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INTERNATIONAL COURT PRACTICE

JUDGMENT OF THE EUROPEAN COURT OF JUSTICE IN THE CASE *B.G.Ż. LEASING SP. Z O.O.* V *DYREKTOR IZBY SKARBOWEJ W WARSZAWIE*

1. Introductory Notes

The legal issue dealt with by the European Court of Justice in the case *C-224/11 B.G.Ż. Leasing sp. z o.o. v Dyrektor Izby Skarbowej w Warszawie* (the Judgment of 17 January 2013) is set in the context of implementation of tax legislation, i.e. regarding implementation of the Council Directive on the common system of value added tax (VAT) in the proceedings between the Polish tax authorities and a local leasing company.

In the proceedings, the issue of the legal nature of related leasing and insurance services was posed, i.e. whether leasing services and insurance of leased item are considered as one complex legal transaction that fall under the same tax treatment or two separate legal transactions to which tax regulations (tax rates) apply separately.

The subject of the proceedings was not the insurance contract and the leasing agreement concluded between the lessee and the lessor, and therefore the Court did not have access to them, but only the tax treatment of several services within one complex transaction.

2. Regulatory Framework

Applicable regulation for such legal issue is the Council Directive 2006/112 EC of 28 November 2006 on the common system of value added tax (VAT).

Pursuant to Article 1 (2) of the Directive, on each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or

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services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components.

Pursuant to Article 24 (1) of the Directive, supply of services' shall mean any transaction that does not constitute a supply of goods.

Pursuant to Article 28 of the Directive, where a taxable person acting in his own name but on behalf of another person takes part in a supply of services, he shall be deemed to have received and supplied those services himself.

Pursuant to Article 73 of the Directive, in respect of the supply of goods or services, other than as referred to in Articles 74 to 77, the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, including subsidies directly linked to the price of the supply.

Pursuant to Article 78 of the Directive, the taxable amount shall include, *inter alia*, "incidental expenses, such as commission, packing, transport and insurance costs (underlined by the author), charged by the supplier to the customer."

Exemptions contained in Article 135 (1) (a) of the Directive – insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents make the case disputable.

3. Subject Matter of the Proceedings and Legal Issues

B.G.Ż. Leasing sp. z o.o. is a company providing leasing services in accordance with national legislation.

According to the general conditions of the national, i.e. Polish law applicable to contracts, the items leased by the lessor remain its property throughout the duration of the lease. The lessee pays a rent to the lessor and also pays others expenses related to the item leased.

According to the general conditions and contractual provisions, *B.G.Ż. Leasing* requires that leased item is insured. *B.G.Ż. Leasing* offers to provide its clients with insurance. If they wish to take up that offer, *B.G.Ż. Leasing* subscribes to the corresponding insurance with an insurer and re-invoices the cost of that insurance to the lessee.

In its VAT return for February 2008, *B.G.Ż. Leasing* took the view that such re-invoicing of the cost of the insurance for the leased item was exempt from VAT. The National Revenue Administration of Poland took the view however that the transaction consisting in the supply of insurance cover was a supply of services ancillary to the leasing service, and as such should be subject to VAT in the same way as the principal service, namely the leasing transaction.

The Second Instance Administrative Court agreed with the opinion of the National Revenue Administration of Poland and therefore *B.G.Ż. Leasing* brought an appeal against that judgment before the Regional Administrative Court in Warsaw.

The Regional Administrative Court in Warsaw agreed with the opinion of the National Revenue Administration of Poland – that transaction was subject to VAT at a rate of 22% in the same way as the principal service, and supported its opinion by Article 78 of the Council Directive of 2006/112 EC on the common system of value added tax (VAT) which read that taxable amount shall include, among other, (see Paragraph a and b Item 1 Article 78), "incidental expenses, such as commission, packing, transport and insurance costs, charged by the supplier to the customer."

The Court stated that a service provided by *B.G.Ż. Leasing,* which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the tax system. The Court held that it is a single supply of services constituted by the leasing and insurance services. According to the Court, a single rate of VAT must be applied to all the elements comprising such a service, which is the rate applicable to the supply of the principal service which is the leasing.

B.G.Ż. Leasing brought an appeal against that judgment before the Supreme Administrative Court claiming that the Regional Administrative Court had incorrectly interpreted, in particular, Articles 2(1)(c), 24(1), 28, 73 and 78(b) of the Directive on the common system of value added tax (VAT). The Supreme Administrative Court addressed the European Court regarding interpretation of the said Articles from the Directive.

3.1. Opinion of the European Court of Justice

The European Court of Justice focused on two key issues:

1. Is the price for combined services, consisting of leasing services and insurance services for the leased item, for VAT purposes, a single service, to which a single rate of VAT must be applied, or two distinct services (to which different tax rates apply)?
2. If those are two distinct services, may the second service be exempt from VAT under Article 135(1)(a) of the Directive 2006/112 EC on the common system of value added tax?

