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By PwC Deutschland | 10 October 2022

ECJ: Financing services provided through sub-participation exempt from VAT

According to the ECJ, financing provided to the originator under a sub-participation agreement is a VAT exempt transaction and complies with the exempt transactions listed Article 135(1)(b) of Council Directive 2006/112/EC (VAT Directive) concerning “the granting and the negotiation of credit and the management of credit by the person granting it”.

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Case of dispute and question referred to the ECJ

The claimant is an investment fund (a non-standardized securitization fund within the meaning of Article 183 et seq. of the polish law on investment funds and the management of alternative investment funds). After having planned the conclusion of sub-participation agreements with banks and other investment funds, the claimant requested the Polish Minister for Finance to issue a tax ruling to ascertain whether the services which it was to provide as a sub-participant would be exempt from VAT.

Based on the conditions of the sub-participation agreements the originator undertakes to transfer to the sub-participant all the proceeds from the receivables specified in that agreement in exchange for a contractually agreed financial contribution received from the sub-participant as soon as the respective agreement is concluded. The debt securities remain in the hands of the originator. The difference between the up-front financial contribution paid to the originator and the amount received by the sub-participant during the term of the agreement will be the sub-participant's remuneration. The purpose of the sub-participation is thus twofold: First, that of a credit instrument, as the originator receives liquidity in advance in exchange for the commitment to transfer the proceeds from the receivables concerned to the sub-participant. Second, that of risk cover, in so far as liquidity is released from the credit risk attached to those receivables.

In the **opinion of the Ministry of Finance**, a sub-participation agreement cannot be treated in the same way as a loan agreement because - for one - the claim remains within the originator's possession and, secondly, the sub-participation agreement - in contrast to a loan agreement - contains a clear identification of the source from which the sub-participant is to be satisfied. Lastly, in case of the debtor's insolvency, the sub-participant has no claim against the originator for repayment of the outstanding amounts. On the other hand, it is the **opinion of the claimant** that the services provided under those sub-participation agreements are exempt from VAT based on Article 43(1)(38) and (39) of the national VAT law, either as financial instruments similar to credit agreements or as services hedging the risk of the debtors' insolvency. The case went before the Supreme Administrative Court of Poland, who asked the ECJ to determine whether this latter view is in accordance with EU law.

ECJ decision

Considering its previous case law, it seemed a fairly clean-cut task for the ECJ to reach his decision, namely that *"the services provided by the sub-participant under a sub-participation agreement (…) fall within the concept of 'granting of credit' within the meaning of Article 135(1)(b) of the VAT Directive."*

The structure at hand constitutes a financing service of which the essential objective is to ensure that the originator can use the funds made available to him or her, in return for the payment to the sub-participant of the amounts corresponding to the value of the proceeds from the receivables concerned. The sub-participation agreement is thus similar in nature to a credit agreement by which the borrower purchases funds from the lender which he or she is entitled to use in any desired way and undertakes to repay them over the duration of the agreement. Like a lender, a sub-participant will receive, in addition to the financing paid, an advantage in the form of cash flow, over and above the capital employed.

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More specifically, the ECJ also pointed out the following aspects, among others, which led to its judgment:

- It follows from established ECJ case-law that, although that remuneration is as a rule ensured in return for the payment of interest, other forms of consideration cannot prevent a transaction from being classified as the granting of credit within the meaning of Article 135(1)(b) of the VAT Directive (judgment of 15 May 2019, *Vega International Car Transport and Logistic*, C?235/18, paragraphs 47 and 48).

- The sub-participant bears the credit risk inherent in any credit transaction. It is irrelevant whether this risk arises from the default of the debtors of the receivables from which the proceeds are transferred to him or from the insolvency of his immediate contractual partner.

- The absence of guarantees provided in favor of the sub-participant is not decisive for the classification of the sub-participation agreement as a credit transaction.

- Neither does the fact that the sub-participant has no legal remedy against the originator in the event of default by the debtors of the receivables nor that debt securities remain in the originator's possession (assets) affect the essential nature of a sub-participation transaction, i. e. financing the initial loans.

Finally, the court notes that this interpretation of the agreement does not call into question the principle of fiscal neutrality which ensures avoiding an increase in the cost of consumer credits.

The ECJ thus concludes that, subject to verification by the referring court, the service provided by the sub-participant to the originator is made up of a single supply which consists, essentially, in a payment of capital in return for remuneration and that is necessary to finally examine whether, by taking a closer look on the overall situation as a whole, such a supply is in the nature of a 'granting of credit' within the meaning of Article 135(1)(b) of the VAT Directive.

Source

The ECJ case reference is **C-250/21**, *O. Fundusz Inwestycyjny Zamkni?ty reprezentowany przez O* judgment of 6 October 2022.

Keywords

Credit, loan