



**TC02778**

**Appeal number: LON/2008/1999**

**VAT – SUPPLY – *whether a particular type of motor vehicle finance agreement, called “Agility”, was a supply of goods or services – supply of goods – Appeal dismissed***

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**MERCEDES-BENZ FINANCIAL SERVICES UK LTD      Appellant**

**- and -**

**THE COMMISSIONERS FOR HER MAJESTY’S      Respondents  
REVENUE & CUSTOMS**

**TRIBUNAL: JUDGE MICHAEL TILDESLEY OBE  
RUTH WATTS DAVIES FCIPD MIH**

**Sitting in public at Bedford Square, London on 30 and 31 July 2012**

**Keith Prosser QC instructed by DLA Piper UK LLP for the Appellant**

**Owain Thomas instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

## DECISION

### The Appeal

1. The Appellant appeals against HMRC's decision on review dated 16 December 2008 upholding an earlier decision dated 15 June 2006 that the proposed 'Agility' contract purchase agreements constituted a supply of goods. Pursuant to that decision, HMRC issued assessments to the Appellant on 12 and 22 August 2008, and 20 and 28 October 2008 with a net liability for VAT of over £10 million.

2. The Appellant was a UK subsidiary of Daimler AG and provided asset-backed financial products and ancillary services (such as service contracts and insurance products) to its customers when they purchased or leased motor vehicles from the Corporate retail dealers.

3. The Appeal concerns the treatment for VAT purposes of a particular type of motor vehicle finance agreement, called, *Agility*, which the Appellant has entered into with customers ever since 1 August 2007. The *Agility* finance product supplemented the Appellant's existing finance options of hire purchase and leasing. The *Agility* agreement included an option to purchase the vehicle. The Appellant marketed *Agility* as a distinct financial product giving the customer a choice of three options (purchase, return, and purchase and part-exchange) in respect of the motor vehicle at the end of the agreement.

4. The Appellant stated that *Agility* was a rental agreement with an option to purchase and that in the normal course of events title in the motor vehicle would not automatically pass unless and until the customer chose to purchase the vehicle. The Appellant, therefore, contends that on a proper analysis of the agreement it makes a supply of services.

5. HMRC considered that the Appellant had misunderstood the wording of the legislation which required only the possibility that title of goods would pass not an inevitability. Given those circumstances HMRC argues that the Appellant makes a supply of goods.

6. The tax effect of the parties' difference of view is that VAT is chargeable at the outset of the agreement, if it is a supply of goods. If, however, it is a supply of services, VAT is chargeable each time the customer is liable to make a payment under the agreement. The overall position at the end of the agreement if the customer exercises the option to purchase or returns the vehicle is VAT neutral<sup>1</sup>. The advantage to the Appellant of treating the supply as one of services is cash flow with the output tax being accounted for at regular intervals throughout the contract rather than as a lump sum at the commencement of the contract.

7. The parties' disagreement is principally one of law, namely the correct construction of Article 14.2(b) of Council Directive 2006/112/EC ("the VAT

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<sup>1</sup> See *Agility – Cash Flow – Illustration Purposes Only* which was produced at the hearing by the Appellant at the Tribunal's request.

Directive”) which 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. The dispute between the parties focussed on the phrase: *in the normal course of events*.

5 8. The Appellant argues that Article 14.2(b) should be construed from a commercial point of view which enables the Tribunal to have regard to the wider purpose of the *Agility* agreement of giving choices to the customer. The Appellant submitted that *in the normal course of events* should be interpreted as a measure of probability, more likely than not. It follows that Article 14(2)(b) applies to a contract  
10 where it is expected (more likely than not) at the outset that ownership would ultimately pass. The fact that a contract contains an option to purchase is not determinative of the issue, if it is not expected at the outset that the option would be exercised, which was the case with the *Agility* agreement. Article 14(2)(b), therefore, did not apply to the *Agility* agreement.

15 9. HMRC contends that the Appellant has misconstrued the provisions of Article 14.2(b). It is the terms of the contract that determines whether Article 14.2(b) applies not the wider commercial considerations. The phrase “*in the normal course of events*” is a qualification as to when ownership would pass (if the option is exercised), not to the exercise itself of the option. Further there is no requirement under the wording of  
20 Article 14.2(b) that the exercise of the option is more likely than not. According to HMRC, Article 14.2(b) is directed at identifying when title normally passes under such agreements. The requirements of Article 14.2(b) are satisfied if the contract provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment, which is the case for the *Agility* agreement. Article  
25 14(2)(b), therefore, applies to the *Agility* agreement.

10. The parties reached a measure of consensus on the factual matrix for the dispute, and had endorsed an agreed statement of facts. Further the parties accepted that the Tribunal should focus on the terms of the agreement. There was, however, a wide difference between them about the relevance and the interpretation of the  
30 evidence on the commercial considerations for the *Agility* contract. In this respect the Appellant invited the Tribunal to find specific facts relating to the *Agility* agreement.

11. The Tribunal heard evidence for the Appellant from Mr Brent Russell Kevin May, FCMA, who was the Appellant’s Chief Financial Officer from 2001 to 30 April 2012. Since 1 May 2012 Mr May has occupied the role of Strategic Projects Director.  
35 The Tribunal admitted an agreed bundle of documents in evidence.

## **The Law**

12. Article 14 of the VAT Directive provides, as follows:

“1. “Supply of goods” shall mean the transfer of the right to dispose of tangible property as owner.

40 2. In addition to the transaction referred to in paragraph 1, each of the following shall be regarded as a supply of goods:

(a) the transfer, by order made by or in the name of a public authority or in pursuance of the law, of the ownership of property against payment of compensation;

5 (b) the actual handing over of goods pursuant to a contract for the hire of goods for a certain period, or 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;

(c) the transfer of goods pursuant to a contract under which commission is payable on purchase or sale.

10 3. Member States may regard the handing over of certain works of construction as a supply of goods”.

13. HMRC referred to the French text in its Skeleton which it stated had a subtly different formulation, not referring to “*the normal course of events*” but to contracts which have a clause that ownership is normally acquired on payment of the final  
15 instalment:

20 “la remise matérielle d'un bien en vertu d'un contrat qui prévoit la location d'un bien pendant une certaine période ou la vente à tempérament d'un bien, assorties de la clause que la propriété est normalement acquise au plus tard lors du paiement de la dernière échéance.”

14. Paragraph 1 of Schedule 4 to the VAT Act 1994 gives effect to Article 14.2 (b), which states that

25 “(1) Any transfer of the whole property in goods is a supply of goods; but, subject to subparagraph (2) below, the transfer-  
of any undivided share of the property; or  
of the possession of goods,  
is a supply of services.

(2) If the possession of goods is transferred-  
30 under an agreement for the sale of the goods, or  
under agreements which expressly contemplate that the property also will pass at some time in the future (determined by, or ascertainable from, the agreements but in any case not later than when the goods are fully paid for),  
it is then in either case a supply of the goods.”

35 15. The parties accepted that nothing turned in this Appeal on the difference between *in the normal course of events* in Article 14.2 (b) and *which expressly contemplate* in paragraph 1 of Schedule 4 of the VAT Act 1994. The UK legislation must be construed in conformity with the VAT Directive.

