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DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
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Brussels, 9 February 2017

# VALUE ADDED TAX COMMITTEE
## (ARTICLE 398 OF DIRECTIVE 2006/112/EC)
## WORKING PAPER NO 917

# QUESTION
## CONCERNING THE APPLICATION OF EU VAT PROVISIONS

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| **ORIGIN:** | **Commission** |
| **REFERENCES:** | **Articles 2(1)(c) and 135(1)(b) and (d)** |
| **SUBJECT:** | **VAT treatment of transactions involving non-performing loans (NPLs)** |

## 1. INTRODUCTION

One of the effects of the economic crisis in Europe is the increase in debts which cannot be repaid. Where the borrower of a loan stops paying back the principal or the interests, the creditor must after a specific amount of time classify that loan as "bad debt" or "non-performing". A loan is generally considered to be non-performing when more than 90 days have passed without the borrower paying the agreed instalments[1].

Non-performing loans[2] (hereinafter, "NPLs") tie up the operational capacity of their creditors and involve high legal and administrative costs stemming from the attempts to recover the defaulted debt[3]. In order to minimise these costs, creditors may decide either to trade NPLs, or to outsource the management thereof (an activity often referred to as "servicing") to specialised companies. In fact, the development of NPL markets where to trade such loans has been pointed out by the European Central Bank (ECB) as one of the measures which could help the banking sector dealing with the high level of NPLs, which weighs on their capacity to extend new credit[4].

Given that NPL ratios remain high in the EU[5] and that transactions involving transfers of NPLs and NPL servicing services are a growing reality, the Commission services wish to discuss with the VAT Committee the VAT treatment of such transactions in order to ensure that it is consistent across the EU.

## 2. SUBJECT MATTER

The two transactions carried out in respect of NPLs which should be analysed are: (i) the sale of NPLs; and (ii) NPL servicing services.

Sale of NPLs

Although sales of loans are not limited to NPLs (performing loans can also be sold), our analysis will focus on NPLs. An NPL can be traded by its holder to third parties (e.g.

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1 ECB, What are non-performing loans (NPLs)?, 2016 (consulted on 01/12/2016).

2 Bad debts are mainly referred to as "non-performing loans" (NPLs) but can also be called "non-performing exposures" (hereinafter, "NPEs"). In fact, "NPE" is the only term which has been defined at EU level for supervisory reporting purposes ("*non-performing exposures are those that satisfy either or both of the following criteria: (a) material exposures which are more than 90 days past-due; (b) the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due*") in Commission Implementing Regulation (EU) 2015/1278 of 9 July 2015 amending Implementing Regulation (EU) No 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions as regards instructions, templates and definitions (OJ L 205, 31.7.2015, p. 1). This definition is very much in line with the one on NPEs proposed by the Basel Committee on Banking Supervision (BCBS) in April 2016: *"delinquency status (90 days past due) or the unlikeliness of repayment"* (see here). For more information on the definition of NPLs, see ECB, Draft guidance to banks on non-performing loans, 2016, section 5; and European Banking Authority (EBA), Draft implementing technical standards on supervisory reporting, 2014. Although "NPL" is the term used in this document, it shall be taken to cover any loan meeting the criteria above.

3 V. Constâncio, Vice-President of the ECB, Challenges for the European banking industry, 2016 (consulted on 07/02/2017).

4 ECB, Financial Stability Review, 2016, p. 57 and 70-71.

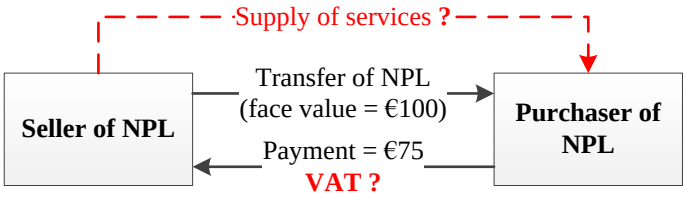
5 ECB, Financial Stability Review, 2016, p. 64; and ECB, Financial Stability Review, 2015, p. 69.

banks, investors, joint ventures, etc.) in secondary markets[6], often in the form of portfolios with other NPLs[7]. A payment is typically made in exchange for the NPL, the price paid usually being lower than the face value of the loan, in order to reflect the loan being in or close to default. As a result of the sale, ownership of the NPL is normally passed on to the purchaser, which implies that the risk of debtors' default is assumed by the NPL purchaser. As to the question of why someone would be willing to pay for an NPL, it must be kept in mind that such bad debt may become a performing loan in the future, in which case the investment would pay off.

