OPINION OF ADVOCATE GENERAL

JÄÄSKINEN

delivered on 14 July 2011 (1)

Case C?93/10

Finanzamt Essen-NordOst

v

GFKL Financial Services AG

(Reference for a preliminary ruling from the Bundesfinanzhof (Germany))

(Purchase of defaulted debts at a price calculated in relation to the likelihood of default – Sixth VAT Directive – Scope – Article 2(1) – Supply of services for consideration –Article 13B(d) – -Exemption – Debt collection and factoring – Article 11A(1)(a) – Taxable amount)

1. This preliminary reference concerns an assignment by a bank (the 'Bank') to GFKL Financial Services AG ('GFKL') of defaulted debts, for a price below the debt's face value. The Bundesfinanzhof seeks to ascertain whether such a purchase is within the scope of VAT, if so whether it amounts to 'debt collection and factoring', and if it does what the taxable amount should be.

2. The reference was made in order to clarify the scope of the judgment in *MKG-Kraftfahrzeuge-Factoring* ('*MKG*'). (2) 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 forming 'debt collection and factoring'. (3) 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. (4)

3. The parties disagree as to whether the present situation falls within the scope of *MKG*, whether it can be distinguished, or whether that case-law should be reconsidered.

4. Diogenes Laertius, author of a work on Greek philosophy and living in the earlier half of the third century, wrote in his book *Lives of eminent philosophers* about Plato's definition of man. (5) He recounts how Plato was applauded when he defined man as 'an animal, biped and featherless'. When Diogenes of Sinope, or the Cynic, plucked a fowl and brought it into the lecture-room with the words 'Here is Plato's man', 'having broad nails' was added to the definition.

5. The definition of 'debt collection and factoring' adopted by the Court in *MKG* is broad, apparently covering not only factoring arrangements that formed the object of that case but also any transaction where a debt and the related risk of default are assigned. Therefore, much like Plato's definition of man, the present reference is an opportunity to further refine the definition

given in *MKG*.

I – **Legal framework**

EU law

– The Sixth VAT Directive (6)

6. Article 2(1) of the Sixth VAT Directive concerns the scope of the directive. It states that 'the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such' shall be subject to VAT.

7. Article 4 defines 'taxable person' as anyone who independently carries out any economic activity specified in that article, whatever the purpose of that activity. The economic activities are listed in paragraph 2 of that article:

'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.'

8. Article 6 is entitled 'supply of services'. It states in the relevant part:

'1. "Supply of services" shall mean any transaction which does not constitute a supply of goods within the meaning of Article 5.

Such transactions may include inter alia:

– assignments of intangible property whether or not it is the subject of a document establishing title,

…'

9. Article 11A(1)(a) defines the taxable amount as 'everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies including subsidies directly linked to the price of such supplies'.

10. Article 13 concerns exemptions from VAT. According to Article 13B(d)(1) to (3) and (5), the following shall be exempt from VAT:

'1. the granting and the negotiation of credit and the management of credit by the person granting it;

2. the negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit;

3. transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection and factoring;

…

5. transactions, including negotiation, excluding management and safekeeping, in shares, interests in companies or associations, debentures and other securities, excluding:

– documents establishing title to goods,

– the rights or securities referred to in Article 5(3).'

II – **The judgment in MKG**

11. M?GmbH imported cars and distributed them through its dealer network onto the German market. Factoring KG (which subsequently became MKG), which together with M?GmbH formed part of the Trapp-Dries/Mitsubishi group, took on the financing operations of M?GmbH. In that respect and pursuant to a factoring contract, Factoring KG acquired each week the debts owed by the dealers to M?GmbH at the price of the face value of those debts, in return for a factoring commission of 2% and a *del credere* fee of 1% of the face value of the debts, as well as interest calculated on the basis of the daily outstanding credit balance of the dealers with Factoring KG.

12. Factoring KG was engaged in both true and quasi factoring since it (i) assumed the risk of default relating to some of the debts without a right of recourse against M?GmbH in the case of non-payment (true factoring), and also (ii) agreed to recover the remainder of M?GmbH's debts with a right to recourse against it (quasi-factoring). According to the practice of German fiscal authorities true factoring was not considered as a supply of services provided by the factor, and therefore no deductions were permitted. Quasi-factoring was, however, considered as a taxable supply of services by the factor. (7)

13. The Bundesfinanzhof referred two questions asking, essentially, whether true factoring constituted taxable transactions, or whether it was exempt under any of the provisions contained in Article 13B(d) of the Sixth VAT Directive.

14. The Court held that a business which purchases debts, assuming the risk of the debtor's default, and which, in return, invoices its clients in respect of commission, pursues an economic activity within the meaning of the Sixth VAT Directive. The Court also held that such an activity was not exempt from VAT since it amounted to 'debt collection and factoring', and was thus excluded from Article 13B(d)(3).

