

wts klient newsletter

WTS Klient.
The Bridge.

Dear Readers,

I'm sitting on the plane coming home from the WTS Global General Meeting, and while we are flying on autopilot I am still thinking about all I heard when I was there.

"Artificial intelligence solutions in devices will take over from humans in preparing and filing corporate tax returns in a few years' time."

We can be sure that the incredible pace of the digital revolution seen in recent years will only speed up as we move forward. Our mandatory online cash registers, the increasing detail required in VAT returns and the data reporting from invoicing software all point in this direction.

Do not forget that development per se cannot be autotelic. We always ask ourselves the question: "Will the IT project in front of us make our processes simpler or cheaper in the foreseeable future?" If the answer is yes then we need to take action because efficiency is what gives us a competitive advantage.

György Kőrösi
partner

Another interesting case at the Court of Justice of the European Union – judgement on Leasing VAT

Another important decision at the Court of Justice of the European Union that addresses the VAT treatment of leasing. » [page 1](#)

Internal financing: financing using own resources

Internal financing can be a cost-effective form of financing, but besides the actual costs we also have to consider loss of earnings. » [page 3](#)

Another interesting case at the Court of Justice of the European Union – judgement on leasing VAT

"Following the decision, the tax authority could reclassify current open-end leasing frameworks as supplies of goods, and demand payment of the VAT in one amount from the lessor when the leased item is handed over."

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Another significant judgement was published on 4 October 2017 by the European Court of Justice (C-164/16), which addresses [leasing](#) from a value added tax perspective, and also changes current practice to a certain extent.

Current practice: leasing from the angle of VAT

In terms of VAT, and keeping things simple, there are two types of financial leasing: closed-end and open-end.

- In the case of **closed-end leasing**, when the leasing period expires and if all the instalments have been paid, the ownership right to the leased item automatically passes to the lessee upon payment of the last instalment.
- With **open-end leasing** the lessee has the option to obtain the ownership right of the leasing item, but this is at the discretion of the lessee.

Based on these definitions the VAT system treats the two kinds of leasing separately. **Closed-end leasing is considered a supply of goods based on the VAT Act** (and the EU's Value Added Tax Directive), **while open-end leasing is a service** (rental). In the case of **closed-end leasing the VAT payment liability arises** in one lump sum **when possession of the leasing item is handed over**, for the entire principal amount (irrespective of the fact that legally the ownership right is not ceded), while for **open-end leasing the VAT payment liability arises when the individual instalments are invoiced**.

Brief description of case examined by the Court

The case in hand involved Mercedes Benz Financial Services UK Ltd. and the British tax authority. Mercedes-Benz offered three types of contract for leasing motor vehicles: a standard hire agreement known as "Leasing", a "Hire Purchase" agreement, and a leasing agreement with an option to purchase called "Agility".

The "Leasing" agreement excludes any transfer of ownership and sets a maximum mileage beyond which the customer is liable to pay a penalty. The "Hire Purchase" and "Agility" agreements, on the other hand, provide for a transfer of ownership, but on different terms.

In a "Hire Purchase" agreement there is an option based on which the customer can buy the vehicle when the agreement expires for a symbolic amount (normally GBP 95). Yet since the sum of the instalments equals the entire cost of the vehicle, from an economic perspective there is then no point in waiving the option to a vehicle that has been paid in full.

Under an "Agility" agreement, the monthly instalments are lower, and the total instalments thus represent only approximately 60% of the vehicle sale price, including the cost of financing. If a user wishes to exercise the option to purchase the vehicle, they must therefore pay approximately 40% of the sale price. This represents the estimated average residual value of the vehicle.

It was clear to the parties that "Leasing" falls within the category of open-end leasing (i.e. rental), while "Hire Purchase" obviously corresponds to closed-end leasing (i.e. a supply of goods). The problem came with the "Agility" version.

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Successful legislative proposals

Changes to rules on accounting entertainment costs

Hungarian companies are normally represented at authorities, banks and with other business partners by their managing director. A popular way to foster business relations is to take business partners for lunch or dinner. Documenting these events was subject to particularly strict rules and created substantial additional administrative burden, but this resulted in such business meals essentially not taking place. This meant additional revenue for the state budget was minimal, mainly because restaurants paid less tax and other contributions as a result.

During the legislative amendment period we submitted several proposals to the Ministry for National Economy. We proposed a simplified procedure, accounting for entertainment costs in a tax-efficient manner up to a certain amount (relative to sales revenue), and we also raised the issue of introducing a single, itemised, easy-to-calculate tax that is common in other European tax cultures (always bearing in mind the aim of reducing the overall tax burdens and administration of companies).

According to the amendment, use of restaurant services for entertainment purposes shall also be deemed an eligible cost for corporate tax purposes from 2014 if the user of the service only has a receipt issued in connection with paying the due amount by bankcard or credit card.

Do you have also an opinion about taxation? Would you like the government to listen to your proposals on tax policy in Hungary? Then come to our Tax Strategy Day 2018 conference!