## Authorities

16. Both parties referred to the recent decision of the Court of Justice of the European Union in *Eon Aset* (Case C-118/11) [2012] STC 982. The case concerned the deductibility of input VAT in respect of motor vehicles leased to the taxpayer and used by him to transport an employee from home to work. The Court of Justice noted that in order to determine the conditions for deductibility, and the time when those conditions have to be satisfied, it is first necessary to categorise the transaction, and in particular to determine whether or not the vehicles were “capital goods” of the taxpayer. In this connection, the Court of Justice said the following, under the heading *preliminary considerations*:

“31 Under Article 168 of the VAT Directive, a taxable person has the right to deduct VAT provided that goods and services are used for the purposes of his taxed transactions. It is therefore necessary at the outset to categorise the activities at issue in the main proceedings in the light of the concept of 'taxable transaction'.

32 Under Article 24(1) of the VAT Directive, "supply of services" shall mean any transaction which does not constitute a supply of goods', and the concept of a supply of goods requires, under Article 14(1) of that directive, the 'transfer of the right to dispose of tangible property as owner'.

33 Since the leasing of a motor vehicle does not constitute a supply of goods, it must, as a general rule, be categorised as a supply of services, according to Article 24(1) of the VAT Directive (see, to that effect, Case C-155/01 *Cookies World* [2003] ECR I-8785, paragraph 45, and Case C-425/06 *Part Service* [2008] ECR I-897, paragraph 61).

34 The lease of a motor vehicle under a financial leasing contract may, nonetheless, present features which are comparable to those of the acquisition of capital goods.

35 As the Court has stated, in the context of a provision enabling Member States to exclude capital goods from the system of VAT deductions for a transitional period, the definition of 'capital goods' covers goods used for the purposes of some business activity and distinguishable by their durable nature and their value and such that the acquisition costs are not normally treated as current expenditure but are written off over several years (see, to that effect, Case 51/76 *Verbond van Nederlandse Ondernemingen* [1977] ECR 113, paragraph 12, and Case C-98/07 *Nordania Finans and BG Factoring* [2008] ECR I-1281, paragraphs 27 and 28).

36 Further, Article 14(2)(b) of the VAT Directive states that the actual handing over of goods pursuant to a contract for the hire of those goods for a certain period, which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment is to be regarded as a supply of goods.

37 In the case of a financial leasing contract, there is not necessarily any acquisition of the goods since such a contract may provide that the lessee has the option of not acquiring those goods at the end of the lease period.

5 38 However, as is clear from the international accounting standard IAS  
17 relating to leases, produced in Commission Regulation (EC) No  
1126/2008 of 3 November 2008 adopting certain international  
10 accounting standards in accordance with Regulation (EC) No  
1606/2002 of the European Parliament and of the Council (OJ 2008 L  
320, p. 1), an operating lease must be distinguished from a finance  
lease, the nature of the latter being that substantially all the risks and  
rewards of legal ownership are transferred to the lessee. The fact that a  
transfer of ownership is provided for on the expiry of the contract or  
the fact that the present value of the lease payments is practically  
15 identical to the market value of the property constitute, separately or  
together, criteria which permit a determination of whether a contract  
can be categorised as a finance lease.

20 39 As the Court has previously stated, the concept of 'supply of goods'  
does not refer to the transfer of ownership in accordance with the  
procedures prescribed by the applicable national law but covers any  
transfer of tangible property by one party which empowers the other  
party actually to dispose of it as if the recipient were the owner of the  
property (see Case C-320/88 Shipping and Forwarding Enterprise Safe  
[1990] ECR I-285, paragraph 7, and Case C-185/01 Auto Lease  
Holland [2003] ECR I-1317, paragraph 32).

25 40 Accordingly, where a financial leasing contract relating to a motor  
vehicle provides either that ownership of that vehicle is to be  
transferred to the lessee on the expiry of that contract or that the lessee  
is to possess all the essential powers attaching to ownership of that  
vehicle and, in particular, that substantially all the rewards and risks  
incidental to legal ownership of that vehicle are transferred to the  
lessee and that the present value of the amount of the lease payments is  
30 practically identical to the market value of the property, the transaction  
must be treated as the acquisition of capital goods.

41 It is for the national court to determine, having regard to the  
circumstances of this case, whether the criteria stated in the preceding  
paragraph of this judgment are applicable.”

35 17. The Appellant acknowledged in its skeleton that the observations of Court of  
Justice should be read, first and foremost, as guidance on the criteria to be applied in  
order to determine whether a leased asset is to be categorised as an acquisition of  
“capital goods” for the purposes of the rules on deductibility of input tax. The  
Appellant, however, went on to suggest that the Court of Justice was also intending to  
give guidance as to when the provision of a leased asset is a supply of goods, which  
40 was relevant to this Appeal.

45 18. The Appellant placed weight on the approach adopted by the Court of Justice in  
paragraph 38 which suggested that the Court of Justice was considering the matter of  
whether a contract can be categorised as a finance lease from a commercial, rather  
than a legalistic, point of view. The Appellant’s suggestion was supported by the  
reference, at paragraph 38, to the accounting treatment of the lessee under a finance  
lease. Further the proposition of a commercial construction was wholly consistent  
with the Court’s observation at paragraph 39, that the concept of a supply of goods

was an autonomous concept of EU law which did not depend upon there being a transfer of ownership under the applicable national law.

19. The Appellant at the hearing drew back from its claim in its skeleton that the Court's observation at paragraph 40 supported its construction of *normal course of events* in Article 14(2)(b) as *more likely than not*. Instead the Appellant relied on two  
5 general themes from the *Eon Aset* decision to support its case. First, the commercial perspective which brought into account the wider purpose of the *Agility* contract of enabling a customer to keep his options open regarding the ownership of the vehicle until maturity. Second the use of Accounting Standards in interpreting EU legislation.

10 20. The Appellant considered that the approach adopted in Accounting Standards<sup>2</sup> for identifying a finance lease from an operating lease where at the outset a judgement is made on the terms of the lease whether the exercise of an option to purchase is reasonably certain had resonance for its preferred interpretation of Article 14(2). In this respect the Appellant argued that the Tribunal should follow the same approach  
15 when considering the terms of the *Agility* agreement, and make an assessment on whether it was more likely than not that ownership of the vehicle would ultimately pass.

21. HMRC relied on *Eon Aset* to support its view that what is important is whether the transfer of ownership is provided for in the contract, in the sense of being an  
20 option that is expressly contemplated. This was self evident from paragraphs 38 and 40 of the preliminary considerations where the Court stated that

“The fact that a transfer of ownership is *provided* (our italics) for on the expiry of the contract permitted a determination of whether a contract can be categorised as finance lease” (para. 38).

25 “ Accordingly, where a financial leasing contract relating to a motor vehicle *provides* (our italics) either that ownership of that vehicle is to be transferred to the lessee on the expiry of the contract ..... the transaction must be treated as the acquisition of capital goods”(para. 40).

30 22. HMRC pointed out that there was no reference in *Eon Aset* to the expectation of whether ownership would transfer. The emphasis in *Eon Asset* on what was provided for in the contract was significant for this Appeal because the Court of Justice clearly had in mind the provisions of Article 14(2)(b)<sup>3</sup> when it uttered the observations in paragraphs 38 and 40.