III – **Factual background and questions referred**

15. On 26 October 2004 GFKL concluded a purchase agreement with the Bank, pursuant to which it acquired mortgages on immovable property and debts arising from 70 terminated and matured loan agreements (the 'portfolio') (8) with a face value of EUR 15 500 915.16, in exchange for a purchase price of EUR 8 034 883.

16. The objects sold were 'recorded or held' for and at the risk of GFKL after the cut-off date set in the purchase agreement, namely 29 April 2004. The debtors of the Bank were informed of the transaction and the change of creditor by 'goodbye letters' sent by the Bank. Furthermore, GFKL was to be entitled to payments attributable to the objects sold made after the cut-off date. Under the purchase agreement, the Bank selling the debt was explicitly excluded from liability for the recoverability of the debts and the economic value of the collateral securities.

17. GFKL was of the view that an acquirer of the debts does not supply a service to the seller which is liable to VAT. It nonetheless submitted a provisional tax return following a letter on 3 June 2004 from the Bundesministerium der Finanzen (Federal Finance Ministry, 'BMF'), which was intending to implement the judgment in *MKG.*

18. In calculating the amount of VAT to be submitted GFKL assumed the consideration to be the difference between the 'economic face value' (*wirtschaftlicher Nennwert*) of the portfolio as

agreed by the parties (the debt likely to be realisable minus the interest for the period over which the debt is likely to be realised, at a rate of 5.97%) and the purchase price. The parties calculated the economic face value of the debt to be EUR 8 399 808.

19. GFKL then lodged an objection to its provisional VAT return. The defendant, the Finanzamt Essen-NordOst (Essen North-East Tax Office) dismissed the objection as unfounded. GFKL appealed to the Finanzgericht (Finance Court) against that decision. The Finanzgericht allowed the appeal, ruling that, unlike true factoring, the transfer of defaulted debts did not constitute a service for the seller that was liable to VAT.

20. The case then reached the Bundesfinanzhof, which found it necessary to refer the following three questions to the Court of Justice for a preliminary ruling:

‘(1) For the interpretation of Article 2(1) and Article 4 of the Sixth Council Directive of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes (77/388/EEC):

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 Council Directive of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes (77/388/EEC):

(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 Council Directive of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes (77/388/EEC):

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

21. Written observations were presented by GFKL, the German Government, Ireland and the Commission, all of whom were present at the hearing held on 12 May 2011.

IV – **Preliminary remarks**

22. It is necessary, at the outset, to clarify the task of the Court in the present case.

23. GFKL and Ireland have tried to distinguish *MKG* on the basis that in that case there was a factoring contract which obliged Factoring KG to acquire debts owed each week, while in the

present case there is a one-off purchase of debts.

24. Whilst I share the view that factoring normally involves a continuing business relationship between the factor and the client, this case does not require consideration of whether the present situation amounts to factoring. In my view, there is no independent notion of factoring in EU VAT law for two reasons.

25. First, there is a divergence in the language versions of Article 13B(d)(3) of the Sixth VAT Directive: 9 of the language versions exclude ‘debt collection and factoring’ from the scope of exemption provided for in that provision, (9) while 11 language versions only refer to ‘debt collection’. (10) The corresponding provision found in Article 135(1)(d) of the VAT Directive no longer mentions factoring in any of the language versions.

26. Second, the situation in *MKG* was excluded from the scope of Article 13B(d)(3) of the Sixth VAT Directive because it amounted to ‘debt collection’. Indeed, the Court concluded that factoring must be regarded as merely a variant of the more general concept of ‘debt collection’, whatever the manner in which it is carried out. (11)

27. Hence, in the present case the Court is called upon to decide whether the relationship between the Bank and GFKL amounts to a supply of debt collection services, a notion broader than factoring, provided by the latter to the former.

V – **Is the present situation within the scope of the Sixth VAT Directive?**

1. Supply of service and economic activity

28. Article 2 of the Sixth VAT Directive states that services supplied for consideration within the territory of the Member State will be subject to VAT. That article must be read in conjunction with Article 4 of the same directive, which states that only activities of an economic nature will be taxed.

29. Supply of services is defined in Article 6 of the Sixth VAT Directive as any transaction which does not constitute a supply of goods. It is therefore a residual category, which has been interpreted broadly by the Court. Article 6 also states that supply of services may include, inter alia, assignments of intangible property whether or not it is the subject of a document establishing title.