The long times waiting for bills are now a thing of the past. We are delighted that hospitality backed up with a credit card payment can now be accepted and accounted for under "entertainment costs".

Dale A. Martin, CEO, Siemens Zrt.

The judgement

According to the ECJ – and we quote from the [judgement](#) – a “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” (Article 14(2)(b) of the VAT Directive), must be interpreted as **applying to a leasing contract with an option to purchase if it can be inferred from the financial terms of the contract that exercising the option appears to be the only economically rational choice that the lessee will be able to make** at the appropriate time if the contract is performed for its full term, which is for the national court to ascertain.

Essence of the judgement

To determine whether a given framework is a supply of goods or a service it is not enough just to examine whether the leased item **automatically passes to the lessee upon payment of the last instalment**. It must also be analysed **in the case of a purchase option whether the transfer of the ownership right does in fact depend on a rational decision by the lessee**.

What happens now?

With this judgement the ECJ has added a subjective factor to the equation, which could cause some headaches in the future. In certain cases for example it can be very difficult to ascertain what size of option really does prompt a genuine decision from the lessee. Also up for discussion is what a rational decision means from the perspective of companies (buying a 5-year-old used car can be rational for a private individual, but for a company this is by no means so clear-cut, even if some revenue could be generated from subsequently selling the 5-year-old car). This means the tax authority could reclassify current open-end leasing frameworks as supplies of goods, and demand payment of the VAT in one amount from the lessor when the leased item is handed over.

When leasing company cars it is also important whether the purchase is deemed a supply of goods or a vehicle rental, since while the VAT on the purchase of passenger cars cannot be deducted, the VAT on car rentals can (if utilisation for business purposes is proven).

So to avoid tax risks we definitely recommend reviewing the VAT statuses of leasing contracts, with due consideration of the ECJ's decision referred to above.

Internal financing: financing using own resources

Most common forms of self-financing:

- related-party financing
- reinvesting profit
- early payment discount

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In my first [article](#) on financing I aimed to present the most important external financing opportunities available. However, we cannot forget that some companies carry out their activity based on internal financing, or self-financing, i.e. they **fund their own operations without external assistance**.

Internal financing opportunities

With internal financing, much like external financing, it is important to **match the financing term with the recovery period** for the financed project or asset. Attention must also be paid to the **interest rate** of the financing as well as to the repayment instalments or any **loss of earnings**. Upon examining these aspects, in certain cases a company may conclude that internal financing is more expensive than sourcing the necessary funds on the money market. Below I look at the most typical self-financing models.

Related-party financing

Although this form of financing would traditionally come under external financing, companies that have this option generally find it **much easier to gain access to such funding** than is the case with a bank loan for instance. Furthermore, borrowing from a related entity means they normally **enjoy significantly looser conditions** in terms of collateral required, the interest rate or the term of the loan.

Of course, related-party loans can also be granted under conditions that are worse than market terms, but here there are usually factors in the background that are not related to just financing.

With **related-entity financing** that differs from market financing it is important to note that both the lender and the borrower may have to adjust their tax bases, which can ultimately impact on the cost of financing. This can all be avoided if the [lending takes place at arm's length](#) between the related parties.

Reinvesting profit

This method of internal financing is essentially reserved for **prosperous companies**. Yet even for profitable companies it is questionable whether the owners will decide to distribute profit as a dividend or reinvest it into the business. These decisions are largely influenced by the additional profit that can be earned from the activity to be financed. Current interest rates in Hungary encourage owners to opt for **reinvesting profit**, at least to some extent. However, this leads to an interesting contradiction because they do so in the hope of generating a greater return from their "reinvested" money. The external financing options presently on the table along with interest rates of virtually zero can often offer even better financing conditions for companies though.

Early payment discount

If we want to encourage our customers to pay their invoices before the payment deadline, meaning we do not have to finance the cost of the sold product or service for as long, and we can reinvest this income more quickly into our activity, then one method is to offer customers a discounted payment option. Not everyone will take advantage of this of course, but depending on their current liquidity position many partners may find a **discount of a few percent** appealing. However, we also need to be aware that there is a cost side to this, as with all types of financing – in this case it is the part of the invoice that we waive in exchange for a faster settlement. Choosing this system is only worthwhile **if the expected benefit** (cost of financing with bank loan, extra time and administration, no late payment interest on account of our liquidity problem) **exceeds or is at least the same as the amount of the discount**.



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"Determining if a given framework counts as a supply of goods or a service will also depend on whether exercising the purchase option is the only rational economic choice for the lessee."

Tamás László, WTS Klient Hungary manager

Source: inforadio.hu



Turn on your radio!



On 4 October the Court of Justice of the European Union adopted a decision that could change VAT payment practices related to leasing. "This judgement adds a subjective factor to the equation, which could cause headaches in the future" – said Tamás László, manager of WTS Klient Hungary, on the decision, who will be analysing the topic of the first article of our newsletter on InfoRadio on the evening of Thursday, 2 November.

[Listen to the conversation at this link!](#)

Please note that the conversation is available only in Hungarian.

This WTS information does not constitute advice and it serves only to provide general information about selected topics.

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