions, but from the object, purpose and effects of those transactions.

(see paras 44-45, operative part 1)

2. If certain contractual terms of leasing transactions to which an undertaking has recourse and/or the intervention of an intermediate third party company in those transactions constitute an abusive practice, those transactions must be redefined so as to re-establish the situation that would have prevailed in the absence of the elements of those contractual terms which are abusive and/or in the absence of the intervention of that company. In that context, the redefinition must go no further than is necessary for the correct charging of the value added tax and the prevention of tax evasion.

(see paras 52-53, operative part 2)

JUDGMENT OF THE COURT (Third Chamber)

22 December 2010 (*)

(Sixth VAT Directive – Concept of ‘abusive practice’ – Leasing transactions effected by a group of undertakings to spread the payment of non-deductible VAT)

In Case C?103/09,

REFERENCE for a preliminary ruling under Article 234 EC from the Court of Appeal of England and Wales (Civil Division) (United Kingdom), made by decision of 24 February 2009, received at the Court on 13 March 2009, in the proceedings

The Commissioners for Her Majesty’s Revenue and Customs

v

Weald Leasing Ltd,

THE COURT (Third Chamber),

composed of K. Lenaerts, President of the Chamber, D. Šváby, R. Silva de Lapuerta (Rapporteur), E. Juhász and T. von Danwitz, Judges,

Advocate General: J. Mazák,

Registrar: L. Hewlett, Principal Administrator,

having regard to the written procedure and further to the hearing on 3 June 2010,

after considering the observations submitted on behalf of:

– Weald Leasing Ltd, by M. Conlon QC and N. Shaw, Barrister, instructed by S. Walsh, Solicitor,

– the United Kingdom Government, by S. Ossowski, acting as Agent, assisted by M. Hall, Barrister,

– Ireland, by D. O'Hagan, acting as Agent, assisted by A. Aston SC,

– the Greek Government, by G. Kanellopoulos, S. Trekli and M. Tassopoulou, acting as Agents,

– the Italian Government, by G. Palmieri, acting as Agent, assisted by F. Arena, avvocato dello Stato,

– the European Commission, by R. Lyal and M. Afonso, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 26 October 2010,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of the concept of 'abusive practice', as referred to in the judgments in Case C?255/02 *Halifax and Others* [2006] ECR I-1609, Case C-425/06 *Part Service* [2008] ECR I-897 and Case C-162/07 *Ampliscientifica and Amplifin* [2008] ECR I-4019.

2 The reference has been made in proceedings between the Commissioners for Her Majesty's Revenue and Customs ('the Commissioners') and Weald Leasing Ltd ('Weald Leasing') regarding value added tax ('VAT') charged to that company on account of certain leasing transactions which it had effected.

Legal context

European Union ('EU') legislation

3 Article 2(1) of Sixth 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 (OJ 1977 L 145, p. 1), as amended by Council Directive 95/7/EC of 10 April 1995 (OJ 1995 L 102, p. 18) ('the Sixth Directive'), provides:

'The following shall be subject to [VAT]:

1. the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such.'

4 Article 17(2)(a) of the Sixth Directive, in the version resulting from Article 28f thereof, provides:

'In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:

(a) [VAT] due or paid within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person.'

5 Article 27 of the Sixth Directive is worded as follows:

‘1. The Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance. Measures intended to simplify the procedure for charging the tax, except to a negligible extent, may not affect the overall amount of tax due at the final consumption stage.

2. A Member State wishing to introduce the measures referred to in paragraph 1 shall inform the Commission of them and shall provide the Commission with all relevant information.

3. The Commission shall inform the other Member States of the proposed measures within one month.

4. The Council’s decision shall be deemed to have been adopted if, within two months of the other Member States being informed as laid down in the previous paragraph, neither the Commission nor any Member State has requested that the matter be raised by the Council.

5. Those Member States which apply on 1 January 1977 special measures of the type referred to in paragraph 1 above may retain them providing they notify the Commission of them before 1 January 1978 and providing that where such derogations are designed to simplify the procedure for charging tax they conform with the requirement laid down in paragraph 1 above.’

National legislation

6 Paragraph 1(1) in Schedule 6 to the Value Added Tax Act 1994 (‘the VAT Act 1994’) provides:

‘Where-

(a) the value of a supply made by a taxable person for a consideration in money is (apart from this paragraph) less than its open market value, and

(b) the person making the supply and the person to whom it is made are connected, and

(c) if the supply is a taxable supply, the person to whom the supply is made is not entitled under sections 25 and 26 to credit for all the VAT on the supply,

the Commissioners may direct that the value of the supply shall be taken to be its open market value.’