30. Two cases are relevant in relation to the assignments of intangible property. In *Swiss Re* the Court held that the transfer for consideration of a portfolio of life reassurance contracts amounted to a supply of services, as it was an assignment of intangible property. (12) In *First National Bank of Chicago* the Court had to consider transactions for the purchase of an agreed amount of one currency against the sale of an agreed amount in another currency and whose details (such as the type of currency, amount and value date) had been agreed by the parties. (13) It held that such transactions were supplies of services by reason of the fact that they were transfers of intangible property, (14) the service being the bank’s preparedness to conclude such transactions. (15)

31. In my view the assignment of intangible property referred to in Article 6(1) of the Sixth VAT Directive concerns a situation where the assignor (the Bank in the present case) is assigning the debt to the assignee (GFKL). In such a case the assignor is providing a service to the assignee.

32. The present case, however, concerns the question of whether the assignee can be said to be providing a service to the assignor. Article 6(1) of the Sixth VAT Directive does not help us in answering that question.

33. Regarding the purchase of debts, the Court ruled in *MKG* that, in the case of true factoring, the purchasing of debts amounts to a service, namely that of relieving the seller from the debt-recovery operations and the risk of the debts not being paid. (16) This, according to the Court, amounted to a debt collection service, and was therefore not exempt under Article 13B(d)(3) of the Sixth VAT Directive. (17)

34. However it cannot, in my view, be that every sale of debt amounts to a provision of a debt collection service by the purchaser.

35. GFKL, the German Government and Ireland argue, though for different reasons, that the transaction between the Bank and GFKL is a ‘pure’ debt assignment, that is, a sale whose object is the portfolio. According to them such a transaction does not involve any taxable supply of service provided by GFKL to the Bank. The Commission also seems to agree that ‘pure’ transfers of debt do not amount to debt recovery services provided by the assignee to the assignor but they conclude from the facts as explained by the referring court that in the present case there is a service element involved.

36. In my view the Court hinted at this possibility in *MKG*, where it stated that it cannot be maintained that a factor should be regarded as *merely* a recipient of assignments by the client of debts owed to him. (18)

37. It is possible to have debt assignments that do not amount to debt collection services. For example, purchasers of business assets in the context of the transfer of undertakings might acquire receivables as part of the assets. To regard those purchases as debt collection services would be contrary to the nature of such transactions.

38. Furthermore, ‘transactions concerning debts’ are exempt from VAT by virtue of Article 13B(d)(3) of the Sixth VAT Directive. This indicates that there must be debt assignments that are not ‘debt collection’ because otherwise that exemption would be meaningless.

39. This is why something more than just a mere transfer of the debt is required in order to amount to a debt collection service and thus to invoke the application of the decision in *MKG*.

40. The economic nature of the transaction in the present case reveals that the Bank receives an extra benefit over and above the simple debt transaction, which indicates that it is seeking and receiving a service in the present case.

41. The purpose of the lending operations of a bank is to gain revenue in the form of interest without risking the capital loaned. The bank does not lend money with the purpose of trading with its receivables on the market, but seeks to get the capital lent back from the original debtor or those who have guaranteed or otherwise provide security for the loan. This distinguishes bank loans from debts instruments traded on the capital markets despite the fact that bonds and similar instruments represent debt of the issuer owed to their holders.

42. In the case of default by the debtor the creditor bank will seek to recover the lent capital with interest and ancillary costs by carrying out debt collection, which may include the realisation of the securities for the loan.

43. In the present case the Bank has supposedly undertaken debt collection measures but

found that it was not reasonable to continue them. It thus engaged the services of GFKL, who assumes that it can collect the defaulted debts more effectively than the Bank because of the legal and public relations considerations restraining the margin of manoeuvre of the Bank in this respect. The role of GFKL in this arrangement is to collect the debts though not necessarily all of them. The interest element included in the calculation of the economic value demonstrates that GFKL is not acquiring the debt portfolio for trading purposes but intends to collect the debt itself during a predefined period of time.

44. The set-up in the present case involves not only the Bank and GFKL, but also the debtors, making it a triangular relationship. Therefore the role of GFKL is much more complex than that of a buyer of a stock of perishable goods such as foodstuffs after the best before date.

45. In the present case the Bank is not transferring a single receivable to GFKL but a portfolio of numerous debts together with the related mortgages and other securities, documentation and ancillary claims. The risk and likely economic value contained in this portfolio has obviously been analysed by GFKL on the basis of the estimated success of further recovery of debts and the value of the securities likely to be realised. The transaction leads to a situation which is obviously more beneficial to the Bank than the situation where it would have continued to collect the debts itself. In addition, GFKL offers the Bank a possibility to end a number of client relationships that have turned out to be unsatisfactory, and relieves it from all the legal and public relations problems related to continuous efforts to collect the debts. In summary, GFKL offers the Bank an economically affordable possibility to close the books once and for all in relation to 70 defaulting clients.