The specific conditions under which transfers of NPLs take place may vary across the EU (e.g. limitations as to the persons allowed to sell and purchase NPLs), given that such markets are regulated at national level. In order to overcome potential divergences, the parties of a transaction concerning the sale of an NPL will be referred to in this document as "the seller" and "the purchaser".

For the purposes of VAT, the transaction described above could be seen as comprising two potential supplies, as set out below.

i. From the point of view of the seller of the NPL, he could be said to be making a supply of services for consideration to the purchaser, consisting in the assignment of intangible property (the NPL).

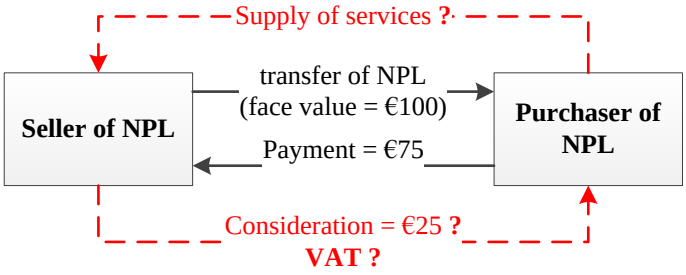



ii. From the point of view of the purchaser of the NPL, he could be said to be supplying a service for consideration to the seller, consisting in freeing the seller from debt-recovery operations and the risk of debts not being paid[8], with a view for the purchaser to recover the debt in the future. This interpretation is based on the fact that the purchase price paid is typically lower than the face value of such loans and, therefore, it could be argued that this difference constitutes a consideration paid by the seller of the NPL (the recipient of the services) to the purchaser of the NPL (the supplier of the services).

6 For more information on NPL markets, see EBA, Report on the dynamics and drivers of NPE in the EU banking sector, 2016, p. 41-42; and IMF Staff Discussion Note, A strategy for resolving Europe's problem loans, 2016, p. 21-23.

7 For the purposes of this document, it is nonetheless presumed that there is only one debtor.

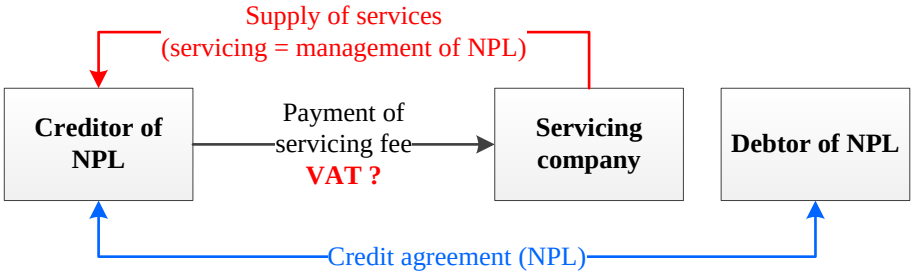
8 This is the wording used by the CJEU in its judgment of 26 June 2003, *MGK*, C-305/01, EU:C:2003:377, paragraph 49, where a similar scenario was tabled (for more information, see section 3.1.2).




For each of these scenarios it should be examined whether there is a taxable supply of services for consideration pursuant to Article 2(1)(c) of the VAT Directive[9] and, if so, whether it can be exempt pursuant to any of the exemptions for financial services laid down in Article 135(1) of the VAT Directive.

NPL servicing services

As an alternative to selling NPLs, their holders may decide to outsource the management to specialised servicing companies (also known as "servicers"), thereby taking advantage of the know-how of such companies and reducing the loan management costs[10]. Such servicing companies manage NPLs on behalf of the creditors, who typically retain ownership of the loan. Servicing activities can be carried out in respect of any loan (also performing loans) and do not necessarily have to be externalised (the creditor can service his own loan). However, the present analysis will focus on servicing activities carried out in respect of an NPL by a third party other than the creditor of that loan.




Given that the activities carried out by servicing companies are not defined at EU level, and that such activities may vary depending on the servicer, a case-by-case analysis of the actual circumstances in which such services are provided will be necessary. In this respect, it must be noted that the definition of "servicer" laid down at EU level for the purposes of banking supervision is rather general: *"servicer means an entity that manages a pool of purchased receivables or the underlying credit exposures on a day-to-day basis"*[11].

