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Landmark Judgement of the German Federal Fiscal Court (BFH) of 16 December 2015 in Respect of Factoring and the Liability of the Purchaser of Receivables for Unpaid VAT Owed by the Originator and Seller of Receivables

Section 13c of the German VAT Act provides that the acquirer of a receivable which includes value added tax, e.g. trade receivables, lease receivables and telephone receivables, becomes liable for the payment of such VAT if the purchaser of the receivables receives the payments from the relevant receivables and the seller of the relevant receivables does not pay the VAT included in the relevant receivables to the relevant tax authorities.

However, according to Section 13c Para. 1 of the Decree regarding the Application of the German VAT Act (*Umsatzsteueranwendungserlass*), issued by the German Federal Ministry of Finance and based on a Circular of 24 May 2004 of the German Federal Ministry of Finance, it has been the practice in the German factoring and securitisation market to hold that such Section 13c of the German VAT Act shall not apply to the extent that the acquirer of the relevant receivable has paid a purchase price to the seller thereof, which the seller is entitled to keep and which is paid on an account to which the acquirer has no access. Of course, such a rule left open a liability risk for the portion of any discounts applied to the nominal amount when calculating the purchase price for the relevant receivables, but at least it mitigated such liability risk.

In its decision of 16 December 2015 the BFH had to decide a case where a factoring company purchased receivables and assumed the credit risk in relation to the debtors from the seller, paid the seller 80% of the nominal amount as non-refundable purchase price upfront and the remaining 20% later after receipt of payment by the debtors, minus fees and commissions. The seller went into insolvency and did not pay the VAT portions contained in the relevant receivables. The competent tax authority turned to the factoring company and claimed payment of the relevant VAT from the factoring company. The factoring company lodged legal remedies, but the BFH ultimately decided that the factoring company is liable to pay such VAT to the competent tax authority.

The BFH also held that the payment of the purchase price for the receivables by the factoring company to the seller was of no relevance and that the above mentioned Decree regarding the Application of the German VAT Act (*Umsatzsteueranwendungserlass*) is only an internal rule applicable within the tax administration but is not binding on German courts.

With reference to the regulations of the German VAT Act, the BFH proposed as a remedy, that the factoring company should pay directly the respective VAT portion of the receivable to the competent tax authority. Only the purchase price remaining after deduction of the VAT portion should be paid to the relevant seller. However, such a route would make factoring and securitisation transactions in Germany more complicated. If parties would choose not to use the route proposed by the BFH, the acquirer of trade receivables must at least closely monitor, during the lifetime of the relevant transaction, that the seller of the receivables duly complies with its VAT payment obligations. In order to achieve such monitoring appropriate provisions need to be included into the relevant asset purchase documentation.

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