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Law Firm Comments on German VAT Case

Summary by taxanalysts®

GSK Stockmann & Kollegen has released an update explaining a case involving the VAT treatment of nonperforming loans that the German Federal Fiscal Court referred to the European Court of Justice.

Full Text Published by taxanalysts®

Non-performing Loans: Federal Fiscal Court Submits Case to the ECJ regarding VAT Treatment

Federal Fiscal Court questions taxable activity of purchaser of a receivable.

03 March 2010

Executive Summary

- Federal Fiscal Court raises doubts regarding a taxable supply of the purchaser of non-performing receivables.
- Significant economic effects on input VAT refund
- Deviation from current administrative practice
- Case submitted to the ECJ

On 24 February 2010, the Federal Fiscal Court (FFC) published a ruling dated 10 December 2009 in which various issues are addressed regarding the VAT treatment of the purchase of non-performing loans to the European Court of Justice (ECJ).

VAT Position in Germany

On the basis of the MKG case of the ECJ (ruling dated 26 June 2003) German tax authorities take the position that the purchaser of a receivable renders a taxable supply to the seller of the receivable. The service shall qualify as a taxable factoring service. The consideration for that service is defined as the difference between the face value of the purchased receivable (e.g., in case of non-performing loans: the amount which probably can be realized at the time of the purchase, "commercial face value") and the purchase price. Since the selling bank as recipient of the supply in general can not claim a (full) input VAT refund, the cost of the transaction thereby is increased by (currently) 19% of the taxable basis.

Questions Referred to the ECJ for a Preliminary Ruling

The Federal Fiscal Court questions whether the treatment of the purchase of non-performing loans by the tax authorities is consistent with EU law.

Firstly, the Federal Fiscal Court refers to the ECJ the question whether the purchase of a non-performing receivable qualifies as a taxable supply (factoring) provided that the purchase price is determined on the basis of the probable loss (rather than by a fixed discount) and provided further that the collection of the receivable, compared to the assumption of the credit risk commercially is not significant.

If the ECJ concludes that the purchaser of a receivable in fact provides a service to the seller, the Federal Fiscal Court will raise the question to the ECJ whether such service is tax exempt as the provision of a guarantee and whether such tax-exempt supply also includes the collection of the receivable.

Finally, if the ECJ concludes that there is a taxable supply which is not tax exempt, the Federal Fiscal Court will raise the question whether the remuneration (and consequently the amount of VAT) has to be determined on the

basis of the actual cost of the collection or on a basis which is discretionally determined by the parties.

Issues Considered by the Court

The Federal Fiscal Court raises doubts whether the discount agreed upon in relation to the purchase of a non-performing loan in fact can be qualified as a consideration for a service since the purchase price in this particular case is determined by a number of factors (e.g., credit worthiness of the debtor, validity and enforceability of securities, timing of enforcement and related costs) and does not necessarily represent the value of the service received. Furthermore, the parties in the case referred to the ECJ have not explicitly agreed upon such remuneration. In case the discount does not qualify as a remuneration, there can not by definition be a service for VAT purposes.

Should the ECJ conclude that there is a service for consideration, such service might be tax exempt as the provision of a guarantee according to the Federal Fiscal Court. Similar to credit card transactions, the purchaser of the receivable might assume the credit risk of the debtor. In that case the question needs to be answered whether the collection of the receivable is a (taxable and non-tax exempt) supply that is distinct from the assumption of the credit risk. It seems that the Federal Fiscal Court favours the view that the collection of the receivable is not a distinct service.

Relevance of the Court Ruling

The VAT treatment of the sale of non-performing receivables by banks has a significant commercial impact. In case the purchase of a receivable qualifies as a taxable supply of the purchaser of the receivable to the seller and provided that the remuneration equals the difference between the purchase price and the fair market value, the cost of the transaction would be drastically increased if the seller of the receivable can not claim a (full) input VAT refund, which in particular is the case with banks.

The German tax administration in the current version of the interpretation guidelines on the VAT Act has limited the risk as they refer to the lower "commercial" face value in order to determine the remuneration (and the corresponding VAT amount). However, it is arguable whether this treatment is correct.

If the ECJ agrees with the Federal Fiscal Court that the purchaser of a non-performing receivable either does not make a taxable supply at all or that the taxable supply is tax exempt, this would indicate that the purchaser of the receivable might have to bear the downside risk of non-deductible input VAT (e.g., related to advisory services). To that extent, the issue of non-refundable input VAT would be shifted from the bank to the purchaser of the receivable, who certainly will try to include the cost in the discount.

In the course of dealing with the current financial crisis, there have been substantial sales of non-performing loans; and there will be further substantial sales by banks in an attempt to tidy up their balance sheets. In this respect, a swift decision of the ECJ would be important for the sector.

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