35 23. HMRC stated that the Accounting Standards were about the appropriate accounting policies and disclosures for leases. The criteria used to distinguish between operating and finance leases comprised open textured questions and not a bright line test. HMRC did not concede that the *Agility* agreement was to be treated

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<sup>2</sup> The Appellant referred to SSAP 21 Accounting for leases and hire purchase contracts (Issued August 1984; amended February 1997), and International Accounting Standard 17 (EC staff consolidated version as of 24 March 2010).

<sup>3</sup> See paragraph 36 of the Preliminary Observations.

for accounting purposes as an operating lease. The Appellant had called no expert evidence to establish such treatment. Further the Accounting Standards did not deal with the VAT treatment of lease supplies and should not be used as a guide to construction of Article 14(2)(b), which should be determined in accordance with the principles of statutory interpretation. This Appeal was about whether the provisions of Article 14(2)(b) applied to the *Agility* agreement not whether that agreement was a finance or an operating lease.

24. HMRC cited *Rodney Hogarth T/A Hogarth Associates v Commissioners for Customs and Excise* (VT 13259) in support of its proposition that there was no requirement under the statutory wording that the exercise of the option was more likely than not. The Tribunal in reaching its decision considered the wording of Article 5(4)(b) of the Sixth VAT Directive which was replicated in Article 14(2)(b). In *Hogarth* the hire purchase agreements in question provided an option to purchase upon the payment of the final instalment and a small purchase option fee. It was argued that the agreements could not be said to have contemplated that the property would pass as anything could have happened to prevent or dissuade the customer from exercising the option to purchase (that, for instance, he might have been made bankrupt, the car might have been stolen, he might have been dissatisfied with the car, or it might have been depreciated so much that it was preferable to terminate the hiring). The VAT Tribunal held:

“What usually happens under a hire purchase transaction is that the customer makes the payments and eventually becomes the owner of the goods, in both cases in accordance with the hire purchase agreement. In my judgment that course of events is one which is referred to in Article 5.4 as ‘the normal course of events’, and such an agreement is an example of an agreement which ‘expressly contemplates’ that the property ‘will’ pass as mentioned in paragraph 1(2)(b).] In my judgment the fact that the agreement also contemplates other possible events in which the property will not pass, such as the premature termination of the agreement, does not prevent the agreement from being an agreement which contemplates that the property will pass; I construe ‘will’ in this context as meaning, not ‘will inevitably’, but ‘will in certain events’.”

25. The Appellant considered that the Tribunal’s reference to “*What usually happens under a hire purchase transaction*” was consistent with its construction of *in the normal course of events* as more likely than not.

26. HMRC also referred to the Tribunal decision in *GMAC v Commissioners for Excise and Customs* (LTL 1/5/2003, 28/01/2003) upheld by the High Court [2004] EWHC 192 (Ch) for the proposition that the fact that a hirer may not exercise its option to purchase was not a relevant consideration for determining the categorisation of a supply as one of goods or services. The Tribunal at paragraph 4 stated that

“A hire purchase transaction is a contract of bailment under which the owner ... lets goods on hire to its customer and further agrees that the customer has the option in the future either to terminate the hiring and return the goods or to purchase the goods. A hire purchase transaction



differs from a contract of sale (including a conditional sale agreement) in that the customer is not bound to purchase the goods. However, for VAT purposes a hire purchase transaction is equated to a sale of goods...”

5 27. The Appellant stated that the decision in *GMAC* had no relevance to this Appeal. *GMAC* was concerned with whether the taxpayer was entitled to make adjustments to its VAT account on return of the vehicle by the hirer. In *GMAC* the parties and the Tribunal assumed that the supplies were one of goods as it was not an issue in that Appeal.

10 28. Finally the Appellant referred to extracts from Bradgate, *Commercial Law*, 3<sup>rd</sup> ed., and Atiyah, *Sale of Goods*, 10<sup>th</sup> ed. on the true nature of traditional hire purchase contracts. Although such agreements contained an option to purchase, the reality was that the objective of hire purchase was the supply of goods on credit terms:

15 “As we have seen, the legal form of a hire purchase agreement is of a hiring or bailment, of goods, by their owner (bailor) to the hirer (bailee), with the hirer being granted an option to purchase the goods at the end of the hire period. However, in reality this arrangement is almost wholly fictional. Certainly the hirer is not bound to exercise the option and complete the purchase of goods, but the payments required of the hirer are normally greatly in excess of the sums which would be required under an ordinary hire or rental agreement. The truth is that the objective of hire purchase is the supply of goods on credit terms, coupled with security for the supplier”. (Bradgate 8.2.1 pages 237 & 238).

20 29. The Appellant contended that Article 14(2) was directed at traditional hire purchase arrangements where the agreement was structured in such a way that the exercise of the option to purchase was almost inevitable. This was not the case with *Agility* when no decision would be taken on purchase until the end of the contract.

### **The Agreed Statement of Facts**

30 30. The Appellant has traded as Mercedes-Benz Financial Services UK Limited since 1 April 2008. Prior to that date, the Company traded as Daimler-Chrysler Financial Services UK Limited (“DCFS”).

31. The Appellant was a UK subsidiary of Daimler AG (“Daimler”), a global automotive manufacturing and distribution company.

35 32. Through its retail business, the Appellant provided asset-backed financial products and ancillary services (for example service contracts and insurance products) to its customers.

40 33. All customers and potential customers were reviewed (referred to by the Appellant as “qualifying”) by the Appellant through interaction with the finance specialist at a dealership. Products were also available through an automated process on the Mercedes-Benz website. The review of the customer was undertaken to ensure that only appropriate financial products are presented to them.

34. Three finance options were available from the Appellant: leasing, hire purchase and *Agility*. *Agility* was launched on 1 August 2007. If the customer has decided that s/he would like to purchase the vehicle, then a hire purchase product may be recommended. If the customer has decided that s/he would not like to purchase the vehicle, then a leasing product would be recommended. If the customer was undecided, or would like to keep their options open, then the *Agility* product would be recommended.

35. Under *Agility* the customer signed a contract and usually paid a deposit. The customer paid an acceptance fee after one month, and made monthly payments thereafter through the life of the contract. Three months before the end of the contract the Appellant wrote to the customer asking if s/he wished to return the vehicle, purchase the vehicle outright, or purchase the vehicle and use it as a deposit for a new vehicle. At contract maturity the customer exercised one of these three options.

(1) If s/he decided to purchase the vehicle then s/he paid a further sum called the optional purchase payment, the amount of which was agreed at the outset of the contract, and a purchase activation fee.

(2) If s/he decided to return the vehicle s/he had no further obligation (but would be obliged to pay an excess mileage fee if s/he have exceeded a pre-agreed mileage limit, and fees to cover any damage or excess wear and tear if any has occurred).

(3) If the customer wished to opt to use the vehicle as a deposit the same procedure as at (1) above was followed, and s/he then part exchanged the car using it as the deposit, or part of the deposit for a new car.

36. Marketing material and customer literature presented these options to the customer. There was separate *Welcome Pack* and *Maturity Pack* literature for hire purchase, leasing and *Agility* customers.

37. There were separate agreements for hire purchase, *Agility* and leasing products. Both an *Agility* and a hire purchase agreement include an option to purchase clause, which, if activated, allowed the customer to take title to the vehicle. In the absence of the customer activating this clause, the vehicle was returned to the Appellant and title did not pass.

