Neutral Citation Number: [2007] IEHC 49

**THE HIGH COURT**

**JUDICIAL REVIEW**

**[2005 No. 725 JR]**

**BETWEEN**

**HAGEMEYER IRELAND PLC**

**APPLICANT**

**AND**
**THE REVENUE COMMISSIONERS**

**RESPONDENT**

**Judgment of Mr. Justice Charleton delivered on the 9th day of February, 2007**

1. The applicant seeks as against the Revenue Commissioners a judgment of this court that it is liable for VAT. The applicant seeks this, because under s. 12 of the Value Added Tax Act, 1972, its expenditure allowable in the conduct of its business exceeds its VAT liability. Notwithstanding the high turnover of the company, its VAT liability is low because of the international element to its services. As a result it has an input credit, as this situation is called.

2. The Value Added Tax Act, 1972, as amended, consolidates the law in relation to the payment of value added tax. The amendment which applies in this case was necessitated by the Sixth VAT Directive, more properly the Sixth Council Directive EEC/77/388 of 17th May, 1977. Under Article 10 of the Treaty of Rome, Ireland is bound to give effect to this directive, as is our obligation under Article 29 of the Constitution. In construing the relevant legal situation, I must have regard to the law of the European Union. Since the legislation mirrors the Directive this does not cause a problem. The relevant provision is therefore Article 13B(d)(3) of the Directive.

**The Correspondence**

3. This case arises in the aftermath of a series of letters exchanged between the applicant and the Revenue Commissioners. On the face of this correspondence, it is asserted that an interpretation has been given by the Revenue Commissioners making the applicant liable for VAT. This assertion is denied and, even if it be true, it is argued that the Revenue Commissioners cannot adopt any position which is contrary to national legislation: the position as regards European Law is argued to be the same.

4. By a letter dated 29th November, 1999, the Revenue Commissioners wrote to the applicant in the aftermath of a visit for the purpose of the examination of VAT records and, in particular, a scrutiny of what is called "the receivables servicing agreement" with a Dutch company. The District Inspector, after dealing with that, stated:-

> "I am of the opinion that the services described in the agreement are debt collection services and therefore taxable Fourth Schedule services. Please quantify the amount of VAT unpaid in respect of the received service and your offer of payment to include interest and penalties."

5. In November, 2002, the applicants' legal advisers wrote to the Revenue Commissioners making the argument that their activity made them liable for VAT and giving details of various transactions involving, in part, an interpretation of documents. After a follow up, this main letter was answered by the District Inspector on 28th August, 2003, as follows:-

> "I am now in a position to finally deal with your letter of 20/11/02. I agree that factoring is a taxable financial service and as such is taxable where received. This accords with the recent ruling by the European Court of Justice in the case of *Finanzamt Gross-Gerau v. MKG-Kraftfahrzeuge-Factory GmbH*. While it does not arise in this instance where there is both a charge for factoring and interest Revenue would regard the factoring charge as taxable and the interest charge as exempt. I agree in the particular circumstances of this case to allow your client to apply this ruling from a current date forward as suggested in your letter."

6. This case concerns both an interpretation of the relevant tax legislation and an assertion that, even if that interpretation goes against the applicant, legitimate expectation would bar the Revenue from resiling from the position in the letter. The aftermath is thus important. Over a period of months, the client's legal adviser sought payment from the Revenue of the input credit, amounting, as I was told in argument, to around €400,000. In September 2004, a reference was made to s. 21A of the VAT Act, 1972, seeking interest on refunds due. Ultimately, on the 1st June, 2005, one year only of VAT accounts having been dealt with in the interim, as I understand it, the Revenue Commissioners wrote as follows:-

> "I refer to correspondence concerning the VAT treatment of invoice discounting/factoring services provided by the above mentioned – company. Revenue has outlined its interpretation of the judgment in the *MKG-Kraftfahrzeuge-Factory GmbH*, case see – 305/01 in Tax Briefing Issue 59 – April, 2005. In its view of what constitutes debt factoring, it considers that the purchaser of the debts who outsources the collection of those debts back to the vendor is carrying on an economic activity, but regards this as an exempt financial service. The purchaser of the debts is the recipient of a debt collection service from the vendor and the VAT on that supply is not deductible in the hands of the purchaser as he is not regarded as engaging in debt factoring or debt collection. Hagemeyer Ireland Plc. outsources the collection of the debts purchased by it back to the vendor. Therefore in accordance with the Revenue's interpretation it would be regarded as carrying out a VAT exempt financial service. It is liable to VAT on the receipt of the debt collection service from the vendor with no entitlement to deductibility."

7. This letter, it is claimed, is a complete reversal of the position accepted by the Revenue Commissioners as expressed in their letter of 28th August, 2003. Further, it is argued that insofar as this is correct it would be unjust to allow the Revenue Commissioners to resile from it, as the applicants have changed their financial position to take into account the calculation of the receipt of the input credit in the amount mentioned: in short, the assertion is that a legitimate expectation has arisen.

**Factoring**

8. It is highly probable that this dispute between the parties would not have arisen had certain internationally used terms, which are subject to national variation, been defined in the Sixth VAT Directive. This declares as one of its objects the harmonisation of "the concepts of chargeable event and the charge to tax". It also recites that "a common list of exemptions should be drawn up so that the Communities' own resources may be collected in a uniform manner in all Member States". These objectives are difficult to achieve without common concepts.