46. In view of that I am of the opinion that the Bank is receiving an advantage going beyond the payment of a price that reflects the current value of the debts. In other words, it is buying a service from GFKL and GFKL is providing such a service to the Bank.

47. Since there is a provision of a service, there must necessarily be an economic activity in the present case. Therefore, it is not necessary to consider Article 4(1) of the Sixth VAT Directive in any more detail.

2. Consideration

48. To be within the scope of the VAT Directive, however, a service needs to be provided for consideration. Most of the referring court’s doubts about the application of the Sixth VAT Directive to the present case centre on the existence of consideration.

49. For consideration to arise within the meaning of the Sixth VAT Directive there must be a legal relationship between the parties that gives rise to reciprocal performance. That is, the remuneration must be given *in return* for a service. (19) This is also known as the ‘direct link requirement’. (20)

50. In *MKG* the Court held that there was a direct link between the factor’s activity and the amount that he received in return by way of payment since he charged factoring commission and a *del credere* fee for the activity that he carried out. (21)

51. In the present case no commission has been expressly agreed by the parties. The question that arises, therefore, is what the consideration could be.

52. Even though consideration may come from a third party, (22) there is no indication that the debtors could be obliged to pay GFKL anything more than what would be due in relation to the Bank. Therefore consideration in the present case might be inferred from two facts: the deduction

made from the face value of the debt in calculating the purchase price (as suggested by the referring court), and the opportunity to make a profit from the purchase of the debt (as suggested by GFKL). (23)

53. In my view, the deduction cannot be said to constitute consideration. This is because the deduction is made in order to reflect the actual amount of the risk that is being assigned since the debts in question are defaulted debts. Therefore, GFKL is simply paying for the market value of the portfolio and is not receiving remuneration for its services. In economic terms, the Bank is not giving any real deduction but simply accepting the price that the buyer is prepared to pay for the portfolio.

54. However, even if the Court considers that to be the consideration provided by the Bank, it is questionable whether there is a direct link between the deduction that is made and the service provided.

55. In *Aardappelenbewaarplaats* the Court held there was no direct link between a service provided and the consideration received in a situation where consideration was held to be an unascertained reduction in the value of shares. (24) In that case a cooperative association running a potato storage depot charged members for storage, as well as giving them shares, in return for the members storing their potatoes. One year the cooperative decided not to charge for storage, but instead reduced members' share value. The Court held that there was no reciprocity in such a case.

56. Recently, however, in *Astra Zeneca*, the Court held that there *was* a direct link between the provision of retail vouchers by Astra Zenca to its employees (the service) and the reduction in employees' wages (the consideration). (25)

57. That outcome is not necessarily in contradiction with the decision in *Aardappelenbewaarplaats*. In *Aardappelenbewaarplaats* the reduction in shares was unascertained. Although the Court did not elaborate on this point, in my view this conclusion can be explained by the fact that it would have been difficult to show the value that the reduction represented, and therefore to show that such a value amounts to the value of the service being provided. The value of the services provided and whether the consideration represents the true return for the services is an important part of ascertaining whether there is a direct link between the consideration supplied and the service rendered. (26)

58. In the present case the apparent deduction from face value is arrived at by considering a variety of circumstances of limited relevance to the service provided by GFKL. They include: the possibly different assessment of the debtors' credit status, the continued value of the security that has been furnished for the debts, the actual enforceability of the debts and the costs incurred in that context.

59. As the referring court has highlighted, the deduction arises not from the service of relieving the Bank from its debt collection burdens and risks, but from an assessment concerning the current value of the debt in the hands of GFKL. In my opinion that deduction mainly relates to the fact that the risks inherent in the portfolio have already become apparent though the portfolio continues to represent considerable uncertainty as to the development of its value. These uncertainties relate not only to the success of GFKL's debt collection activities but also to the economic development in general and the developments of the property markets affecting the value of mortgages in particular.

60. In such circumstances it cannot, therefore, be said that the deduction is given in return for the value of the service that GFKL is providing to the Bank. Thus, there is no direct link between

the service provided and the consideration.

61. Even if the consideration is said to be the opportunity that GFKL receives to make a profit as a result of the purchase of debts, I do not think that there is a direct link.

62. First, the Court has held that the yield from placements in investment funds does not constitute direct consideration for supplies of services consisting in making capital available for the benefit of a third party. (27) By analogy, the profit made from speculating on defaulted debts should not constitute direct consideration for the inherent debt collection service.

63. Second, the Court has held that where the consideration depends on partly unknown factors, there will be no direct link. (28) This is the case in relation to the present case since the amount of profit likely to be made can be ascertained only arbitrarily. It is not excluded that at the end of the day GFKL receives more than the economic face value of the debts, a sum between that and the price paid or even less than it paid to the Bank.