Some of the existing definitions at national level could nonetheless give an idea about which activities a servicing service may entail. For instance, Ireland introduced in 2015 a regulatory regime for servicing companies[12]. According to this framework, carrying out

9 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1).
10 ECB, Draft guidance to banks on non-performing loans, 2016, p. 10.
11 Article 142(1)(8) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (OJ L 176 27.6.2013, p. 1)
12 Consumer Protection (Regulation of Credit Servicing Firms) Act 2015, p. 3

the activity of "servicing" in relation to a credit agreement means managing or administering the credit agreement, including any of the following activities:

"*(…)*

*a. notifying the relevant borrower of changes in interest rates or in payments due under the credit agreement or other matters of which the credit agreement requires the relevant borrower to be notified,*
*b. taking any necessary steps for the purposes of collecting or recovering payments due under the credit agreement from the relevant borrower,*
*c. managing or administering any of the following:*
  *i. repayments under the credit agreement;*
  *ii. any charges imposed on the relevant borrower under the credit agreement;*
  *iii. any errors made in relation to the credit agreement;*
  *iv. any complaints made by the relevant borrower;*
  *v. information or records relating to the relevant borrower in respect of the credit agreement;*
  *vi. the process by which a relevant borrower's financial difficulties are addressed; and*
  *vii. any alternative arrangements for repayment or other restructuring*

*(…)*".

Such definition is in line with the description of "servicing", as found in existing literature[13]:

"*(…)*

*The following provides an overview of some of the core elements of a servicing agreement for the management of loans and, in particular, non-performing loans.*

***Core elements: management of loan receivables***

*The supervision, recapitalisation or liquidation of loans and the connected collateral constitutes a core element of any NPL servicing agreement. For this reason, the functions to be performed by the servicer are described in detail. Examples for such activities are:*

- *collection;*
- *monitoring payment transactions in connection with the loan receivables – this may include preparing and examining repayment calculations and the settlement of payments received in certain periods;*
- *maintaining correspondence and other communication with borrowers, courts, sequestrators, banks and other third parties involved;*
- *examination and, if applicable, re-evaluation of the collateral securing the loans; and*
- *compiling reports (business plans) regarding the loan portfolio or individual loans for the client in periods which are determined in advance.*

[13] S. Grieser and J. Wulfken, "Performing and Non-Performing Loan Transactions Across the World: a practical guide", Euromoney Books, 2014, p. 80.

*Apart from the activities that are characteristic of loan portfolios, the general duties and responsibilities of the servicer in connection with the portfolio management are usually also determined. Among those duties and responsibilities are:*

*(…)*

. *assuming accounting and reporting duties in correspondence to the provisions of the servicing agreement – this may include the duty to collect, process, administer and use data necessary for the supervision and management of the loans*

*(…)*"

That raises the question whether supplies of services consisting in NPL servicing by third parties to NPL holders under the circumstances described, which seem to fall within the scope of VAT, can be exempt pursuant to Article 135(1) of the VAT Directive. To determine this, it is relevant to look at the question whether such services can be said to constitute "debt collection" within the meaning of Article 135(1)(d) of the VAT Directive, keeping in mind that debt collection is excluded from the exemption granted to transactions concerning debt.

## 3. THE COMMISSION SERVICES' OPINION

A supply of services is subject to VAT when made for consideration by a taxable person acting as such, pursuant to Article 2(1)(c) of the VAT Directive. In turn, a taxable person is defined as any person carrying out an economic activity, whatever the purpose or results of that activity under Article 9 of the VAT Directive.

Concerning the existence of consideration, from the settled case-law of the Court of Justice of the European Union (CJEU) it is clear that a supply of services is effected for consideration within the meaning of Article 2(1)(c) of the VAT Directive, and hence is taxable, only if there is a direct link between the services supplied and the consideration received[14]. Such a direct link is established 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 actual consideration given in return for the service supplied to the recipient[15].

A taxable supply of services can still be exempt depending on it falling within the scope of certain provisions. The relevant ones in the case at hand are those of Article 135(1) of the VAT Directive which refer to financial services supplied in connection with credit.

*"Article 135*

*1. Member States shall exempt the following transactions:*

*(…)*

[14] Amongst others, judgment of 7 October 2010, *Loyalty Management UK*, C-53/09, EU:C:2010:590, paragraph 51; and judgment of 8 March 1988, *Apple and Pear Development Council*, C-102/86, EU:C:1988:120, paragraph 12.

[15] Amongst others, judgment of 27 March 2014, *Le Rayon d'Or*, C-151/13, EU:C:2014:185, paragraph 29; and judgment of 3 March 1994, *Tolsma*, C-16/93, EU:C:1994:80, paragraph 14.