38. Under, *Agility* the *Optional Purchase Payment* fee was calculated at the outset as an amount equal to the anticipated market value of the vehicle at contract maturity (the *Agility* agreement called this the “guaranteed future value”). The demand for second-hand Mercedes Benz vehicles was such that the vehicle was expected to retain a substantial proportion of its initial value.

39. Under a hire purchase agreement an option to purchase fee was payable and this was collected by direct debit, which was typically £95. On some agreements there would also be a substantial balloon payment the month before the contract terminated.

40. Both *Agility* and leasing agreements provided for charges for excess mileage and for vehicle damage. There were corresponding vehicle damage clauses in the hire purchase agreement (clause 4.2 or 10.1.4 in both cases)

41. 100 per cent of the leased vehicles would be returned at maturity of the contract.

5 42. The percentage of customers returning vehicles (i.e. they have not exercised either the option to purchase the vehicle or use it as a deposit for a new vehicle) on *Agility* contract maturity has ranged from approximately 25% to 75%, with an average return percentage of around 50%. The remainder were purchased outright.

10 43. Under an *Agility* agreement, the Appellant, as a business, remained neutral in terms of the customer's future decision. This was due to the fact that the Appellant has a guaranteed buyback agreement with its sister company which owns the used car network in the UK. Returned vehicles could therefore be disposed of at retail value rather than wholesale value.

15 44. Under an hire purchase contract the general expectation was that the customer would purchase the vehicle but the Appellant did not know the purchase would be completed until the option to purchase was made by payment of the option to purchase fee.

#### **The Commercial Rationale for Agility**

20 45. On 1 August 2007 the Appellant launched the *Agility* product after acquiring the trademark. The tax treatment of the product was not critical to its launch. The VAT consequences of treating an *Agility* contract as a supply of services was not factored into the price of the product.

25 46. The commercial rationale for the *Agility* product had its origins from the Appellant's desire to establish a finance led competitive position. Its traditional financial product, hire purchase, did not give it a competitive edge, particularly as the Appellant's principal competitors were subsidiaries of banks.

30 47. Following a strategic review the Appellant identified that it was not playing to its strengths, in that as a captive finance company it should be utilising the strength of the Mercedes-Benz brand in the form of leveraging the residual value of the vehicle. The residual value effectively represented the resale value of the vehicle at the end of the contract.

35 48. The Appellant held confidential commercial information on the product development of its vehicles, such as launch of new products, specification changes, replacement, and face lift, which enabled it to be more confident in establishing the residual value of the product than its banking competitors.

49. The Appellant also had an arrangement with Mercedes Benz UK, the authorised distributor of the branded used Mercedes Benz market, to buy back vehicles returned under the *Agility* agreement, at the agreed residual value. This meant that the Appellant avoided the need to auction vehicles which would be the case if they were

returned under a hire purchase agreement. Further the Appellant's competitors were less willing to take a risk of a vehicle being returned at contract end as their remarketing options were more restricted.

5 50. With the introduction of the *Agility* product, the Appellant had a competitive financial product which allowed the Appellant to concentrate on its core competence of assessing financial risk without having the risk associated with the resale of the vehicle<sup>4</sup>.

### **Agility Agreement**

10 51. The Appellant supplied sample copies of agreements for *Agility*, hire purchase and operating lease.

52. The key features of the *Agility* agreement were as follows:

(1) Described as a Hire Purchase Agreement regulated by the Consumer Credit Act 1974.

15 (2) Period of hire: fixed period<sup>5</sup> starting on the date of the agreement. First payment one month after the date of the agreement<sup>6</sup>, with subsequent payments due monthly thereafter.

(3) An acceptance fee (£180) was payable which would be taken one month after the date of the agreement.

20 (4) An option to purchase, phrased as follows: In addition, if you wish to purchase the vehicle at the end of the period of hire, an optional purchase payment of £..... will be due 36 months after first payment. The purchase activation fee would also be payable at the same time as the optional purchase payment.

25 (5) Financial information provided details of the vehicle, total cash price, deposit, which was due on the start date of the agreement and total charge for credit.

(6) Key information covered default charges which were:

Interest on late payments

30 Possibility of compensation to the Appellant if the person failed to use or look after the vehicle properly

Payment of reasonable expenses including legal fees if the car is repossessed

Compensation for early termination of the agreement

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<sup>4</sup> Mr May called this risk as taking a risk on the metal.

<sup>5</sup> The samples provided specified a 36 and 38 month period

<sup>6</sup> The second *Agility* sample agreement at 204 in the agreed bundle stated first payment was due after 2 months.

Payment of an excess distance charge if the person did not exercise right to purchase the vehicle.

(7) Information about the customer's rights including early settlement, cancellation, termination and re-possession.

5 (8) Signature clause stating that this was a hire purchase agreement regulated by the Consumer Credit Act 1974. Sign it if you want to be bound by its terms.

(9) Vehicle condition terms stating that payments have been calculated on the assumption that if the vehicle was returned it would be in a good and clean condition and have been properly serviced/ maintained/ repaired in accordance with contract terms. Compensation would be payable if the vehicle was not  
10 looked after properly and regard should be had to the following points:

    Servicing: vehicle must be serviced and maintained in accordance with Mercedes-Benz published service intervals within the Official Workshop Network

15      Damage: maintain the vehicle in a condition which is consistent with the attached Vehicle Return Standards.

    Keys: required to return all keys

    Registration document: require to return the registration document

20      Cherished Plate has to be removed and placed on retention with DVLA prior to the return of the vehicle.

(10) Terms and Conditions covering Interpretation, Delivery and Acceptance, Payment and Interest, Your Obligations, Application of Insurance Monies, Indemnities, Exclusion of Liability, Early Termination by You , Early Termination by Us, Your Liability on Termination by Us, Option to Purchase, Excess Distance and Miscellaneous.  
25

(11) The clauses on Option to Payment stated as follows:

    11.1 You will have an option to purchase the Vehicle once you have made all payments liable to be made under this agreement, apart from the Optional Purchase Payment and the Purchase Activation Fee.

30      11.2 You may exercise your option to purchase only by making the Optional Purchase Payment to us on or before the due date.

    11.3 We will remain the owners of the Vehicle unless and until you have both exercised your option in accordance with clause 11.2 and also made any other payments falling due under this agreement. For the avoidance of doubt, such payments would include (but not be limited to) interest, default charges, the purchase activation fee, but would exclude any excess distance charge that would otherwise have fallen due under clause 12 if you had not exercised your option to purchase.  
35

40      11.4 If you do not exercise this option in accordance with clause 11.2 (or if you do, but fail to make any further payment due in accordance with clause 11.3 within 14 days of the Optional Purchase Payment date) then this Agreement is terminated and you will cease to be in possession of the Vehicle with our consent. You shall forthwith return

the vehicle to us in good condition, repair and working order at your own risk and cost at such address as we may reasonably specify and deliver up all registration and other documents relating to the Vehicle.

53. The structure of the financial payments in the first sample *Agility* agreement<sup>7</sup> was as follows:

Payment Details	Amount payable (£)	% of Cash Price
Total Amount Payable	26,510	
Less Credit Charges	4,185	
Cash Price for Vehicle	22,325	100
Deposit	3,325	15
Net Monthly Payments <sup>8</sup>	9,500	42.5
Optional Purchase Price	9,500	42.5

54. The structure of the financial payments in the second sample *Agility* agreement is set out below. The second sample included no deposit payment. Mr May was unable to indicate in his evidence the proportion of *Agility* agreements which required a payment of a deposit.

