



## ECJ: Sub-participation in receivables constitutes VAT exempt granting of credit

### 1 Background

Financing services are ever present in our everyday lives and may take several forms. From a VAT perspective, the question regularly arises as to whether the granting of credit is VAT exempt. In its judgment in *O. Fundusz Inwestycyjny Zamknięty reprezentowany przez O S.A.* (C-250/21), the ECJ has, once again, clarified that the granting of credit for the purposes of VAT exemption is to be interpreted broadly.

### 2 Facts

An investment fund in Poland concludes contracts with banks and funds for the sub-participation in loan receivables held by the latter. Under these agreements, the investment fund (sub-participant) grants the bank or fund (originator) a certain amount of advance financing. The originator undertakes to pay the sub-participant all of the benefits it generates from the receivables. The projected proceeds exceed the financing amount. The originator maintains legal ownership of the receivables. In the event of the debtor becoming the subject of insolvency proceedings, the sub-participant does not have a right of action against the originator. The sub-participant is only entitled to the proceeds that the originator obtains through the realisation of the collateral granted to him. The sub-participant does not receive its own collateral.

### 3 ECJ decision

The ECJ first states that the sub-participant carries out a supply of services to the originator for consideration. As a mutual agreement, the sub-participation contract provides for the sub-participant to make a financial contribution available to the originator and to receive, in return, the (in principle) positive difference between the proceeds and the financial contribution.



Laura Klein  
Certified Tax Consultant  
Master of Science (M.Sc.)

+49 (0) 89 21759 1296  
laura.klein@kmlz.de

The ECJ goes on to state that, subject to verification by the referring court, the sub-participant's supply essentially consists of a payment of capital in return for consideration. The ECJ does not consider the assumption of the risk of the debtor's default to be a further essential service component. A credit risk must be borne whenever credit is granted. In the ECJ's view it is irrelevant as to whether this relates to the contracting party's default or that of an underlying debtor.

The ECJ thus deviates significantly from the Advocate General's view. In her Opinion, the Advocate General considered the assumption of the default risk to be an essential service component of a complex, single supply by the subcontractor and therefore rejected the VAT exemption of the supply as granting of credit.

The ECJ, on the other hand, considers the conditions for the VAT exempt granting of credit to be fulfilled. Firstly, capital is provided and secondly, this is done in return for consideration. The ECJ does not impose any further requirements for the VAT exempt granting of credit. In this respect, the ECJ first reconfirms two essential principles from its previous jurisprudence. For one, it is irrelevant for the assumption of a VAT exempt granting of credit as to whether the remuneration takes the form of a payment of interest or another form. Moreover, only the nature of the service is crucial for the classification of a supply as VAT exempt granting of credit, not the supplier's status as a bank or financial institution. Beyond this, the ECJ considers the particular features of the sub-participation agreement, as compared to a classic loan agreement, to be irrelevant. Neither the fact that the receivables remain with the originator nor the lack of collateral or possibilities of recourse of the debtor affect the essential nature of a sub-participation transaction consisting of financing of the initial loan.

#### 4 Consequences for the practice

While the judgment concerns a special financial market vehicle, namely a sub-participation agreement, in the context of the sale of loans, the judgment is, nevertheless, of considerable importance due to the economic relevance of sub-participations and comparable transactions. The ECJ's clear opinion in favour of VAT exemption is therefore to be welcomed.

Moreover, despite the special topic under review, the ECJ makes general statements on the granting of loans that can also be applied to circumstances in similar constellations. In doing so, the ECJ continues its broad interpretation of the concept of the "granting of credit" already manifested in its previous jurisprudence. The crucial prerequisite is solely that the essential nature of the supply of services is the provision of capital in return for consideration. In particular, the ECJ does not require the transaction to be comparable to classic credit and loan agreements, for example regarding the existence of collateral. This means that the concept of granting credit, from a VAT perspective, can clearly extend beyond that of the German Banking Act.

It should be noted, however, that requiring the payment of capital in return for consideration to be the essential service component continues to distinguish the granting of credit from other financing instruments. As regards factoring, for example, the essential nature of the supply of services is usually not financing, but the collection of receivables (sec. 2.4 para 4 of the German VAT Circular). However, the granting of credit is possible in the case of a sale of receivables without the assumption of the collection of receivables (sec. 2.4 para. 5 of the German VAT Circular). Furthermore, the granting of credit must be distinguished from securitisation, i.e. the conversion of loans into securities which, in principle, fall under the VAT exemption for transactions in securities.