*(b) the granting and the negotiation of credit and the management of credit by the person granting it;*

*(…)*

*(d) transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection;*

*(…)*

*(f) transactions, including negotiation but not management or safekeeping, in shares, interests in companies or associations, debentures and other securities, but excluding documents establishing title to goods, and the rights or securities referred to in Article 15(2);*

*(…)"*

At the outset it should be noted that the CJEU has repeatedly stressed that the exemptions referred to in Article 135 of the VAT Directive are to be interpreted strictly, since they constitute exceptions to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person[16]. Furthermore, they constitute independent concepts of EU law whose purpose is to avoid divergences in the application of the VAT system as between one Member State and another and which must be placed in the general context of the common system of VAT[17].

### 3.1. Sale of NPLs

#### *3.1.1. From the point of view of the seller of NPLs*

*Subjection to VAT*

The transfer against payment of an NPL by the seller to the purchaser seems to constitute a taxable supply of services (from the seller to the purchaser), on the basis of Article 25(a) of the VAT Directive. This provision establishes that *"a supply of services may consist, inter alia, in the assignment of intangible property, whether or not the subject of a document establishing title"*.

At this point, what needs to be examined is whether that supply of services has been effected for consideration within the meaning of Article 2(1)(c) of the VAT Directive.

In the circumstances described, where the seller receives a payment in exchange for the sale of the NPL and the price paid by the purchaser is lower than the principal of the loan, some could question the existence of consideration on the basis that such payment does not reflect the cost price of the loan.

16 Judgment of 19 July 2012, *Deutsche Bank*, C-44/11, EU:C:2012:484, paragraph 42 and case-law cited.
17 Judgment of 22 October 2009, *Swiss Re Germany Holding*, C- 242/08, EU:C:2009:647, paragraph 33 and case-law cited.

Nonetheless, it is not generally required for VAT purposes that a consideration has to reflect the value of the goods or services supplied in order for a transaction to be qualified as taxable. In fact, as to the concept of "consideration", it is settled case-law[18] of the CJEU that the taxable amount for the supply of goods or services is represented by the consideration actually received for them. That consideration is thus the subjective value, that is to say, the value actually received, and not a value estimated according to objective criteria[19].

The CJEU has often dealt with cases where the consideration is lower than the cost price of the goods or services supplied. In *Gåsabäck*[20], where the VAT treatment of food supplied by a hotel to its personnel for a consideration below cost price was examined, the CJEU stated that *"the fact that an economic activity is carried out at a price higher or lower than the cost price is irrelevant for the purposes of describing it as being carried out for consideration"*[21]; and in *Campsa Estaciones de Servicio*[22], the CJEU confirmed that "*the possibility of classifying a transaction as 'a transaction for consideration' requires only that there be a direct link between the supply of goods or the provision of services and the consideration actually received by the taxable person. Thus, the fact that the price paid for an economic transaction is higher or lower than the cost price (…) is irrelevant as regards that classification*"[23].

Moreover, the sale of the NPL takes place within the framework of a legal relationship between the parties of the transaction, which entails a reciprocal performance and mutual obligations between the parties (the supply of the loan is made in exchange for the payment and *vice versa*). This direct link between the supply of the NPL and the consideration paid means that the criteria laid down by the CJEU for a taxable supply to exist would be fulfilled.

Two further considerations, as outlined below, would confirm the assessment above.

Firstly, the concept of taxable person is defined in Article 9 of the VAT Directive irrespective of the results of the economic activity carried out, that is, independently from the supplier making a benefit or a loss. Therefore, where there is a supply of an NPL and the seller obtains a consideration lower than the principal of that loan, he could still qualify as a taxable person.

And secondly, the treatment of the transaction at hand as a taxable supply of services consisting in the assignment of intangible property would also be in line with the existing case-law on the subject, as explained below.

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18 Amongst others, judgment of 5 February 1981, *Coöperatieve Aardappelen*, C-154/80, EU:C:1981:38, paragraph 13; judgment of 23 November 1988, *Naturally Yours*, C-230/87, EU:C:1988:508, paragraph 16; and judgment of 29 July 2010, *Astra Zeneca*, C-40/09, EU:C:2010:450, paragraph 28.

19 Article 80(1)(a), (b) and (c) of the VAT Directive comprises an exhaustive list of the circumstances under which a Member States may levy VAT on a transaction on the basis of its open market value rather than of the consideration actually paid. For the definition of open market value, see Article 72 of the VAT Directive.

20 Judgment of 20 January 2005 *Gåsabäck*, C-412/03, EU:C:2005:47.

21 *Ibid*, paragraphs 35 and 36.

22 Judgment of 9 June 2011, *Campsa Estaciones de Servicio*, C-285/10, EU:C:2011:381.

23 *Ibid*, paragraph 25.