Payment Details	Amount payable (£)	% of Cash Price
Total Amount Payable	30,308	
Less Credit Charges	6,753	
Cash Price for Vehicle	23,555	100
Deposit	Nil	
Net Monthly Payments <sup>9</sup>	12,105	51
Optional Purchase Price	11,450	49

<sup>7</sup> See page 149 in the bundle.

<sup>8</sup> 36 payments at £373.35 = £13,440 minus £3,940 (interest) = £9,500 which represents the capital amount paid

<sup>9</sup> 36 payments at £516.20 = £18,583 minus £6,478 (interest) = £12,105 which represents the capital amount paid

55. There was no mention in the *Agility* agreement of the facility to use the guaranteed future value of the vehicle in part exchange of a new vehicle at the contractual end. The *Welcome Pack* on the *Agility* product stated that the customer had the choice to part-exchange the vehicle after purchasing it for a new model. The  
5 *Welcome Pack* provided no further details except that *Your local retailer can tell you how.*

### **Comparison of the *Agility* agreement with Hire Purchase and Operation Lease Agreements**

56. The Tribunal accepts HMRC's contention that there were striking similarities  
10 between the provisions of the *Agility* agreement and those of the hire purchase agreement offered by the Appellant. The striking similarities together with the distinguishing features from the terms of the operating lease were as follows:

(1) The *Agility* and hire purchase agreements were both described as Hire  
15 Purchase Agreements regulated by the Consumer Credit Act 1974. The lease agreement, on the other hand, was described as a Hire Agreement regulated by the Consumer Credit Act 1974.

(2) The *Agility* and high purchase agreements incorporated an option to  
20 purchase the vehicle at the end of the agreement under which ownership was transferred upon payment of all the sums due under the contract, including both the balloon payments and the nominal £95 fee. The lease agreement did not have an option to purchase.

(3) The *Agility* and high purchase agreements have a nominal £95 fee upon  
25 exercise of the option to purchase although this was termed differently (under *Agility*, the *purchase activation fee*, under HP, *option to purchase fee*).

(4) The high purchase agreement could involve the making of a balloon  
30 payment at the end of the contract, which was termed as the *final payment* rather than the term *optional purchase payment* as used in *Agility*.

(5) The *Agility* and hire purchase agreements gave the customer the right not  
35 to exercise the option to purchase, in which case the agreements would be terminated and the customer would cease to be in possession of the vehicle with the Appellant's consent.

(6) The *Agility* and hire purchase agreements provided for the option to  
40 purchase and the option to return. An hire purchase agreement was not a contract with downstream purchase obligatory as asserted by Mr May.

(7) The *Agility* and hire purchase agreements included a provision for a  
45 deposit which was not in the lease agreement.

(8) The *Agility* and hire purchase agreements gave a detailed breakdown of  
50 financial information which included, amongst other matters, the total amount payable, the cost of the vehicle, and the charge for credit. The lease agreement, on the other hand, simply supplied details of the monthly rental payments.

(9) The financial structuring of the exhibited hire purchase agreement with a balloon<sup>10</sup> was comparable with that for the exhibited *Agility* agreements. The ratio of payment types to cost of the vehicle for the high purchase agreement was deposit (13%); net monthly payments (43%); and final payment (44%).

5 57. The *Agility*, hire purchase and lease agreements imposed a liability on the customer if the vehicle was returned otherwise than in good condition repair and working order<sup>11</sup>. The *Agility* and lease agreements, however, incorporated standards for vehicle returns which were not included in the hire purchase agreement.

10 58. The *Agility* agreement included a requirement for the vehicle to be serviced and maintained at the published service intervals within the Mercedes Benz Official Workshop network, which was not required under the hire purchase agreement. The Tribunal considered that the lease agreement had a similar requirement to that of the *Agility* agreement.<sup>12</sup>

15 59. The *Agility* and lease agreements imposed a liability for an excess distance charge upon return of the vehicle. There was no such liability under the hire purchase agreement.

20 60. The APR for the cost of credit cited in the exhibited hire purchase agreements was higher than that in the *Agility* agreements. In the latter the monthly payments were generally lower but overall *Agility* represented a more expensive method of purchasing a vehicle than hire purchase due to the capital balance being higher at any one time.

### **Marketing and Wider Evidence on Agility**

25 61. Mr May stated that *Agility* was marketed as being tailored and affordable to the individual where the Appellant could either sell at a lower monthly rental than the competitors' hire purchase or up sell the vehicle specifications for the same rental or some combination thereof. Mr May also pointed out that the *Agility* offering gave the customer greater flexibility in terms of his available options at the end of the contract when compared with the competitors' hire purchase product. In Mr May's view, the sales proposition of *Agility* was a *no brainer* with the lower monthly payments and  
30 additional options at contract maturity.

62. The Appellant produced separate *Welcome Pack* and *Maturity Pack* literature for hire purchase, leasing and *Agility* customers.

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<sup>10</sup> Exhibited at page 156 of the bundle (£7,957 monthly payments; £2,415 deposit; £8,145 final payment = £23,555).

<sup>11</sup> The lease agreement used the words keep the vehicle in good condition and properly maintained.

<sup>12</sup> See section on Vehicles Tools, Documentation and Service History at page 166.



63. The *Welcome Pack* for the *Agility* product<sup>13</sup> explained that as the customer had chosen a contract type which either required him or gave him the option of returning his Mercedes Benz, the *Pack* provided guidance on keeping the vehicle in the best possible condition and the Appellant's expectations on the returned state of the vehicle. The *Pack* stated that towards the end of the *Agility* agreement the Appellant would write to explain the available choices, two of which involved purchase, and the other of handing back the vehicle. In respect of the option for *purchase and part-exchange*, the *Pack* advised that the purchase activation fee would be debited from the customer's bank account which would complete the purchase of the Mercedes Benz leaving the customer free to part-exchange or simply enjoy his car. The *Maturity Pack* repeated the same information about the three options for *Agility* customers.

64. The *Welcome Pack* for the hire purchase product explained that near the end of the agreement the Appellant would remind the customer that the agreement was about to end and that once all payments had been made, the Mercedes Benz belonged to the customer. The *Maturity Pack* offered the Appellant's services for answering any questions and helping the customer to choose his next Mercedes Benz.

65. The Appellant developed an online web based wizard which enabled potential customers to choose the best financial product for their individual circumstances. In this respect, the *Finance Decision Tree* on the website identified the choices as *own* (hire purchase); *keep options open* (*Agility*); and *lease*.

66. The wizard gave customers the facility to compare the financial implications of the *Agility* product with those for the Appellant's hire purchase agreement. The online print out of the comparison between *Agility* and hire purchase without balloon<sup>14</sup> showed that the total amount payable by the customer for the vehicle was some £15,000 cheaper than hire purchase. The reason for this difference was that under *Agility* the wizard assumed that the customer would not be paying interest charges on the optional purchase payment.

67. The online print out described *Agility* as *guaranteed future value + lower payments + option to purchase or return*. The description for hire purchase was *fixed payments + agreed terms = simple vehicle ownership*.