64. Therefore the present case does not come within the scope of the Sixth VAT Directive since the requirement of a direct link between consideration and the service is not established.

65. It may be useful to add that if the interpretation proposed above is sound then many of the so-called bad banks established in the Member States in order to liberate balance sheets of financial institutions from default debt may in many cases be considered, from a VAT point of view, as supplying debt collection services. As to the requirement of consideration, it will have to be analysed on a case-by-case basis whether there is a direct link between the service provided and the compensation, if any, received by the bad bank.

66. In case the Court is not of the same opinion I will also answer the second and third questions posed.

VI – **Is the present situation exempt under Article 13B(d) of the Sixth VAT Directive?**

1. Exemptions

67. The parties in the present case have submitted arguments on the basis of exemptions contained in Article 13B(d)(1), (2), (3) and (5) of the Sixth VAT Directive.

a) Article 13B(d)(1) of the Sixth VAT Directive

68. GFKL submits that the transaction should be regarded as a grant of credit within the meaning of Article 13B(d)(1) of the Sixth VAT Directive since payment is made immediately whereas the debt is acquired by GFKL at a later date.

69. It is true that the definition in that article is broad enough to cover credit granted by a supplier of goods in the form of deferral of payment. (29) Furthermore, that article is not limited to loans or credits granted by banking and financial institutions. (30) However, in my view the grant of credit involves a continuing debt relationship between the parties for a certain period of time until the credit is repaid. In the present case there is no such continuing debt relationship after the portfolio has been purchased. (31)

70. Furthermore, GFKL cannot be said to grant credit to the Bank as the debts are already defaulted and the purpose of GFKL is to collect them. (32) As to the relationship between the Bank and GFKL, in this case, unlike in quasi factoring, GFKL is not providing any financing for the Bank to be set off later with the payments received from the debtors.

71. Therefore, the present situation cannot be exempt under Article 13B(d)(1) of the Sixth VAT Directive.

b) Article 13B(d)(2) of the Sixth VAT Directive

72. The referring court wonders whether the present situation amounts to dealings in credit guarantees since it seems similar to the situation in *Bally*. (33) That case concerned the payment by credit card for certain goods that were purchased. The Court held that such a situation amounted to a guarantee and was therefore exempt. According to the referring court that case also involved a transfer of debt from Bally to the credit card company, in exchange for money.

73. I do not find that analogy convincing. In a credit card transaction the seller accepts that the buyer will not fulfil his obligation to pay the agreed price with legal tender but instead accepts that the payment takes the form of a new debt relationship that emerges between the credit card company and the seller (corresponding to a debt owed by the buyer to the credit card company). The actual payment by the credit card company to the seller is always deferred, that is, it takes place after the buyer should have paid had he chosen to pay in cash. Therefore from the point of view of the original parties to the sales transaction the function of the credit card company is to guarantee that the seller gets the agreed price, less the commission of the credit card company, which forms the consideration the latter receives for its supply of a guarantee service to the seller.

74. In the present case there is no legal relationship between the debtors and GFKL that would exist independently of the purchase of the portfolio. GFKL has not promised to the debtors or to the Bank to pay for the original debts at face value. It simply pays a price for the portfolio which constitutes a part of their face value. Therefore, even though the present case involves the transfer of debt in exchange for money, that transfer does not take place in a pre-defined contractual relationship between the guarantor and the creditor typical for guarantee services including those where a seller agrees with a credit card company that its cards are welcome.

75. Ireland submits that the present case might amount to ‘dealings in security for money’, another part of Article 13B(d)(2) of the Sixth VAT Directive, since some of the debts are secured by immovable goods.

76. I am not convinced by this argument either. As Ireland itself conceded, this provision would not apply to part of the portfolio in question, namely the unsecured loans contained in it. In my view the portfolio should be looked at as a whole and cannot be artificially split so that some of the debts contained in it are exempt under one provision while others are not. Furthermore, in making a payment GFKL cannot be said to be providing security for money to the Bank.

c) Article 13B(d)(5) of the Sixth VAT Directive

77. Finally, Ireland argues that the transaction might be classified under Article 13B(d)(5) of that directive as a transaction in debentures and other securities, since the loan documentation was clearly negotiable.

78. Although it is true that the present case contains negotiable loan documentation, that fact is not essential in defining the scope of Articles 13B(d)(3) and (5) of the Sixth VAT Directive, since both provisions cover negotiable instruments. What is important is that loan agreements with individual customers of a bank, even if they are formed or secured by negotiable promissory notes, are not intended to be exchanged on the securities markets in the same manner as debentures and other securities.