The CJEU found in *Swiss Re Germany Holding*[24], for instance, that the transfer for consideration of a portfolio of life reassurance contracts amounted to a taxable supply of services, as it was an assignment of intangible property. The case *GFKL Financial Services*[25] resembles even more the scenario at hand, since it concerned the sale by a bank to a company of defaulted debts for a price below the debt's face value. The question referred specifically to the VAT treatment of the transaction from the point of view of the purchaser of the debts and that is why the CJEU did not pronounce itself on the existence of a potential supply from the seller to the purchaser of the defaulted debt. However, the Advocate General in the case made some preliminary remarks, among which the following: *"In my view, the assignment of intangible property (…) 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…"*[26]. This implicitly confirmed the existence of such a supply.

*Exemption*

The following question is whether this taxable supply of services could be exempt. To this effect, several of the provisions in Article 135(1) of the VAT Directive which are related to debt or lending could be considered.

It nonetheless seems that the provision with the clearest link to the transaction at hand is the exemption for "transactions concerning debt" provided for under Article 135(1)(d) of the VAT Directive. Although not defined in the VAT Directive, this would cover cases consisting in the transfer of a right to a particular sum of money, as stated by the Advocate General in *Granton Advertising*[27]. In the same vein, the Advocate General in *GFKL Financial Services*[28] found that "transactions concerning debts" meant "debt assignments" or, in other words, a "transfer of the debt".

It seems that the taxable supply of services consisting in the transfer of an NPL is nothing more than the mere transfer of debt, which gives to the purchaser of the NPL the right to a particular sum of money (the repayment of the debt); and this would therefore be covered by the exemption pursuant to Article 135(1)(d).

It could also be argued that the exemption for "transactions concerning debentures" pursuant to Article 135(1)(f) of the VAT Directive could be applied in the present case, on the grounds that NPLs could qualify as debentures[29].

Debentures are debt financial instruments used by companies and large entities to obtain funds and, broadly speaking, could be described as being the debt-based equivalent of

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24 Judgment of 22 October 2009, *Swiss Re Germany Holding*, C- 242/08, EU:C:2009:647.

25 Judgment of 27 October 2011, *GFKL Financial Services*, C-93/10, EU:C:2011:700.

26 Opinion of Advocate General Jääskinen of 14 July 2011, *GFKL Financial Services*, C-93/10, EU:C:2011:486, point 31.

27 Opinion of Advocate General Kokott of 24 October 2013, *Granton Advertising*, C-461/12, EU:C:2013:700, point 40.

28 *GFKL Financial Services*, points 38-39.

29 Some further guidance on the definition of debentures can be found in the background paper TAXUD/2014/08, p. 32. It concerned the proposals as regards the treatment of insurance and financial services put forward in 2007 (COM(2007) 747 and COM(2007) 746), which have since been withdrawn – Withdrawal of Commission proposals (OJ C 155, 30.4.2016, p. 3).

shares, the latter being equity-based[30]. A debenture usually gives the creditor the right to recover his investment, and establishes the rate of interest and the repayment date. Since debentures are technically speaking a "loan" from the public, and the issuer of such debentures may be unable to repay that debt, they might in some circumstances be referred to as non-performing loans.

However, the concept of NPLs seems to be broader than that of debentures. So, while some debentures might become non-performing loans, not all NPLs would qualify as debentures (for instance, in cases where the NPL is based on a credit agreement between two parties, and has not been issued as a funding instrument available to the public).

In cases where NPLs are a debenture, it seems that the exemption pursuant to Article 135(1)(f) of the VAT Directive could be applied, but this would not hold for all NPLs in general and each case should be assessed separately. Hence, the Commission services tend to believe that exempting the sale of NPLs on the basis of Article 135(1)(d), as explained above, would be more suitable.

As regards the potential application of the exemption for "the granting of credit" pursuant to Article 135(1)(b) of the VAT Directive, it does not seem possible that the transfer of an NPL could be covered by this provision as the case at hand would not fit into the scope of this exemption. The granting of credit refers to the provision of "new" money involving a change in the financial situation of the parties in a credit agreement. In contrast, the sale of an NPL does not entail the provision of money or any financial changes for the debtor, but just a switch concerning the creditor's identity of an already existing loan.

*3.1.2. From the point of view of the purchaser of NPLs*

*Subjection to VAT*

The question is whether in the circumstances described, the purchaser of the NPL can be said to be providing a service to the seller. In this respect, some could say that a person who, at his own risk, purchases defaulted debts at a price below their face value is actually making a taxable supply of services, the difference between the nominal value of the debt and the lower purchase price being the consideration. Such a supply of services would then consist in relieving the seller of the NPL from debt-recovery operations and from the risk of debts not being paid.