68. The online wizard also produced a pictorial depiction of the *Agility* product<sup>15</sup> which showed a vehicle described as *Your Mercedes Benz* in three segments<sup>16</sup>: the boot representing the deposit, the compartment containing the front and back seats equating with the monthly payments, and the bonnet with the choice of three options. Mr May stated that the use of the word *Your* was marketing hype. He denied that the

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<sup>13</sup> The *Welcome Pack* for the *Agility* product exhibited in the bundle also incorporated information on operating lease and contract hire agreement.

<sup>14</sup> Exhibited at page 247

<sup>15</sup> Exhibited at page 255

<sup>16</sup> Picture exhibited at 256 reversed sequence: deposit = bonnet & choice = choice of 3 options.

pictorial segmentation of the vehicle gave the impression that the potential customer under the *Agility* product owned two thirds of the vehicle by the time a decision was required on the available options.

5 69. Mr May supplied a graphical presentation of the financial profiles for *Agility* and hire purchase without balloon. The monthly payment for *Agility* comprised 85 per cent capital and 15 per cent interest; whereas for hire purchase the relevant percentages were 93 per cent capital and 7 per cent interest.

10 70. Mr May indicated that the high rate of return of vehicles applied equally to vehicles subject to hire purchase agreements. Environmental factors and the customer's perception of the equity in the vehicle were the factors that influenced the rate of return.

### **Consideration**

15 71. The issue in this Appeal is whether the provisions of Article 14(2)(b) applied to the *Agility* agreement. The Appellant argues that Article 14(2)(b) did not apply, in which case the supply under the *Agility* agreement was one of services. HMRC disagrees, contending that Article 14(2)(b) applied, in which case the supply under the *Agility* agreement was one of goods.

20 72. The parties differed on the proper construction of Article 14(2)(b). The Appellant argued that Article 14.2(b) should be construed from a commercial point of view which enabled the Tribunal to have regard to the wider purpose of the *Agility* agreement of giving choices to the customer. HMRC disagreed. It was the terms of the contract that determined whether Article 14.2(b) applied not the wider commercial considerations. Further, the parties disagreed on the correct meaning of *in the normal course of events*.

25 73. The Tribunal's starting point is to determine on the facts the correct characterisation of the *Agility* agreement.

30 74. The Appellant argued that the Tribunal was entitled to take into account the wider circumstances to ascertain the commercial function of *Agility*. According to the Appellant, article 14(2)(b) should be construed in the context of Article 14 as a whole which suggested that the purpose of the additional situations identified in Article 14 was to identify transactions in terms of commercial and economic character similar to a sale of goods. The Appellant stated that the Tribunal's evaluation of the facts should be based on the terms of the *Agility* agreement and the circumstances surrounding its making not on whether it had close similarities with a hire purchase agreement.  
35 HMRC contended that Article 14(2)(b) was a deeming provision and that the surrounding provisions added nothing to its interpretation. The words of Article 14(2)(b) should be read straightforwardly which direct attention to what was provided for in the contract, not on the wider circumstances.

40 75. The Tribunal prefers HMRC's approach. The wording of Article 14(2) is concerned with the terms of the contract not with the wider circumstances. Article

14(2) is framed in such a way that attention is directed to what the contract provides. In this respect the Tribunal finds support from the preliminary observations of the Court of Justice in *Eon Aset* which having taken account of Article 14(2) examined the categorisation of a contract from what is provided for in that contract. The Tribunal considers that the Appellant's purposive construction of Article 14 did not progress its argument for having regard to the wider circumstances. In the Tribunal's view, the purposive construction was simply a restatement of HMRC's description of Article 14(2)(b) as a deeming provision.

76. The Appellant's case for consideration of wider circumstances appeared to stem from the reference of the Court in Justice in *Eon Aset* at paragraph 39 to a wider concept of transfer of ownership not restricted to those defined by the applicable national law. The Tribunal considers that paragraph 39 should be interpreted in the context of the preliminary observations as a whole. The Tribunal's understanding of the Court of Justice's approach is that the Tribunal should examine the terms of the contract and if it concludes that those terms result in a transfer of ownership the conclusion remains valid despite the national law giving a contrary interpretation. The words of paragraph 39 are not support for looking beyond what is provided for in the contract.

77. The Tribunal agrees with the Appellant's proposition that it should make its findings in respect of characterisation on the terms of the *Agility* agreement and not on whether it has striking similarities with the Appellant's hire purchase agreements. The Tribunal's agreement, however, does not extend to disregarding the description of the *Agility* agreement and preventing it from drawing conclusions on those facts as to whether it fits with the legal characterisation for hire purchase agreements. The issue of striking similarities with the Appellant's hire purchase agreements would be relevant if the Tribunal is obliged to have regard to the wider circumstances.

78. The Tribunal makes the following findings of fact on the terms of the *Agility* agreement:

(1) The *Agility* agreement was a hire purchase agreement regulated by the Consumer Credit Act 1974.

(2) The agreement was for a fixed period of time under which the customer was required to make monthly payments to discharge the amount of credit including interest borrowed by the customer in respect of a named vehicle. In return the customer was entitled to have possession of the vehicle.

(3) The agreement gave the customer an option to purchase once s/he made all payments liable under the agreement except the Optional Purchase Payment and Purchase Activation Fee. The option to purchase was exercised only by making the Optional Purchase Payment before the due date.

(4) The Appellant retained the ownership of the vehicle until the customer had exercised the option to purchase and made all the payments due under the agreement.

(5) If the customer did not exercise the option to purchase s/he was required to return the vehicle to the Appellant in good condition. If the customer returned the vehicle, s/he may be liable for excess distance and damage charges.

(6) The agreement included a provision for the payment of a deposit.

5 (7) The agreement specified detailed financial information which included the total payable, the total cash price of vehicle and the total charge for credit.

(8) The analysis of the financial payments in the sample agreements in paragraphs 53 and 54 above demonstrated that the monthly payments included a significant capital contribution in respect of the vehicle.

10 (9) The agreement required the vehicle to be serviced and maintained at the published service intervals within the Mercedes Benz Official Workshop network.

79. The Appellant suggested that the purpose of *Agility* as reflected in its terms was the hiring of a Mercedes Benz motor vehicle to a customer who wished to keep  
15 his/her options regarding ownership of the motor vehicle open until maturity. The Tribunal disagrees with the Appellant's characterisation of *Agility* agreement. The description of the agreement as a hire purchase, the provision for a deposit payment, the specified financial information including the cash price for the vehicle, the substantial capital payment inherent in the contract structure, and the option to  
20 purchase were compelling indicators of *Agility* being a contract of sale of a car. The requirement regarding the maintenance of the vehicle was consistent with a characterisation of a sale contract, in that it preserved the customer's capital investment in the vehicle.

80. The Appellant contended that *Agility* gave the customer options at the maturity  
25 of the agreement. The reality as depicted by the terms and structure of the agreement was very different from that portrayed by the Appellant. The agreement was silent on the part-exchange option utilising the guaranteed future value of the vehicle. Examination of the terms demonstrated that the return of the vehicle was the default position for the customer who lost his/her capital investment and incurred potential  
30 liability for additional charges for excess distance and damage if the vehicle was returned. The Tribunal concludes that on a proper analysis the sole realistic option under the agreement was to purchase the vehicle.

81. The term in *Agility* allowing retention of title by the Appellant until exercise of the option to purchase mirrored the legal position under hire purchase. In the  
35 Tribunal's view, *Bradgate's* description of hire purchase as a supply of goods on credit terms coupled with security for the supplier neatly summed up the essence of *Agility*.

