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Tax Alert

Luxembourg

Transfer of debts portfolio and VAT

ECJ judgment - GFKL Financial Services AG

Introduction

The European Court of Justice (ECJ) released on 27 October 2011 its decision in the case GFKL Financial Services AG, Case C - 93/10 (GFKL).

The questions referred to the ECJ by the German Bundesfinanzhof concern the transfer of non-performing loans to a specialist debt collector. Specifically the German Court seeks an answer to the questions whether the transfer by a bank of non-performing loans to a specialist debt collector (GFKL) constitutes a service for consideration and whether such consideration should be VAT taxable or VAT exempt. Finally the question of how should such a consideration be calculated was raised.

Facts

GFKL acquired mortgages on immovable property and debts from 70 terminated loan agreements. At the closing date, the face value of the debts was €15.5m ("face value"). In the Purchase Agreement the Parties stated that the expected collection value was €8.9m ("economic value"). This value was discounted to €8.399m ("discounted economic value") taking into account an interest rate of 5.97% and a collection period of 3 years. The purchase price was finally fixed at €8.035m.

The German tax authorities (Finanzamt) took the position that GFKL owed German VAT on the difference between the discounted economic value and the purchase price, as in their view and based on the interpretation of the principles set in the case C-305/01 (MKG), this difference corresponded to the consideration received in exchange for factoring services. GFKL succeeded before the lower court (Finanzgericht). The authorities appealed to the German Supreme Tax Court who referred the case to the ECJ, essentially asking whether the acquisition of a non-performing loan portfolio is a taxable factoring/collection of debt supply in the sense of MKG.

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Grounds and the judgment

The Court followed the opinion of Advocate General Niilo Jääskinen and considered that there is no direct link between the economic activity (which the judgment identifies as debt collection) and any consideration.

Argument was heard that the consideration for the debt collection activity might be either the deduction from the economic value, or the ability of GFKL to make a profit. The ECJ concludes that neither of these is sufficiently closely linked to the economic activity to make it a supply for VAT purposes. The deduction is made to reflect the actual amount of the risk being taken on, and this results in a market value being paid for the portfolio.

On those grounds, the ECJ ruled that *"an operator who, at his own risk, purchases defaulted debts at a price below their face value does not effect a supply of services for consideration within the meaning of the Directive and does not carry out economic activity falling within the scope of that Directive when the difference between the face value of those debts and their purchase price reflects the actual economic value of the debts at the time of their assignment"*.

In light of the above, the Court did not need to decide on the two other questions referred by the Bundesfinanzhof concerning VAT liability of the supply and determination of the value of the consideration.

In our view, the decision is not surprising and does not alter the current policy on the VAT treatment in Luxembourg.

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