The CJEU has examined this very same question in *GFKL Financial Services*, where a company (GFKL) purchased from a bank defaulted debts for a price below the debt's face value and assumed responsibility for debt recovery and the risk of loss. In the words of the Advocate General[31], GFKL offered the bank an economically affordable possibility to end a number of unsatisfactory relationships with defaulting clients, as well as relieving it from all the legal and public relations problems related to continuous efforts to collect the debts.

In this case, it was concluded 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 and does not carry out an economic activity when the difference between*

[30] Judgment of 6 February 1997, *Harnas & Helm*, C-80/95, EU:C:1997:56, paragraph 19.
[31] *GFKL Financial Services*, point 45.

*the face value of those debts and their purchase price reflects the actual economic value of the debts at the time of their assignment"*[32].

This decision was based on the fact that there was no consideration paid by the bank (the seller of the loan) to GFKL (the purchaser of the loan). The existence of a difference between the nominal value and the purchase price of the debts was rather seen as a reflection of the lower economic value of the debts, which resulted from the fact that they were in or close to default.

The underlying reasoning of the CJEU is in line with the clearer reflections of the Advocate General[33], for whom the sale of debt does not necessarily amount to the provision of a debt collection service by the purchaser to the seller, but is rather a transaction which has to be assessed independently. Thus, something more than just the mere transfer of debt would be required for there to be a debt collection service.

Reference must also be made to *MGK*[34], a case prior to *GFKL*, where similar facts were examined by the CJEU but with a different outcome. In *MGK*, a company (M-GmbH) selling cars to dealers, undertook a factoring[35] contract with another company (MGK). MGK acquired the debts owed by the dealers to M-GmbH at the price of the face value of those debts in return for a commission, and assumed the risk of the debtors' default. The question was whether the activities by MGK constituted a taxable service and in that regard the CJEU in its judgment held that a business which purchases debts, assuming the risk of the debtors' default, in return invoices its clients in respect of a commission, is supplying a taxable service.

According to the description, the activities undertaken by the purchasers of the defaulted debts in both *GFKL Financial Services* and *MGK* seem to be the same (the purchase of debts with full assumption of responsibility for debt recovery and the risk of loss). The different outcome of the cases was nonetheless justified by the CJEU on the grounds of the facts not being identical from the perspective of the remuneration: there was a lack of consideration in *GFKL*, as opposed to a consideration being obtained by the purchaser of the debt in *MGK* (MGK paid for the defaulted loans, but obtained a commission in exchange).

As expressed by the CJEU, "*in contrast to the facts of the dispute that gave rise to the judgment in MGK,* [in the facts examined in *GFKL*] *the assignee of the debts receives no consideration from the assignor, and therefore it does not carry out an economic activity* (…) *or effect a supply of services (…). Unlike the factoring commission (…) which, in the dispute that gave rise to the judgment in MGK, was retained by the factor, this difference* [between the face value and the purchase price of the debts] *does not constitute, in the*

[32] *GFKL Financial Services*, paragraph 26.
[33] *GFKL Financial Services*, points 34-37.
[34] Judgment of 26 June 2003, *MGK*, C-305/01, EU:C:2003:377. The interpretation of this judgment in certain circumstances was discussed in the 86th meeting of the VAT Committee, held in March 2009, on the basis of Working paper No 611. The scenario dealt with at that time was the same which would later on be settled by *GFKL Financial Services*.
[35] The activities are described as consisting in "true" factoring (i.e. the factoring company purchases debts assuming the full risk of default), as opposed to "quasi-factoring" (the factoring company does not become the owner of the debts and does not assume any risk of default, but only collects the debts).

*main proceedings a payment intended to provide direct remuneration for a service supplied by the purchaser of the assigned debts"*[36].

Therefore, and having regard to the above-mentioned case-law, the Commission services believe that the acquisition of NPLs by a purchaser assuming the risk and at a discount price does not constitute a supply of services for consideration, provided that such discount price reflects the lower value of the loan at the time of the purchase. Whether the difference between the face value of the NPL and its purchase price reflects the actual economic value of the debts at the time of their assignment must be assessed on a case-by-case basis.

If this condition is however not met, that is, if an NPL purchaser assumes the risk of the debtors' default in exchange for a consideration (e.g. in the form of a specific commission; or where the purchase price is lower than the NPL face value and this is not merely the result of the debt having a lower economic value), the transaction would constitute a taxable supply of services from the purchaser to the seller, as confirmed by the CJEU in *MGK*.

