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GFKL ruling clarifies VAT treatment for sale of defaulted debts

The European Court of Justice (“ECJ”) has issued on 27 October 2011 the decision in the case GFKL Financial Services (C-93/10) towards the VAT treatment applicable to the transfer of defaulted debts at a price different than their face value.

- ❖ In the case, GFKL Financial Services AG (“GFKL”) purchased from a bank a portfolio of defaulted debts. As per the agreement between the parties, GFKL, as purchaser, took over all rights and risks in connection with the portfolio transferred to it. Upon determining the price of the defaulted debts, the parties have considered the risks and likelihood of the said portfolio being able to recover part or all of the money due.
- ❖ Thus the parties set out in the agreement the economic value of the portfolio. Moreover, considering the estimated three years period for the recovery of the bad debts, the parties reached agreement as to the grant by the purchaser to the seller of credit entailing a certain interest. Such interest was also deducted from the economic value set by the parties in the debt purchase agreement.
- ❖ The German Federal Tax Court has then referred the case to the ECJ to ascertain whether the sale (purchase) of defaulted debts constitute, on account of the assumption of responsibility of recovery and the risk of loss and considering the factors used to determine the purchase price, a service for consideration and an economic activity performed by GFKL, in its capacity as purchaser.
- ❖ The Advocate - General (“AG”) has recently issued an opinion in GFKL case, whereby it proposed the answer to this question to be that the purchase of a portfolio of defaulted debts constitutes a service and an economic activity on the part of the purchaser of the debts. However, since in GFKL’s case there is no direct link between the service provided and the consideration received, the supply of such a service does not fall within the VAT scope.
- ❖ Now, as **per ECJ’s decision**, it should be interpreted that *an operator who, at his own risk, purchases defaulted debts at a price below their face value (but close to their economic value) does not effect a supply of services for consideration and does not carry out an economic activity falling within the scope of VAT when the difference between the face value of those debts and their purchase price reflects the actual economic value of the debts at the time of their assignment.*

Should you need any further clarifications on this ruling and its implementation, we are pleased to assist you on this matter.



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