

Flash News

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Opinion on the VAT treatment applicable to transfers of non-performing receivables

The VAT treatment applicable in case of transfers of receivables generated interest and debates throughout the EU due to the several aspects that became unclear after the Court of Justice of the European Union's judgment in case C-305/01 MKG.

Background

In 2010, the German Federal Tax Court (Bundesfinanzhof) referred a case to the Court of Justice of the European Union ('the Court') concerning an assignment by a bank (the 'Bank') to GFKL Financial Services AG ('GFKL') of a portfolio of defaulted debts, for a price below the debt's face value (discounted price).

The portfolio was made of mortgages on immovable property and debts arising from terminated and matured loan agreements. This was an one-off purchase of debts.

The reference was made in order to clarify the scope of the judgment in case C-305/01 MKG ('MKG'). In that case, the Court held that an economic activity by which a business purchases debts, assuming the risk of the debtors' default and, in return, invoices its clients in respect of commission, constitutes a supply of service representing debt collection, which is subject to VAT. According to the Court, the service provided in such a case is the relief of the assignor from debt-recovery operations and from the risk of debts not being paid.

The MKG case generated large debates, most of them surrounding the question whether the conclusions of the Court should apply to all debt assignment cases or such decision should be regarded as applying only in certain circumstances as it was in the MKG case.

In this new case, GFKL is of the view that an acquirer of debts does not supply a service to the seller which is liable to VAT. It nonetheless submitted a provisional VAT return envisaging implementing the Court's judgment in MKG.

In computing the amount of VAT, GFKL assumed the consideration to be the difference between the 'economic face value' of the portfolio as agreed by the parties and the purchase price. GFKL then lodged an objection to its provisional VAT return.

The disputed matter is whether such a purchase is within the scope of VAT and if so, whether it represents debt collection and if it does, what the taxable amount should be.

On 14 July 2011, Advocate General Jääskinen ('AG') delivered his opinion in this case. The main points are highlighted below.

Is this transaction within the scope of VAT?

Answering to the first question addressed to the Court, the AG considered, on one hand, that the purchaser of the debts (i.e. GFKL) supplies a service to the Bank when acquiring such debts. The basis for this opinion was that the role of GFKL had been much more complex than that of merely a recipient of assignments of debts, while the Bank is receiving an advantage going beyond the payment of a price that reflects the current value of the debts.

On the other hand however, the AG was of the opinion that there is no consideration paid by the Bank to GFKL for the provision of this service. Further on, assuming the existence of such consideration, the AG stated that anyhow there is no direct link between the services provided and the consideration received.

On this basis and considering the principle stated by the Court in previous case-law that a service in the VAT sphere needs to be provided in return for a consideration based on a legal relationship between the parties that gives rise to reciprocal performance (the direct link requirement), the AG concluded that such service would be outside the scope of VAT.

This means that there would be no VAT-able supply performed by GFKL to the Bank upon performing the transfer of those receivables.

This debate is the most significant part of the case since many commentators and the referring court questioned the applicability of the conclusions from the MKG case (that is to say, the existence of a VAT-able debt collection service supplied by the purchaser to the seller of the receivables) beyond the very specific situation and facts of the MKG case.

The AG did nevertheless answer to the other two questions raised before the Court for covering the event whereby the Court would not follow his conclusion on that key element.

Is this transaction VAT exempt?

After analysing the scope of the VAT exemptions, the AG states that the supply should qualify as debt collection, which is excluded from the scope of the VAT exemption.

Furthermore, the AG considers that GFKL would not supply two independent services to the Bank, i.e. VAT-able debt collection and VAT exempt granting of credit, but a single VAT-able debt collection service.

What is the value of the consideration?

In AG's opinion, the consideration in the case at hand should be represented by the difference between the amount GFKL eventually collects from the debtors and the price it paid to the Bank for purchasing the portfolio, although that would lead to delays in determining the taxable amount and in collecting the amount due.

Conclusions of the opinion

The AG considers that there is no service in the scope of VAT performed by GFKL to the Bank upon purchasing the portfolio of debts.

Should the Court disagree with this point of view, the AG is of the opinion that:

- No VAT exemption would apply in respect of this service performed by GFKL to the Bank since it represents debt collection and
- The taxable basis for this service is represented by the difference between the amount that GFKL will eventually collect from the debtors and the price paid by GFKL to the Bank for purchasing the debts.

Potential implications and next steps

Should the Court agree with the AG's opinion that no service in the VAT sphere is supplied by GFKL to the Bank, the main consequence would be that no VAT would be due for the acquisition of portfolio of defaulted debts acquired at a discounted price to the extent that no consideration for a service is paid.

In any case, this opinion from the AG has created the hope that the Court will bring clarity to the treatment of defaulted debts transactions which has been subject to a debate since the release of the MKG case. It should then hopefully reduce the current lack of legal certainty arising to the heterogeneous treatment of these transactions amongst the EU.

The Court did not provide a date for delivering its judgement, but we would expect that this happens by the end of the year.

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