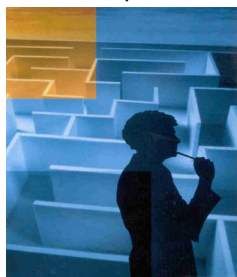


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Calculating Part Private Use – a leaf from the ECJ on the Sudholz Case

The European Court of Justice (ECJ) recently announced its decision on the leading VAT case, *Finanzamt Sulingen v Walter Sudholz* (Case C-17/01).



Mr. Walter Sudholz, who runs a painting business, purchased a passenger car, which he allocated as to 70% for business purposes and

30% private use. Under German legislation, passed in April 1999 as part of a simplification measure, only 50% of the VAT on the purchase of a car partly used for private purposes was deductible – the other 50% being effectively “blocked”. Mr. Sudholz argued that such a 50% flat rate limit was disproportionate, since it reduced his entitlement to deduct VAT at the actual extent of his 70% business use of the car.

On a reference the ECJ held that the German 50% flat rate limit was legitimate and in accordance with the relevant EU VAT law (Art. 27(1) EC 6th Directive). The flat rate limit was introduced to combat the risk of tax evasion or avoidance, as it was very difficult for the German authorities to check the exact level of private use in individual cases. The measure therefore made verification more straightforward.

The ECJ also held that the 50% limit was proportionate as an average of actual private usage. The fact that persons who intended to use their vehicle more than 50% for business purposes could not deduct more than that percentage was inherent in such a simplification measure. Some persons would pay less VAT on the scheme and some may pay more. But the amount of tax due at the final consumption stage would remain unaffected by the measure, except to a negligible degree.

As the ECJ points out in this judgment the German simplification measure, both in its objective and effect, is no different from other flat rate limits adopted by other EU Member States. Significantly, the UK Government submitted observations to the Court in support of the German Government. No surprise there given that the same reasoning underpins flat rate measures in the UK/IOM. One notable example is the 50% VAT recoverable limit on the leasing charge on cars where there is any private

use. Another is the scale charge on the proportion of VAT relating to expenditure on fuel used for private purposes in company cars. Both of these schemes are designed to capture output tax on the private use in an administratively convenient way.

With respect to business yachts (on which VAT has been recovered in full) where there is any part private or non-business use, UK/IOM Customs have always expected taxpayers to adopt a “fair and reasonable value” approach in calculating the output charge on the private or non-business use – while reserving their powers to strike down individual, “unreasonable” calculations. The benefit of the Sudholz judgment is to give both judicial precedence and case law certainty to the 50% flat rate approach to the calculation.

Deduction of VAT by Holding Companies

The leading European VAT case of *Polysar Investments* (Case C-60/90) remains seminal. The ECJ held that the mere holding of shares of subsidiaries by a holding company does not of itself constitute an “economic activity”. As a result a pure holding company that does not have any other taxable activities is not a taxable person and cannot recover VAT on its activities. Therefore in structuring the affairs of holding companies for VAT purposes particular consideration needs to be given to the substance of their activities.

Anti-avoidance Disclosure Rules – Hue and Cry

Several professional bodies, including the Institute of Chartered Accountants in England and Wales, the Chartered Institute of Taxation and the Institute of Indirect Taxation, have made representations to the UK Treasury criticising the new anti-avoidance disclosure rules relating to “avoidance schemes”.

They question the effect of the proposed rules on notions of client confidentiality. Also the lack of Parliamentary scrutiny, since much of the detail has so far been released through secondary and tertiary legislation, which does not get debated in Parliament. The chairman of a House of Lords select committee echoed similar views. The chorus is loud, but it is unlikely to halt the advance of the measure, which is expected to come into force on 1 August 2004.

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