82. The Tribunal is, therefore, satisfied that *Agility* was a contract for sale of goods on deferred terms under which the vehicle was handed over to the customer who had  
40 the option of purchasing the vehicle upon payment of the final instalment.

83. The final issue in respect of *Agility* is whether it met the requirement of Article 14(2)(b) of providing that in the normal course of events ownership is to pass at the

latest upon payment of the final instalment. The operative words for this dispute were *in the normal course of events*.

84. The Appellant's construction of *in the normal course of events* took on various guises starting with *intended and expected* to *expected to happen*, and ending with *more likely than not*. The Appellant considered that *more likely than not* was consistent with the ordinary and usual meaning of *normal*. The Appellant illustrated its preferred construction against traditional hire purchase<sup>17</sup> where it could be said at the outset of the contract with reasonable certainty that ownership would pass to the customer on final payment. Whereas this could not be said for *Agility* because the customer kept open his/her options until maturity of the contract. In this respect the approach adopted in International Accounting Standards 17 of assessing which risks and rewards incidental to ownership rested with the lessor or the lessee had resonance for the Appellant's assessment of contracts against the *more likely than not* test.

85. HMRC contended that *in the normal course of events* was concerned to identify *when* title normally passed under such agreements. The provision was not concerned with how many cases reached that point but rather with the kind of contract which provides for a transfer of ownership at some point after the goods have been handed over, and it settled on identifying those transactions where ownership was normally acquired at the latest on payment of the final instalment. In short, *in the normal course of events* qualified *when* the ownership normally passed if the option was exercised, that is normally it would do so *at the latest upon payment of the final instalment*.

86. In the alternative, HMRC proposed that *in the normal course of events* was to be construed as a question of whether the passing of ownership was *normal* under the terms of the contract, rather than *abnormal*, in which case *Agility* was caught by the provisions of Article 14(2)(b). The possible passing of title was an essential feature of *Agility* rather than an eventuality which may only arise in limited and exceptional circumstances.

87. The Tribunal was not persuaded by the Appellant's construction of *more likely than not*. In the Tribunal's view, the construction departed from the clear intent of Article 14(2)(b) of examining whether the contract provided for ownership to pass by introducing an assessment of whether the option to purchase would be exercised. In essence the Appellant's construction focussed on the performance of the contract rather than on what the contractual terms said.

88. The Appellant was not explicit about the method for determining whether a contract met the *more likely than not* test. The Appellant's reference to a traditional hire purchase meeting the test implied that a hire purchase with balloon would not. This suggested that the *more likely than not* test incorporated a risk assessment of not paying the final payment. The Appellant's reliance on Accounting Standards which were about risk evaluation reinforced the Tribunal's view that the Appellant's

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<sup>17</sup> The Tribunal assumes that the Appellant use of traditional refers to hire purchase without balloon.

application of the *more likely than not* test would cause confusion and inconsistency and deflect attention away from the contractual terms.

5 89. Equally the Tribunal was not convinced with HMRC's preferred position which was that *in the normal course of events* qualified *when* the ownership normally passed. The Tribunal agrees with the Appellant's argument that it could not be linguistically correct for *normal course of events* to qualify not only that ownership would pass but also *when*. In the Tribunal's view the qualification for *when* ownership would pass was provided by the phrase *at the latest upon payment of the final instalment*, not by *normal course of events*.

10 90. The Tribunal did not consider the French language version of Article 14(2)(b) on the assumption that the English language version was of equal linguistic value. The Tribunal acknowledges that on the face of it the French language version supported HMRC's preferred position.

15 91. The Tribunal prefers HMRC's alternative construction of *in normal course of events* namely that the possible passing of title was an essential feature of *Agility* rather than an eventuality which may only arise in limited and exceptional circumstances. HMRC's alternative construction did not stray away from the governing principle that the application of Article 14(2)(b) was determined by the terms of contract. The Tribunal's analysis of *Agility's* terms found that the option to  
20 purchase constituted the sole realistic option under the agreement. The transfer of ownership was, therefore, central to the *Agility* contract, not tangential.

25 92. The phrase *normal course of events* is directed at the legal realities of a contract for sale with an option to purchase. The phrase recognises that under the terms of such a contract ownership might not pass but that possibility did not prevent the contract from being a contract for sale under which ownership normally transferred. Thus the fact that ownership might not transfer under the *Agility* contract did not preclude it from being a contract for sale. The passing of title was central to *Agility* which meant that ownership would normally pass under its terms.

30 93. This Tribunal has arrived at the same conclusion as expressed in *Rodney Hogarth*

35 "What usually happens under a hire purchase transaction is that the customer makes the payments and eventually becomes the owner of the goods, in both cases in accordance with the hire purchase agreement. In my judgment that course of events is one which is referred to in Article 5.4 as 'the normal course of events', and such an agreement is an example of an agreement which 'expressly contemplates' that the property 'will' pass as mentioned in paragraph 1(2)(b).]

40 In my judgment the fact that the agreement also contemplates other possible events in which the property will not pass, such as the premature termination of the agreement, does not prevent the agreement from being an agreement which contemplates that the

property will pass; I construe ‘will’ in this context as meaning, not ‘will inevitably’, but ‘will in certain events’” .

94. Although Hogarth was concerned with the wording of paragraph 1(2)(b) of Schedule 4 VAT 1994, there was no argument put forward in this Appeal to suggest that the terms of Article 14(2)(b) were more restrictive than those of the VAT Act 1994.

95. The Tribunal considers the ratio in *Hogarth* and HMRC’s construction of *normal*, rather than *abnormal* were fundamentally different from the Appellant’s *more likely than not test*. The former were looking to what the contracts provided as to when ownership is to pass. Whereas, the Appellant’s *more likely than not test* was about the likelihood of the subsequent exercise of the option to purchase. The likelihood appeared to be determined by some form of risk evaluation based upon a range of extraneous factors not directly related to the terms of contract. In this respect the Tribunal’s rejection of a role for risk evaluation in deciding the application of Article 14(2)(b) meant that there was no place for the Accounting Standards in this Appeal which was not concerned with the distinctions between operating and finance leases.

96. The Tribunal also considers that HMRC put forward two other powerful arguments for why the Appellant’s position was wrong. First the classification of a transaction as a supply of goods or services was not one that could only be known at the end of the term of the contract. If the supply under the *Agility* contracts was a supply of goods then VAT must be accounted for on the sale price of the car at the time when it was handed over the customer. Under the Appellant’s construction the correct characterisation of the supply under *Agility* would only be known at contract maturity when a decision was required on the option to purchase. Thus the Appellant’s construction resulted in a situation where the application of Article 14 did not produce an answer one way or the other at the time the vehicle was supplied. Such a proposition was clearly wrong and offended the principle of legal certainty. Second if the Appellant’s interpretation was correct, it would exclude all hire purchase agreements, given the possibility of termination either in the exercise of a right or because of a default.

97. Before the Tribunal concludes with its decision on the Appeal, the Tribunal considers that it should state its findings on the wider circumstances if a higher judicial body decides that it was wrong to exclude the wider circumstances from its consideration. Also the Appellant at the hearing asked the Tribunal to make findings in relation to eleven matters which for completeness should be included in the decision.

98. The Appellant submitted that the wider circumstances demonstrated that the commercial purpose for *Agility* was to give choice to customers which enabled them to keep their options open until maturity of the contract. The Tribunal considers that the Appellant’s submission was based on an incomplete picture of the factual matrix underpinning the circumstances surrounding *Agility*.