The dispute in the main proceedings and the questions referred for a preliminary ruling

7 The Churchill Group of Companies (‘the Churchill Group’) predominantly supplies insurance services exempt from VAT.

8 Churchill Management Ltd (‘CML’) and its subsidiaries, Churchill Accident Repair Centre (‘CARC’) and Weald Leasing, are members of the Churchill Group.

9 CML and CARC have an input VAT recovery rate of about 1%, so that, when they purchase equipment, they may deduct only 1% of the VAT on the purchase of that equipment.

10 Weald Leasing’s trading activity consists in purchasing the assets in question and then leasing them out.

11 Suas Ltd (‘Suas’) is a company owned by a VAT consultant to the Churchill Group and his

wife but is not part of that group. Its only significant trading activity is leasing assets from Weald Leasing and then subleasing them to CML and CARC.

12 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.

13 By resorting to that series of transactions, CML and CARC avoided having to purchase outright the equipment they needed or to pay in a single sum the total amount of non-deductible VAT on those purchases.

14 The aim of those transactions was to divide and spread the payment of that amount in order to defer the Churchill Group's VAT liability.

15 CML and CARC were not immediately liable for the non-deductible VAT on the total cost of the equipment purchased, but on the amount of rent relating to that equipment, spread over the term of the leasing agreements.

16 The Commissioners raised VAT assessments disallowing the deduction by Weald Leasing of the input VAT paid on the assets leased between October 2000 and October 2004, on the ground that the transactions at issue were not economic activities and constituted an abuse of rights.

17 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.

18 After the judgment in *Halifax and Others* was delivered, the Commissioners abandoned their argument that the leasing transactions at issue were not economic activities and argued only that those transactions constituted an abusive practice.

19 By decision of 7 February 2007, the VAT and Duties Tribunal held that the essential aim of those 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.

20 The VAT and Duties Tribunal held also that any abuse could only arise not from the leases themselves, but from the level of rentals under the leases and from the arrangements to avoid a Direction from the Commissioners under Schedule 6 to the VAT Act 1994.

21 The Commissioners appealed against that decision to the Chancery Division of the High Court of Justice of England and Wales on the ground that the tax advantage obtained by the Churchill Group was contrary to the purpose of the Sixth Directive.

22 By judgment of 16 January 2008, the Chancery Division of the High Court of Justice of England and Wales dismissed the Commissioners' appeal against that decision, on the ground that the fact that the transactions at issue were not carried out in the context of normal commercial operations was not sufficient to conclude that they were an abusive practice, since the tax advantage obtained by the Churchill Group by having recourse to those transactions was not contrary to the principle of fiscal neutrality or to any other provision of the Sixth Directive.

23 The Commissioners appealed to the referring court on the ground that the Chancery Division of the High Court of Justice of England and Wales had failed to examine the question whether the leasing transactions at issue were part of the participants' normal commercial operations. They argued 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.

24 In those circumstances the Court of Appeal of England and Wales (Civil Division) decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

'(1) In circumstances such as those that exist in the present case, where a largely exempt trader adopts an asset leasing structure involving an intermediate third party, instead of purchasing assets outright, does the asset leasing structure or any part of it give rise to a tax advantage which is contrary to the purpose of the Sixth Directive within the meaning of paragraph 74 of the [j]udgment in … *Halifax [and Others]*?

(2) Having regard to the fact that the Sixth VAT Directive contemplates the leasing of assets by exempt or partly exempt traders, and having regard to the Court's reference to "normal commercial operations" in paragraphs 69 and 80 of the [j]udgment in *Halifax [and Others]* and 27 of [the judgment in] *Ampliscientifica [and Amplifin]* and also to the absence of any such reference in the [j]udgment in … *Part Service*, is it an abusive practice for an exempt, or partly exempt, trader to do so even though in the context of its normal commercial operations it does not engage in leasing transactions?

