Case C-93/10

Finanzamt Essen-NordOst

v

GFKL Financial Services AG

(Reference for a preliminary ruling from the Bundesfinanzhof)

(Sixth VAT Directive – Articles 2(1) and 4 – Scope – Concepts of ‘supply of services effected for consideration’ and ‘economic activity’ – Sale of defaulted debts – Sale price lower than the face value of those debts – Assumption of responsibility by the purchaser for the recovery of those debts and for the risk of defaulting debtors)

Summary of the Judgment

Tax provisions – Harmonisation of laws – Turnover taxes – Common system of value added tax – Supply of services effected for consideration – Meaning

(Council Directive 77/388, Arts 2(1) and 4)

Articles 2(1) and 4 of Sixth Directive 77/388 on the harmonisation of the laws of the Member States relating to turnover taxes must be interpreted as meaning 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 Article 2(1) and does not carry out an economic activity falling within the field of application 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 such circumstances, the assignee of the debts receives no consideration from the assignor, the difference between the face value of the assigned debts and the purchase price of those debts constituting a reflection of the actual economic value of the debts at the time of their assignment, which results from the fact that they are doubtful and from the increased risk of default of the debtors.

(see paras 22, 25-26, operative part)

JUDGMENT OF THE COURT (Third Chamber)

27 October 2011 (*)

(Sixth VAT Directive – Articles 2(1) and 4 – Scope – Concepts of ‘supply of services effected for consideration’ and ‘economic activity’ – Sale of defaulted debts – Sale price lower than the face

value of those debts – Assumption of responsibility by the purchaser for the recovery of those debts and for the risk of defaulting debtors)

In Case C?93/10,

REFERENCE for a preliminary ruling under Article 267 TFEU from the Bundesfinanzhof (Germany), made by decision of 10 December 2009, received at the Court on 17 February 2010, in the proceedings

Finanzamt Essen-NordOst

v

GFKL Financial Services AG,

THE COURT (Third Chamber),

composed of K. Lenaerts, President of the Chamber, J. Malenovský, R. Silva de Lapuerta (Rapporteur), G. Arestis and D. Šváby, Judges,

Advocate General: N. Jääskinen,

Registrar: K. Malacek, Administrator,

having regard to the written procedure and further to the hearing on 12 May 2011,

after considering the observations submitted on behalf of:

– GFKL Financial Services AG, by A. Bartsch and B. Keller, Rechtsanwälte,

– the German Government, by T. Henze and C. Blaschke, acting as Agents,

– Ireland, by D. O'Hagan and G. Clohessy, acting as Agents,

– the European Commission, by D. Triantafyllou, acting as Agent,

after hearing the Opinion of the Advocate General at the sitting on 14 July 2011,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 2(1), 4, 11A(1)(a) and 13B(d)(2) and (3) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1, 'the Sixth Directive').

2 The reference has been made in the course of proceedings between Finanzamt Essen-NordOst (Essen North-East Tax Office, 'the Finanzamt') and GFKL Financial Services AG ('GFKL') concerning the value added tax ('VAT') to which the latter was subject on account of the purchase, by one of its subsidiaries, of debts relating to 70 loan agreements that had been terminated and declared mature.

Legal context

3 Article 2(1) of the Sixth Directive provides:

‘The following shall be subject to [VAT]:

1. the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such’.

4 Article 4(1) and (2) of that directive is worded as follows:

‘1. “Taxable person” shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.

2. The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity.’

The dispute in the main proceedings and the questions referred for a preliminary ruling

5 GFKL is the sole and controlling member of a company incorporated under German law which on 26 October 2004 purchased from a bank mortgages on immovable property and debts relating to 70 loan agreements that had been terminated and declared mature.

6 On the reference date, 29 April 2004, the face value of those debts was EUR 15 500 915.16.

7 The purchase agreement stipulated, inter alia, that, from the reference date, those mortgage rights and debts were deemed managed or held for and at the risk of the purchaser, that the purchaser was entitled to the payments attributable to the mortgage rights and debts and that liability of the seller for the recovery of the debts in question was excluded.

8 However, following a letter from the Federal Finance Ministry of 3 June 2004 concerning the implementation of the Court’s judgment in Case C?305/01 *MKG-Kraftfahrzeuge-Factoring* [2003] ECR I?6729, the parties to the debt purchase agreement considered that, in the light of considerable payment defaults, the realisable portion of the debts in issue was much lower than their face value and set the economic value of those debts at EUR 8 956 101.

9 Furthermore, taking the view that recovery of those debts was to be spread out over a period of about three years, the parties, on the basis of an agreed interest rate set at 5.97%, reached agreement as to the grant by the purchaser to the seller of credit entailing interest of EUR 556 293, so that, after the deduction of that interest, the economic value of the debts was EUR 8 399 808.

10 The definitive purchase price for the debts in issue was finally fixed at EUR 8 034 883 and the purchase agreement did not provide for the possibility of adjusting this price at a later time.

11 Furthermore, the parties were of the view that, by purchasing those debts, the purchaser did not supply a service to the seller which was liable to tax. However, they stipulated that, in the event that the tax authorities did not agree with that analysis, the difference of EUR 364 925 between the economic value reduced by the interest and the definitive purchase price of the debts should be regarded as the consideration for that service.