79. In my opinion, Article 13B(d)(5) of the Sixth VAT Directive is not applicable in the present case. The exemptions listed in Article 13B(d) of that directive do not represent a clear-cut systematic whole. Nevertheless, the text of that provision leads to the conclusion that the different exemptions target different groups of transactions typically provided by economic operators engaged in financial services. (34)

80. The exemption in Article 13B(d)(5) of the Sixth VAT Directive is aimed at transactions in securities representing either the company's own capital or its foreign capital, typical to the primary or secondary markets of securities and corporate financing. These transactions are usually carried out by investment banks, financial service providers and investors.

81. On the other hand, the exemption in Article 13B(d)(3) concerns operations that are normally implemented by a financial institution engaged in retail banking but not exempted under Article 13B(d)(1) and (2) of that directive. This exemption applies to the various operations relating to accounts, debts and payments and related negotiable instruments.

82. That is the why the present situation is not to be regarded under Article 13B(d)(5) of the Sixth VAT Directive, but rather under Article 13B(d)(3) of that directive.

d) Article 13B(d)(3) of the Sixth VAT Directive

83. Article 13B(d)(3) of the Sixth VAT Directive exempts transactions concerning debts but excludes from that exemption 'debt collection'. The question is, therefore, whether the present case falls within the meaning of 'debt collection' contained in that provision.

84. It is trite law that exemptions should be interpreted strictly, while exceptions to the exemptions are to be interpreted broadly. (35)

85. 'Debt collection' is not defined in the Sixth VAT Directive but has been considered in two judgments to date. (36) According to that case-law 'debt collection' refers to financial transactions designed to obtain payment for pecuniary debt. (37) The term applies equally to defaulted debts and to other debts. (38) Consequently, the fact that the debts are overdue does not affect the possibility of qualifying a transaction as 'debt collection'. (39)

86. For the reasons set out in points 39 to 46 of this Opinion I consider that the present situation falls within the notion of 'debt collection' contained in Article 13B(d)(3) of the Sixth VAT Directive, and GFKL is providing a debt collection service to the Bank.

2. Single supply?

87. There remains the final issue under the second preliminary question of whether the supply of services here might be regarded as a single supply or whether there are two services being provided: one which relieves the Bank of the debt recovery operations (which I have classified above as the debt collection service), the other qualifying as credit being granted under Article 13B(d)(1) of the Sixth VAT Directive.

88. According to the Court's case-law, where a transaction comprises a bundle of elements and acts, regard must be had to all the circumstances in which the transaction in question takes place in order to determine whether there are two or more distinct supplies or one single supply. (40)

89. The Court has also held, first, that it follows from Article 2 of the Sixth VAT Directive that every transaction must normally be regarded as distinct and independent and, secondly, that a transaction which comprises a single supply from an economic point of view should not be

artificially split, so as not to distort the functioning of the VAT system.

90. There is a single supply where two or more elements or acts supplied by the taxable person to the customer are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split. (41) There is also a single supply where one or more elements are to be regarded as constituting the principal supply, while other elements are to be regarded, by contrast, as one or more ancillary supplies which share the tax treatment of the principal supply. In particular, a supply must be regarded as ancillary to a principal supply if it does not constitute for customers an end in itself but a means of better enjoying the principal service supplied. (42)

91. In the present case the economic purpose of the transaction is to relieve the Bank of its debt collection activities. It is of course true that a payment is made by GFKL to acquire the debts in question but the payment is made in exchange for the receivables which GFKL receives. Therefore, it cannot be said that there are two independent services being provided by GFKL, but rather they are inextricably interlinked.

92. For those reasons it must be concluded that the present situation amounts to ‘debt collection’ within the meaning of Article 13B(d)(3) of the Sixth VAT Directive, and is therefore not exempt from VAT.

VII – **What is the value of consideration in the present case?**

93. By the third question the referring court essentially asks what should be considered as consideration in the present case for the purposes of calculating the taxable amount: the recovery costs presumed by parties, or the actual recovery costs.

94. Article 11A(1)(a) of the Sixth VAT Directive defines the taxable amount as ‘everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies including subsidies directly linked to the price of such supplies’.

95. According to established case-law, consideration must be the subjective value and not an estimated value that is arrived at by applying objective criteria. (43) Thus, the basis of assessment for the provision of services is the amount of consideration actually received, and not the face value.

96. This is why the consideration in the present case cannot be calculated on the basis of the difference between the so-called economic face value and the price paid. As the referring court has stated, it is very likely that the parties agreed on the economic face value solely for VAT purposes. Therefore the economic face value probably reflects either GFKL’s expected profit margin in relation to the transaction, or the sum on the basis of which they are prepared to pay VAT. In my opinion, in a case where the taxable base is based on the profit margin, that margin should be based on real developments, not on preliminary estimations, otherwise the taxable persons might be obliged to pay VAT for consideration they never receive.