(3) If the answer to question 2 is yes:

(a) what is the relevance of "normal commercial operations" in the context of paragraphs 74 and 75 of the [j]udgment in *Halifax [and Others]*: is it relevant to paragraph 74 or to paragraph 75 or to both;

(b) is the reference to "normal commercial operations" a reference to:

(1) operations in which the taxpayer in question typically engages;

(2) operations in which two or more parties engage at arm's length;

(3) operations which are commercially viable;

(4) operations which create the commercial burdens and risks typically associated with related commercial benefits;

(5) operations that are not artificial in that they have commercial substance;

(6) any other type or category of operations?

(4) If the asset leasing structure or any part of it is found to constitute an abusive practice, what is the appropriate redefinition? In particular, should the national court or the tax collecting authority:

(a) ignore the existence of the intermediate third party and direct that VAT be paid on an open market value of the rentals;

(b) redefine the leasing structure as an outright purchase; or

(c) redefine the transactions in any other way which either the [national] court or the tax

collecting authority considers to be an appropriate means by which to re-establish the situation that would have prevailed in the absence of the transactions constituting the abusive practice?'

The questions referred

The first and second questions

25 By its first and second questions, which it is appropriate to examine together, the national court asks, in essence, whether the fact that an undertaking resorts to asset leasing transactions such as those at issue in the main proceedings, involving an intermediate third party company, instead of purchasing assets outright, results in the accrual of a tax advantage the grant of which is contrary to the purpose of the Sixth Directive and whether, if that undertaking does not engage in leasing transactions in the context of its normal commercial operations, resort to such transactions constitutes an abusive practice.

26 It should be recalled that the application of EU legislation cannot be extended to cover abusive practices by economic operators, that is to say, transactions carried out, not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for under EU law and that that principle of prohibiting abusive practices also applies to the sphere of VAT (see *Halifax and Others*, paragraphs 69 and 70, and *Ampliscientifica and Amplifin*, paragraph 27).

27 On the other hand, a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system. Where the taxable person chooses one of two transactions, the Sixth Directive does not require him to choose the one which involves paying the higher amount of VAT. On the contrary, taxpayers may choose to structure their business so as to limit their tax liability (see *Halifax and Others*, paragraph 73, and *Part Service*, paragraph 47).

28 In that context, the Court has held that, in the sphere of VAT, finding that an abusive practice exists requires that two conditions be met.

29 First, notwithstanding formal application of the conditions laid down in the relevant provisions of the Sixth Directive and in the national legislation transposing it, the transactions concerned must result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions (see *Halifax and Others*, paragraph 74, and *Part Service*, paragraph 42).

30 Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. The prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages (see *Halifax and Others,* paragraph 75, and *Part Service*, paragraph 42).

31 As regards the main proceedings, the decision making the reference states that the essential aim of the leasing transactions at issue in the main proceedings was to obtain a tax advantage, namely spreading the payment of the VAT on the purchases in question, so as to defer the Churchill Group's VAT liability.

32 However, before it can be concluded that there was an abusive practice, it must also be the case that, notwithstanding formal application of the conditions laid down in the relevant provisions of the Sixth Directive and the national legislation transposing it, that tax advantage is contrary to

the purpose of those provisions.

33 In that regard, it should be pointed out that the leasing transactions come within the scope of the Sixth Directive and that the tax advantage that could arise through recourse to such transactions does not, in itself, constitute a tax advantage the grant of which would be contrary to the purpose of the relevant provisions of that directive and the national legislation transposing it.

34 A taxable person cannot be criticised for choosing a leasing transaction which procures him an advantage consisting, as is apparent from the decision making the reference, in spreading the payment of his tax liability, rather than a purchase transaction which does not procure him any such advantage, provided that the VAT on that leasing transaction is duly and fully paid.

35 It is not disputed that that is the position as regards the VAT on the leasing transactions at issue in the main proceedings and that, for each of those transactions, the companies concerned have paid the correct amount of output VAT and deducted, when they could, the correct amount of input VAT.

36 In fact, if Weald Leasing was entitled to deduct VAT on the assets it purchased, it was because it carried on, not insurance business, but leasing activities subject to, and not exempt from, VAT.

37 Likewise, CML and CARC did not deduct the VAT on the rentals paid to Suas, because 99% of it was irrecoverable.

38 Furthermore, resort to a leasing transaction in respect of an asset does not automatically mean that the amount of VAT on that transaction will be less than would have been paid if the asset had been purchased.

39 That being so, the national court will have to determine, first, whether the contractual terms of the leasing transactions at issue in the main proceedings are contrary to the Sixth Directive and of the national legislation transposing it. That would particularly be the case if the rentals were set at levels which were unusually low or did not reflect any economic reality.