The Court started with the general condition (contained in Article 1 (2) of the Directive) that services should in principle be considered separately, but that there are cases where several formally different services that could be provided separately and taxed differently are still considered a single service – when such services are closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split. In such cases, ancillary services share the tax treatment of the principal service.

Therefore, the key issue for the Court was the degree of interconnectedness between the two services – leasing and insurance.

As the first step in determining the degree of interconnectedness of services, the Court considered whether services are supplied together, i.e. it sought to apply a legal standard previously used in case law in similar situations, based on whether ancillary services were only relevant in relation to the principal service.

However, the Court has held that the application of that standard would lead to a logical impasse, since insurance service is *always* related to another subject and only relevant in relation to the subject matter of insurance, so applying that standard to insurance would call into question the scope of Article 135 (1) of the Directive, which excludes insurance and reinsurance transactions from the scope of the Directive. In other words, as insurance is essentially always relevant only in relation to the item to be insured, then any insurance service would be considered ancillary to the subject matter of insurance and no insurance transaction could be excluded from the scope of VAT rules, which is quite contrary to the intention of the legislator.

Instead, the Court asked the following question: Is the insurance service an end in itself or is it just a way to provide the principal service better and easier?

In this regard, the Court concluded that despite the fact that insurance reduces the risks burdening the subject of leasing (which is owned by the lessor), and that thus significantly contribute to the position and security of the lessor, and even despite the fact that insurance of leased item is one of the conditions for obtaining it, these two contracts are not sufficiently connected to be considered as one service from the aspect of tax regulations. The fact that the lessor has the right to terminate the leasing agreement if the lessee does not pay the insurance premium (as one of the leasing agreement's obligations), according to the Court, is not substantial to consider both leasing and insurance as one service.

The Court held that the insurance service in the specific case does not constitute a single service together with leasing service, because decisions on leasing and the decision on insurance of leased item are two separate decisions of the lessee. The lessee may decide to obtain insurance through the lessor (and even then this economic decision is separate from the decision on the lease itself), from another participant in the insurance market – e.g. personal broker, and can also independently choose an insurance company with which he wants the subject of leasing to be insured, so for the lessee a decision on insurance is "an end in itself" and not just an ancillary service that allows him to use leasing services under the most favourable conditions .

Therefore, the Court concluded that leasing and insurance must be regarded separately in terms of Article 78 of the Directive.

The next question considered by the Court was whether the specific situation where the leasing company re-invoiced the insurance premium costs to the lessee fell under the exemption under Article 135 (1) (a) of the Directive, i.e. whether it is an insurance transaction. Although it was not disputed that the service provided

by the leasing company was an insurance service, what was somewhat disputable was whether the insurance service offered in the "package" with another service (specifically leasing) fell within the scope of this exemption. The problem was to some extent that the Directive on the common system of value added tax itself did not contain a definition of "insurance transaction", so the Court concluded on the basis of previously established case law that the expression "insurance transaction" is broad enough in principle to include the "provision of insurance cover by a taxable person who is not himself an insurer or a market participant." Furthermore, applying the principle of fiscal neutrality, the Court concludes that contrary to the regulations, treating similar goods and services, which are thus in competition with each other, differently for VAT purposes, so insurance service provided for the leased item through a leasing company cannot be treated differently as an insurance service acquired for the subject of leasing by the lessee.

According to the Court, within the total consideration paid to the leasing company, the lessee pays the part related to insurance as a consideration for insurance and not to leasing, so this amount must be taxed as insurance premium, i.e. without VAT.

4. Brief Overview of the Judgment

Essentially, the court resolved a dilemma referring to two contradictory Articles of the Directive on the common system of value added tax. On one hand, Article 78 stipulated that the taxable amount (tax base) consisted of "incidental expenses, such as commission, packing, transport and insurance costs charged by the supplier to the customer", while on the other hand, Article 135 stipulated that "insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents are excluded from the scope of the Directive", so that they are not subject to VAT.

The Court has held that the insurance of the subject of leasing, in terms of VAT regulations, should be treated as a separate service from the leasing service, and that VAT is not charged to insurance premium, even though it was charged under complex legal transaction (included in the leasing consideration).

However, it is important to note that the Court took this position having in mind two important things.

First, the Court's position is based on the assumption that the lessor invoices the lessee the same amount agreed with an insurance company to cover the risk, i.e. that the same (correct) amount of premium is re-invoiced without any increases. If, by any chance, the lessor invoices a larger amount than the one contracted with an insurance company, then this judgment cannot be applied to such situations.

Secondly, the Court believes that the rule in the Directive covering the notion of service is not absolutely and clearly defined (especially regarding complex

transactions consisting of several legal transactions/various considerations), so it is up to the Court to take into account all the circumstances of the particular case, assess the degree of connection of the service, i.e. whether services are considered "single" or separate from the aspect of tax regulations, taking into account legal standards established in previous case law referring to the question whether a legal transaction is an "end in itself" or only facilitates use of the principal service.

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