97. The amount of consideration cannot be based on the difference between the face value of the debt included in the portfolio and the price paid by GFKL either, since it simply equates to the depreciation in the value of the debt.

98. In my view, the consideration in the present case has to be calculated on the basis of what GFKL actually receives from the Bank. That means the difference between the amount it eventually collects from the debtors in the portfolio and the price it purchased the portfolio for.

99. This conclusion is based on two judgments where the Court was faced with similar problems in relation to the calculation of the amount of consideration.

100. In *First National Bank Chicago*, the Court stated that in foreign exchange transactions in which no fees or commission are calculated with regard to certain specific transactions, the taxable amount is the net result of the transactions of the supplier of the services over a given period of time. (44) What is more, the Court rejected the idea that the spread representing the difference between the bid price and the offer price could be used as the taxable base. (45)

101. The judgment in *Argos* is also useful in the present case by way of analogy. That case concerned the sale of vouchers by a store, which sometimes sold them at their face value, and sometimes at a discounted value. The Court was asked what the amount of consideration should be in a situation where the voucher in question had been bought at a discounted value – the face value, or the value that the voucher was bought for. The Court held that it was not the face value that was relevant but the amount that the store had actually received. (46)

102. It is true that this conclusion will cause delays in knowing what the taxable amount is and in collecting the amount due. However, the Court has already ruled that consideration may be accrued over a period of time. (47)

103. In light of that, I find that in the present case the consideration should be based on the difference between the amount of debt that is actually recovered by GFKL, and the price paid by it in acquiring the debt from the Bank.

VIII – **Conclusion**

104. In view of what has been stated above I propose to the Court to give the following answer to the referring court:

(1) The purchase of a portfolio of defaulted debts constitutes a service and an economic activity on the part of the purchaser of the debts within the meaning of 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.

However, since there is no direct link in the present case between the service provided and the consideration received, the supply of such a service does not fall within the scope of application of the Sixth VAT Directive.

105. There is no need to answer to the second and third questions. However, in the alternative I propose the following:

(2) The present situation amounts to ‘debt collection’ within the meaning of Article 13B(d)(3) of the Sixth VAT Directive, and is therefore not exempt from VAT.

(3) The consideration in the present case should be based on the difference between the amount of debt that is actually recovered by GFKL, and the price paid by it in acquiring the debt from the Bank.

1 – Original language: English.

2 – Case C?305/01 *MKG* [2003] ECR I?6729.

3 – *MKG*, ibid., paragraph 80.

4 – *MKG*, ibid., paragraph 49.

5 – Diogenes Laertius (translated by Hicks, R.D.), *Lives of eminent philosophers*, Books VI?X, Loeb Classical Library, p. 43.

6 – 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 ('Sixth VAT Directive') (OJ 1977 L 145, p. 1). Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1) ('the VAT Directive') replaces the Sixth VAT Directive with effect from 1 January 2007. The aim of the VAT Directive is to present the applicable provisions in a clear and rational manner, consistent with the principle of better regulation (recital 3 in the preamble).

7 – According to the approach of the German authorities, also defended by Germany in the present case, the decisive difference between taxable debt recovery services (such as quasi-factoring) and assignments of debt not taxable under VAT is transfer of risk. If the creditor retains the risk, the transaction is taxable; if the risk is transferred we are faced with a sale of obligations not implying a supply of services provided by the buyer to the seller.

8 – They included, inter alia, mortgages on immovable property and all other rights and claims arising from the loan agreements listed in the attached portfolio data, including the loan debts, all present and/or future, qualified and/or temporary ancillary debts, such as interest, costs, fees and commissions, all additional and third-party securities, all titles and all other documents associated with the various loan agreements, such as certificates, customer files, correspondence and any other business documents.

9 – English, Swedish, Estonian, Latvian, Lithuanian, Hungarian, Maltese, Polish and Slovenian.

10 – Spanish, Czech, Danish, German, Greek, French, Italian, Dutch, Portuguese, Slovakian and Finnish. No translations are available for Bulgarian and Romanian.

11 – *MKG*, cited in footnote 2, paragraph 77.

12 – Case C?242/08 *Swiss Re Germany Holding* [2009] ECR I?10099, paragraphs 27 and 28.

13 – Case C?172/96 *First National Bank of Chicago* [1998] ECR I?4387, paragraphs 21 and 22.

14 – *First National Bank of Chicago*, ibid., paragraph 25.

15 – *First National Bank of Chicago*, ibid., paragraph 29.

16 – *MKG*, cited in footnote 2, paragraph 49.