40 Secondly, the national court will also have to determine whether the involvement of an intermediate third party company, in this case Suas, in those transactions is such as to preclude the application of those provisions.

41 In that regard, the national court will have to ascertain whether, as is apparent from certain documents in the case file and as was stated at the hearing, the involvement of Suas in those transactions precluded the Commissioners from applying Paragraph 1 in Schedule 6 to the VAT Act 1994 so far as the transactions were concerned.

42 In that context, Weald Leasing’s argument that the principle of prohibiting abusive practices does not apply to breach of Paragraph 1 in Schedule 6 to the VAT Act 1994 because that provision is purely a question of national law cannot be accepted, because that provision was adopted on the basis of Article 27 of the Sixth Directive and forms part of the national legislation implementing that directive.

43 Moreover, the fact that an undertaking which resorts to leasing transactions such as those at issue in the main proceedings does not engage in leasing transactions in the context of its normal commercial operations does not affect the foregoing considerations.

44 A finding that there was an abusive practice is inferred, not from the nature of the commercial operations usually engaged in by the party which made the transactions in question,

but from the object and effects of those transactions, as well as their purpose.

45 In those circumstances, the answer to the first and second questions is that the tax advantage accruing from an undertaking's recourse to asset leasing transactions, such as those at issue in the main proceedings, instead of the outright purchase of those assets, does not constitute a tax advantage the grant of which would be contrary to the purpose of the relevant provisions of the Sixth Directive and of the national legislation transposing it, provided that the contractual terms of those transactions, particularly those concerned with setting the level of rentals, correspond to arm's length terms and that the involvement of an intermediate third party company in those transactions is not such as to preclude the application of those provisions, a matter which it is for the national court to determine. The fact that the undertaking does not engage in leasing transactions in the context of its normal commercial operations is irrelevant in that regard.

The third question

46 In view of the answer given to the first and second questions, there is no need to answer the third question.

The fourth question

47 By its fourth question, the national court asks, in essence, how the leasing transactions at issue in the main proceedings should be redefined, if they or any part of them constituted an abusive practice.

48 In that regard, it should be borne in mind that, where an abusive practice has been found to exist, the transactions involved in it must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice (see *Halifax and Others*, paragraphs 94 and 98).

49 In the first place, it is therefore 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 at issue in the main proceedings constituted an abusive practice.

50 If that were the case, it would, secondly, 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.

51 Thus, if the national court concluded that certain contractual terms of the leasing transactions at issue in the main proceedings and/or the intervention of Suas in those transactions constituted an abusive practice, that court would have to redefine those transactions disregarding the existence of Suas and/or by varying or disapplying those contractual terms.

52 In that context, the redefinition by that court must go no further than is necessary for the correct charging of the VAT and the prevention of tax evasion (see, to that effect, *Halifax and Others*, paragraph 92).

53 In those circumstances, the answer to the fourth question is that, if certain contractual terms of the leasing transactions at issue in the main proceedings, and/or the intervention of an intermediate third party company in those transactions, constituted an abusive practice, those transactions must be redefined so as to re-establish the situation that would have prevailed in the absence of the elements of those contractual terms which were abusive and/or in the absence of the intervention of that company.

Costs

54 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Third Chamber) hereby rules:

1. **The tax advantage accruing from an undertaking's recourse to asset leasing transactions, such as those at issue in the main proceedings, instead of the outright purchase of those assets, does not constitute a tax advantage the grant of which would be contrary to the purpose of the relevant provisions of Sixth 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, as amended by Council Directive 95/7/EC of 10 April 1995, and of the national legislation transposing it, provided that the contractual terms of those transactions, particularly those concerned with setting the level of rentals, correspond to arm's length terms and that the involvement of an intermediate third party company in those transactions is not such as to preclude the application of those provisions, a matter which it is for the national court to determine. The fact that the undertaking does not engage in leasing transactions in the context of its normal commercial operations is irrelevant in that regard.**

2. **If certain contractual terms of the leasing transactions at issue in the main proceedings, and/or the intervention of an intermediate third party company in those transactions, constituted an abusive practice, those transactions must be redefined so as to re-establish the situation that would have prevailed in the absence of the elements of those contractual terms which were abusive and/or in the absence of the intervention of that company.**

[Signatures]

* Language of the case: English.