12 Having submitted a provisional turnover tax return in which it stated that that difference

constituted the payment for a taxable service provided to the seller of the debts in issue, GFKL lodged an objection to its provisional tax return, which the Finanzamt dismissed as unfounded.

13 GFKL then brought an action before the Finanzgericht, which upheld the action, holding that, unlike true factoring, the transfer of defaulted debts does not result in the supply to the seller of those debts of a service liable to turnover tax.

14 The Finanzamt brought before the referring court an appeal on a point of law ('Revision') against the judgment of the Finanzgericht.

15 In those circumstances, the Bundesfinanzhof decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

'(1) For the interpretation of Article 2(1) and Article 4 of the Sixth … Directive …:

Does the sale (purchase) of defaulted debts constitute, on account of the assumption of responsibility for debt recovery and the risk of loss, a service for consideration and an economic activity on the part of the purchaser of the debts even if the purchase price

– is not based on the face value of the debts, with a flat-rate reduction agreed for the assumption of responsibility for debt recovery and the risk of loss, but

– is set by reference to the risk of loss estimated for the debt concerned, with only secondary importance attached to the recovery of the debt compared to the reduction for the risk of loss?

(2) If the answer to Question 1 is in the affirmative, for the interpretation of Article 13B(d)(2) and (3) of the Sixth … Directive …:

(a) Is the assumption of the risk of loss by the purchaser of defaulted debts at a purchase price significantly lower than their face value exempt from tax, as being the provision of a different security or guarantee?

(b) If the assumption of the risk is exempt from tax, is the recovery of the debts exempt from tax, as part of a single service or as an ancillary service, or taxable as a separate service?

(3) If the answer to Question 1 is in the affirmative and no exempt service has been supplied, for the interpretation of Article 11A[1](a) of the Sixth … Directive …:

Is the consideration for the taxable service determined by the recovery costs presumed by the parties or by the actual recovery costs?'

Consideration of the questions referred

The first question

16 By its first question, the referring court asks, in essence, whether Articles 2(1) and 4 of the Sixth Directive must be interpreted as meaning that an operator who, at his own risk, purchases defaulted debts at a price below their face value effects a supply of services for consideration and carries out an economic activity.

17 It must be recalled at the outset that, within the framework of the VAT system, taxable transactions presuppose the existence of a transaction between the parties in which a price or consideration is stipulated. Thus, where a person's activity consists exclusively in providing services for no direct consideration, there is no basis of assessment and the services are therefore

not subject to VAT (see Case C?246/08 *Commission* v *Finland* [2009] ECR I?10605, paragraph 43).

18 In that context, a supply of services is effected ‘for consideration’ within the meaning of Article 2(1) of the Sixth Directive, and is thus liable to tax, only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient (*MKG-Kraftfahrzeuge-Factoring*, paragraph 47).

19 In that regard, according to settled case-law, the concept of the ‘supply of services effected for consideration’ within the meaning of Article 2(1) of the Sixth Directive requires the existence of a direct link between the service provided and the consideration received (Case C?40/09 *Astra Zeneca UK* [2010] ECR I?0000, paragraph 27 and the case-law cited).

20 In its judgment in *MKG-Kraftfahrzeuge-Factoring*, the Court held that a factor’s guaranteeing to a client of payment of the debts by assuming the risk of the debtors’ default must be considered to be exploitation of the property in question for the purpose of obtaining income therefrom on a continuing basis, within the meaning of Article 4(2) of the Sixth Directive, where that operation is carried out, in return for payment, for a given period (see *MKG-Kraftfahrzeuge-Factoring*, paragraph 50).

21 It is to be observed that, in the context of the assignment of debts that was at issue in the case giving rise to that judgment, the assignee of the debts undertook to provide factoring services to the assignor, in return for which it received payment, namely factoring commission and a *del credere* fee.

22 However, as regards the main proceedings, it must be noted that, in contrast to the facts of the dispute that gave rise to the judgment in *MKG-Kraftfahrzeuge-Factoring*, the assignee of the debts receives no consideration from the assignor, and therefore it does not carry out an economic activity within the meaning of Article 4 of the Sixth Directive or effect a supply of services within the meaning of Article 2(1) of that directive.

23 It is true that there is a difference between the face value of the assigned debts and the purchase price of those debts.

24 However, unlike the factoring commission and the *del credere* fee which, in the dispute that gave rise to the judgment in *MKG-Kraftfahrzeuge-Factoring,* were retained by the factor, this difference does not constitute, in the main proceedings, a payment intended to provide direct remuneration for a service supplied by the purchaser of the assigned debts.

25 The difference between the face value of the assigned debts and the purchase price of those debts constitutes not the consideration for such a service, but a reflection of the actual economic value of the debts at the time of their assignment, which results from the fact that they are doubtful and from the increased risk of default of the debtors.

26 In those circumstances, the answer to the first question is that Articles 2(1) and 4 of the Sixth Directive must be interpreted as meaning 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 Article 2(1) and does not carry out an 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.

The second and third questions

27 In view of the answer given to the first question, there is no need to answer the second and third questions.

Costs

28 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Third Chamber) hereby rules:

Articles 2(1) and 4 of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment must be interpreted as meaning 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 Article 2(1) and does not carry out an 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.

[Signatures]

* Language of the case: German.