*Exemption*

The second question is whether such transactions, if taxable, could be exempted from VAT pursuant to Article 135(1) of the VAT Directive.

Article 135(1)(d) of the VAT Directive exempts "transactions concerning debt" but explicitly excludes the activity of "debt collection" from the possibility of being exempt. So, if an NPL purchaser was found to be making a taxable supply of services to the seller of the NPLs consisting in debt collection, the exemption would not apply.

The question, therefore, is whether such services fall within the meaning of "debt collection". In this respect, it must be borne in mind that exceptions to the exemptions, thus resulting in taxation according to the normal arrangements, have to be interpreted broadly[37].

As a preliminary remark, it must be pointed out that the English and Swedish language versions of Article 13B(d)(3) of the Sixth VAT Directive[38], which is the equivalent of present Article 135(1)(d) of the VAT Directive, expressly referred to "debt collection and factoring". Such wording was changed in the VAT Directive, which only refers to "debt collection".

In light of the existing case-law, the meaning of such exclusion remains nonetheless unaltered, since factoring is just a specific type of the wider concept of debt collection (the CJEU held that the other language versions of the Sixth Directive had to be interpreted as also excluding from the exemption all forms of factoring[39], despite "factoring" not being specified).

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36 *GFKL Financial Services*, paragraphs 22-24.

37 *MGK*, paragraph 72.

38 Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment **(**OJ L 145, 13.6.1977, p. 1).

39 *MGK*, paragraph 77.

"Debt collection" is not defined in the VAT Directive, but has been considered in several judgments. In *AXA UK*[40], which concerned a company collecting payments due to dentists (the services comprised the collection, processing and onward payment of sums of money due from patients to dentists), the CJEU defined "debt collection" as financial transactions designed to obtain payment for pecuniary debt. The same conclusion was drawn in *MGK*, which examined the supply of factoring services. They were found to be supplied within the framework of the more general activity of "debt collection": *"the essential aim of factoring is the recovery and collection of debts owed to a third party. Therefore, factoring must be regarded as constituting merely a variant of the more general concept of debt collection, whatever the manner in which it is carried out"*[41].

The circumstances of the scenario at hand seem to be very close to those of *MGK*. As explained in section 2, the essential aim of the purchasers of NPLs is to keep the amounts due to be recovered from the borrower. So, where it can be established that the purchaser of an NPL is receiving consideration and therefore is making a taxable supply of services, such services would qualify as debt collection and could not be exempt.

### 3.2. NPL servicing services

*Subjection to VAT*

Services supplied by a servicing company to the holder of an NPL in exchange for a servicing fee, which consist in the management of the loan as described in section 2, seem to constitute a taxable supply of services for consideration pursuant to Article 2(1)(c) of the VAT Directive. In this respect, we must stress the direct link between the consideration received (the servicing fee) and the supply made (management of the NPL on behalf of the creditor).

*Exemption*

The second question is whether such transactions could be exempted from VAT pursuant to Article 135(1) of the VAT Directive.

The most relevant provision would be the one laid down in Article 135(1)(d), which exempts "transactions concerning debt", but explicitly excludes "debt collection" from the scope of the exemption. Concerning the concept of "debt collection" as described in existing case-law, we refer to section 3.1.2.

Concerning the case at hand, it seems that servicing services offered by third parties to NPL holders could fall within the meaning of "debt collection" and, consequently, could be seen as constituting a taxable supply of services excluded from the application of an exemption. Servicing aims at obtaining payment of the distressed debts and generating a cash-flow from the debtor to the creditor, and all activities typically undertaken by a servicing company would serve towards that end.

It is true that servicing activities performed in respect of NPLs may not only involve the mere handling of payments but also other activities, as described in section 2 (e.g. channelling communications with the borrower; or negotiating changes in the terms of the

[40] Judgment of 28 October 2010, *AXA UK*, C-175/09, EU:C:2010:646, paragraph 31.
[41] *MGK*, paragraph 77.

loan with the debtor, such as debt restructuring). Hence, some people may think that not all activities would have to qualify as "debt collection" and, moreover, that the exemption pursuant to Article 135(1)(b) of the VAT Directive for activities of "negotiation of credit" could be applied in respect of some of these activities.

However, the Commission services would rather consider that the activities undertaken by the servicing firm should be seen on the whole as "debt collection", and that the exemption laid down in Article 135(1)(b) of the VAT Directive would be inapplicable, for the reasons outlined below.