99. The Tribunal considers that the decisive factor for determining the commercial purpose for *Agility* was the rationale for its introduction. The facts of which are set out in paragraphs 45 – 50 above. Essentially *Agility* was a repackaged hire purchase finance product incorporating the Appellant’s commercial knowledge of its motor vehicles which eliminated the risks associated with the *metal* (the vehicle) and in turn gave the Appellant a competitive edge over its competitors’ hire purchase products.

100. The characterisation of *Agility* as hire purchase was supported by the striking similarities between the *Agility* and hire purchase agreements (see paragraph 56 above), and their comparable financial profiles with significant capital repayment (see paragraph 69 above).

101. The Tribunal is of the view that the evidence on marketing was contradictory. On the one hand, the *Finance Decision Tree* and *Welcome Pack* indicated that *Agility* was for customers who wished to keep their options open but on the other hand, the online pictorial depiction and the use of the word *Your* gave the impression that *Agility* was about ownership of the vehicle (see paragraphs 63, 65 and 68 above).

102. The Tribunal considers that even on the wider circumstances the question of choice was illusory. The option of part exchange still required the customer to purchase the vehicle beforehand. The option of return was still a default position which was largely governed by the environmental factors at the time of maturity. The rates of vehicle return under *Agility* and hire purchase were very similar. The advantage of *Agility* over hire purchase to the customer was that it involved lower monthly payments which in the Tribunal’s view gave the impression that *Agility* was a more affordable way of purchasing the vehicle (see paragraphs 55,61 & 70 above)..

103. The Tribunal concludes from its assessment of the wider circumstances that from a commercial perspective *Agility* would be categorised as an affordable hire purchase product which carried no risks on the metal for the Appellant.

104. The Tribunal sets out below the eleven matters upon which the Appellant requested findings. The Tribunal’s primary position is that most of the eleven matters were irrelevant to its determination. The Tribunal makes comment where appropriate against the eleven matters.

<b>Appellant’s Proposed Finding of Fact</b>	<b>Tribunal’s Comment</b>
The objective purpose of <i>Agility</i> is the hiring of a Mercedes Benz motor vehicle to a customer who wishes to keep his options, regarding ownership of the motor vehicle, open until maturity	The Tribunal disagrees. In relation to its determination (see paragraph 79 above, and to wider circumstances see paragraph 103 above)



<p>This is reflected in the name of the product, implying flexibility, and this is how <i>Agility</i> is advertised/described to customers.</p>	<p>Contradictory marketing evidence (see paragraph 101 above)</p>
<p>And <i>Agility</i> is recommended both online and at dealerships to customers who wish to keep their options open; alternative products are recommended to customers who decide at the outset that they do or instead do not wish to own the motor vehicle</p>	<p>HMRC challenged the accuracy of this statement because the Appellant adduced no evidence to substantiate it. The Tribunal ruled that HMRC was not entitled to do this because it was an agreed statement of fact. The Tribunal, however, considers this agreed statement of fact has to be weighed against the commercial rationale (see paragraph 99 above).</p>
<p>The purpose of <i>Agility</i> is reflected in its terms: the customer hires the vehicle for a fixed period in return for monthly payments, and at maturity he has an option to purchase for a fixed price which is calculated at the outset to be equal to the market value of the vehicle at maturity.</p>	<p>The Tribunal disagrees. See its findings at paragraphs 79 and 80.</p>
<p>The calculation is genuine and expert estimate of the residual value of the vehicle; it is made partly by reference to external guides eg Glass guide, and partly by reference to Mercedes Benz own knowledge about forthcoming developments which are likely to affect future values, for example, new models</p>	<p>Agreed. The Tribunal, however, questions its relevance for the Appellant's case of flexibility based on the wider circumstances.</p>
<p>The typical period of an <i>Agility</i> contract for a new vehicle is 3-4 years; for a second hand vehicle it is slightly less. For new and second hand vehicles, the period of an <i>Agility</i> contract is always substantially less than the useful life of the Mercedes Benz motor vehicle. This means that the residual value is substantial not a nominal sum.</p>	<p>An agreed statement of fact. The substantial sum has to be weighed against the evidence which showed that the customer's contribution in respect of monthly payments with interest and deposit exceeded the residual value by a significant sum. In the Tribunal's view, the amount already paid was important in relation to the characterisation of the agreement and the customer's decision to exercise the option.</p>

Merely by entering into the <i>Agility</i> agreement, and merely by paying the obligatory monthly payments, the customer is not commercially committing himself to becoming the owner of the vehicle.	The Tribunal does not understand the term <i>commercially</i> committing. The Tribunal accepts that the customer has to exercise an option to purchase before ownership is transferred. The Tribunal, however, considers the monthly payments represent a significant investment in the vehicle by the customer.
Statistics show that the purpose of <i>Agility</i> is in fact achieved; on average around 50 per cent of vehicles are purchased and 50 per cent are returned	Hire purchase have similar high rates of return
The Appellant is neutral as to whether or not an <i>Agility</i> customer decides at maturity to purchase or not to purchase, the motor vehicle.	The Appellant carries no risk if the vehicle is returned.
However, because there is a very real prospect of the customer returning the vehicle, <i>Agility</i> , obliges the customer at maturity to pay for damage to the vehicle, and to pay for excess mileage, and also obliges him to service the vehicle at Mercedes-Benz approved workshops only.	Agreed statement of fact. Relevant to the Tribunal's characterization of <i>Agility</i> as a contract for sale of a vehicle (see paras 79 and 80 above).
Having regard to the terms of <i>Agility</i> there is no expectation at the outset that a typical <i>Agility</i> customer will purchase the vehicle	Tribunal disagrees. Its findings on the agreement and wider circumstances demonstrate that <i>Agility</i> is portrayed as an affordable means to purchase the vehicle.

## Decision

105. The Tribunal summarises its findings as follows

- 5 (1) The words of Article 14(2)(b) should be read straightforwardly which direct attention to what is provided for in the contract, not on the wider circumstances.
- (2) The description of the agreement as hire purchase, the provision for a deposit payment, the specified financial information including the cash price for  
10 the vehicle, the substantial capital payment inherent in the contract structure,

and the option to purchase are compelling indicators of *Agility* being a contract of sale of a car

(3) On a proper analysis the sole realistic option under *Agility* is to purchase the vehicle

5 (4) *In the normal course of events* is to be construed as a question of whether the passing of ownership was *normal under the terms of the contract*, rather than *abnormal*.

(5) The fact that ownership might not transfer under the *Agility* contract did not preclude it from being a contract for sale. The passing of title is central to  
10 *Agility* which meant that ownership would normally pass under its terms.

106. The Tribunal is satisfied on its findings that *Agility* is a contract 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. Article 14(2)(b) of the VAT Directive, therefore, applied to *Agility*.

15 107. The Tribunal decides under *Agility* the Appellant makes a supply of goods.

108. The Tribunal dismisses the Appeal.

109. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later  
20 than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

25 Final Decision with corrections to clerical mistakes or other accidental slips or omissions pursuant to Rule 37 of Tribunal Rules 2009

30 **MICHAEL TILDESLEY OBE**  
**TRIBUNAL JUDGE**

**RELEASE DATE: 17 December 2012**

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