17 – *MKG*, cited in footnote 2, paragraph 77.

18 – *MKG*, cited in footnote 2, paragraph 50.

19 – Case C?16/93 *Tolsma* [1994] ECR I?743, paragraph 14.

20 – Case C?215/94 *Mohr* [1996] ECR I?959, paragraph 17; Case 154/80 *Coöperatieve Aardappelenbewaarplaats* [1981] ECR 445; Case 102/86 *Apple and Pear Development Council* [1988] ECR 1443.

21 – *MKG*, cited in footnote 2, paragraphs 48 to 49.

22 – Article 11A(1)(a) of the Sixth VAT Directive. Normally the debtor in default is obliged to compensate for the recovery costs including the fees of those taking care of the debt collection. I presume that GFKL is entitled to such compensation in the same manner as the Bank would have been had it continued to collect the debt itself.

23 – I note that the spread, be it between the economic face value or the money actually collected and the price GFKL has paid to the Bank is not only consideration for debt collecting but also involves capital gain and loss resulting from GFKL holding the portfolio over a period of time.

24 – *Coöperatieve Aardappelenbewaarplaats*, cited in footnote 20, paragraph 12.

25 – Case C?40/09 *Astra Zeneca UK* [2010] ECR I?0000, paragraph 29.

26 – Case C?246/08 *Commission* v *Finland* [2009] ECR I?10605. In that case the question arose as to whether the consideration received for the provision of legal aid services was subject to tax; the Court held that it was not since the contribution depended only partly on the services rendered. The other factors included the recipient's financial assets and his income and was not directly linked to the services offered.

27 – Case C?77/01 *EDM* [2004] ECR I?4295, paragraph 63.

28 – See, by analogy, Case C?142/99 *Floridienne and Berginvest* [2000] ECR I?9567, paragraphs 22 and 23 where the Court held that since the dividends were paid as a result of a decision taken unilaterally by someone else, they were based on partly unknown factors and there was therefore no direct link.

29– Case C?2/95 *SDC* [1997] ECR I?3017, paragraph 34.

30– *SDC*, ibid., paragraph 34.

31 – In that respect it is important to note that the interest in the present case is used to calculate the economic face value of the debt. The Bank is not obliged to pay interest to GFKL after the transaction is concluded.

32– It is a separate question whether GFKL may in individual cases re-negotiate the loan terms by providing extended time for payment and thus granting credit to the bank's former clients (the debtors). This would amount to a new transaction between GFKL and the debtor in question.

33 – Case C?18/92 *Bally* [1993] ECR I?2871.

34 – See, for example, Case C?455/05 *Velvet & Steel Immobilien* [2007] ECR I?3225, paragraphs 21 and 22.

35 – Case C?175/09 *AXA UK* [2010] ECR I?0000, paragraph 30 and case-law cited there.

36 – *MKG*, cited in footnote 2, and *AXA*, ibid.

37 – *MKG*, cited in footnote 2, paragraph 78, and *AXA*, ibid., paragraph 31.

38 – *AXA*, ibid., paragraph 34.

39 – In contrast, factoring relates to the management by the factor of existing receivables of the client. That is why, in my view, transactions concerning defaulted debts cannot be qualified as factoring services even though factoring as a commercial concept may also include buying of defaulted debts.

40 – Case C?41/04 *Levob Verzekeringen and OV Bank* [2005] ECR I?9433, paragraph 19, and Case C?111/05 *Aktiebolaget NN* [2007] ECR I?2697, paragraph 21.

41 – *Levob Verzekeringen and OV*, ibid., paragraphs 20 and 22, and *Aktiebolaget NN*, ibid., paragraphs 22 and 23.

42 – Case C?349/96 *CPP* [1999] ECR I?973, paragraph 30; *Levob Verzekeringen and OV Bank*, cited in footnote 40, paragraph 21; Case C?572/07 *RLRE Tellmer Property* [2009] ECR I?4983, paragraph 18; and Case C?276/09 *Everything Everywhere* [2010] ECR I?0000, paragraphs 24 and 25.

43 – *Coöperatieve Aardappelenbewaarplaats*, cited in footnote 20, paragraph 13; Case C?34/99 *Primback* [2001] ECR I?3833, paragraph 24; Case C?288/94 *Argos Distributors* [1996] ECR I?5311, paragraph 16 and case-law cited there.

44 – *First National Bank of Chicago*, cited in footnote 13, paragraph 47.

45 – *First National Bank of Chicago*, cited in footnote 13, paragraph 45.

46 – *Argos Distributors*, cited in footnote 43, paragraphs 16, 18, 20, 23.

47 – *First National Bank of Chicago*, cited in footnote 13, paragraph 48 and case-law cited there.