Firstly, as regards Article 135(1)(b) of the VAT Directive, existing case-law[42] suggests that "negotiation" must be a *"distinct act of mediation"* where the provider of the exempt service acts as an intermediary between two parties, without occupying the position of any of the two. In the case at hand, and given that the servicing company is typically acting on behalf of the creditor (following the mandate and instructions given in the servicing contract), this condition would not be met and the activities could not qualify as negotiation of credit.

Secondly, even if there was an activity of negotiation of credit, that activity would in the circumstances described be ancillary to a principal service consisting of debt collection, and could therefore not be exempted[43].

And thirdly, the previous remark would hold in respect of all activities undertaken by servicing firms, and not only "negotiation". Although technically speaking some of such activities could be said not to qualify as collection of loan repayments, they would in the circumstances described have to be seen as ancillary to a principal service consisting of debt collection, and could not be exempted. In this respect, it should be considered that having his loan repaid is the ultimate goal of the creditor, and that the activities undertaken by a servicing firm in respect of an NPL only serve that purpose.

The exemption for the "management of credit by the person granting it", provided for under Article 135(1)(b) of the VAT Directive, would also seem inapplicable in this case, given that the management of the credit is carried out by a third party (the servicing firm) and not by the creditor.

As a final remark, we acknowledge that some may wonder whether there are differences between the services described in section 3.1.2 (services supplied by the purchaser to the seller of an NPL, described as "factoring" in *MGK*), and servicing services provided by a third party to the holder of an NPL described in this section, and whether such difference may have an impact on the VAT treatment of those servicing services.

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42 "Negotiation of credit" has never been defined as such by the CJEU, although the nature of negotiation activities has been examined in respect of other provisions of Article 135(1) of the VAT Directive. For instance, see judgment of 13 December 2001, *CSC*, C-235/00, EU:C:2001:696, paragraph 39.

43 Judgment of 25 February 1999, *CPP*, C-349/96, EU:C:1999:93, paragraph 30: *"There is in particular a single supply in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal service; and that a service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied"*.

In this respect, two comments must be made.

Firstly, it must be stressed that servicing services typically have a well-defined servicing fee which constitutes a consideration for the purposes of Article 2 of the VAT Directive, while the existence of consideration, resulting in a taxable supply of services, in cases of an NPL sale has to be looked at with more care.

And secondly, while potential suppliers of the services described in section 3.1.2 (NPL purchasers) obtain ownership of the loans (this is the reason why such services were found to qualify as true factoring in *MGK*), it is not so that a servicing firm as a result of the servicing agreement becomes the owner. Who retains ownership of the debts, or the possible description of the activities as "factoring" or "servicing", is nonetheless irrelevant to the analysis at hand. It is the nature of the activities undertaken which has to be looked at in order to determine their VAT treatment, and regardless of the labels under which the services may be provided. The only issue which has to be assessed in order to determine the VAT treatment of such services, other than the requirements in Article 2(1)(c) of the VAT Directive, is whether these activities amount to "debt collection", the only parameter referred to in the VAT Directive.

### 3.3. Conclusions

In conclusion, given the legislation as it stands and taking into account the pertinent case-law, the VAT treatment of the transactions examined in this document would, in the opinion of the Commission services, be the following:

- The sale of an NPL would constitute a **taxable supply** of services from the seller to the purchaser of that NPL consisting in the assignment of intangible property pursuant to Article 25(a) of the VAT Directive. Such taxable supply could be **exempt** pursuant to Article 135(1)(d) on the basis of it being a transaction concerning debt.

- Based on *GFKL Financial Services*, it is confirmed that the acquisition of NPLs by a purchaser assuming the risk and at a discount price is **not a taxable supply**, provided that such discount price reflects the lower value of the loan at the time of the purchase. Whether the difference between the face value of the NPL and its purchase price reflects the actual economic value of the debt at the time of its assignment must be assessed on a case-by-case basis.

- However, if the difference between the face value of the NPL and its purchase price does not reflect the actual economic value of the debt, the NPL purchaser could be said to assume the risk of the debtors' default in exchange for a consideration, and the transaction would constitute a **taxable** and **non-exempted** supply of services qualifying as "debt collection" supplied by the purchaser to the seller.

- NPL servicing services provided to the creditor of an NPL, consisting in the management of the loan and involving multiple activities, whose essential aim is the recovery and collection of debts, would constitute a **taxable supply** of services qualifying as "debt collection" and would therefore be **excluded from the exemption** pursuant to Article 135(1)(d) of the VAT Directive.

## 4. DELEGATIONS' OPINION

The delegations are requested to give their opinion on this matter.

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