9. With that in mind, Article 13 of the Directive lists the exemptions which should be applied, as is stated, for the purpose of ensuring

the correct and straightforward application of such exemptions and of preventing any possible evasion, avoidance or abuse. It is perhaps dangerous to attempt to characterise this complex legislation in simple terms. However, under Article 13A, there are exemptions laid down for activities in the public interest, such as hospitals, and then Article 13B describes a mixed bag of exemptions which have no common thread, followed by Article 13C giving the right to Member States to allow certain exemptions at their option. Guidance is therefore almost impossible from the text; save that the overall purpose of the directive is to impose liability for VAT on all economic activity subject to exceptions. Given that is the case, one might construe the exceptions carefully within their precise terms. This matter becomes more problematic because the applicants claim liability to be assessed for VAT on the basis of a derogation from the exception.

10. Article 13.1B(d)(3) applies an exemption in respect of:-

> "Transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection and factoring;"

11. The whole of subparagraph (d) seems to be concerned with banking, credit, currency and securities (including shares). It is of little assistance toward construing the Directive in accord with an inferred purpose. Of even less assistance is the absence of a definition for factoring. This is particularly unfortunate given the diversity of definitions that might be applied.

12. I note that factoring may take many forms. In *"Factoring: The Law and Practice of Invoice Finance"* (3rd Ed., Sweet and Maxwell, London, 1999) by Salinger, numerous definitions are put forward as possible for this term. In the United States a very restricted definition is apparently accepted. This requires:-

> "A continuing arrangement between a factoring concern and the seller of goods or services on open account, pursuant to which the factor performs the following services with respect to the accounts receivable arising from sales of such goods and services: 1. Purchases all accounts receivable for immediate cash.
>
> 2. Maintains the ledgers and performs other book-keeping duties relating to such accounts receivable.
>
> 3. Collects the accounts receivable.
>
> 4. Assumes the losses which may arise from the customer's financial inability to pay (credit losses)."

13. A similar definition may be applied, I do not know, in various States of the European Union which seek to closely circumscribe liability for VAT. The "*Concise Oxford Dictionary*" defines a factor as a company that buys a manufacturer's invoices and takes the responsibility for collecting the payments due on them and defines factoring as selling one's debts to a factor. This description, as it is quoted in Salinger, is, as he comments, very wide. He describes factoring in the following working definition, at p. 2:-

> "The purchase of debts (other than debts incurred for goods or services purchased by a debtor for his personal, family or domestic use and debts payable on long terms or by instalments) for the purpose of providing finance, or relieving the seller from administrative tasks or from bad debts or for any or all such purposes."

14. In this case it is argued by the applicant that true factoring, and not quasi-factoring, is the activity which the applicants have engaged in. It is argued that they have purchased debts for the purpose of providing finance. On the contracts, to which I shall soon turn, the applicants are certainly not relieving the seller of such debts from administrative tasks, but they are argued to be accepting the liability for default.

15. It would not appear that the existence or non-existence of a contract of factoring has any legal consequence beyond a contractual dispute between the parties, apart from the issue related to VAT in this case. Therefore, cases defining factoring have not been opened to the court. However, because money lending is subject to legal regulation and its avoidance will create an illegal contract, possibly unenforceable, there has been some discussion as to the distinction between money lending and factoring. In *Olds Discount Company Limited v. John Playfair Limited* [1938] 3 All E.R. 275, an issue as between money lending and factoring arose. *Playfair* were credit drapers who sold goods on terms that the price was to be paid by their customers in instalments. *Olds Discount* were a hire purchase finance company. The parties entered into an agreement whereby the debts of *Playfair* were assigned to *Olds Discount* but *Playfair* undertook to collect these debts at their own expense as agents on behalf of Olds Discount. *Playfair*, apart from sending out initial bills, also sent out a series of monthly bills to their customers. The agreement provided that when all the instalments had come in to *Playfair* then, apart from the sum already paid by *Olds Discount* to purchase the book of debts, that a further sum, a top-up, should also be paid. It was argued that this was a contract of money lending.

16. Branson J. analysed the transaction and held that it was not a money lending contract. At p. 277 he stated:-

> "… if it be the fact that the agreement entered into between the parties was an agreement for the purchase of book debts, the agreement is a perfectly, good and lawful agreement, notwithstanding that the operative reason in the minds of the defendants for entering into it was that they desired to raise money as a temporary matter in the same way as they would have raised it if they had merely entered into a transaction of loan. In other words, it is the nature of the agreement entered into, and not its object, at which the court has to look in order to decide whether in any particular case the agreement is a money lending agreement or otherwise."

17. The issue as to whether factoring was in fact a disguised loan came up again in *Chow Yoong Hong v. Choong Fah Rubber Manufactory* [1962] A.C. 209. The facts of that case were rendered more complex by reason of the fact that both parties were, on occasion, engaging in the purchase of each other's debts at a discount from the book value. If these transactions, which were defaulted on, were money lending it would have offended the Money Lending Ordinance, 1951 (Malaya). The Privy Council held that the purchase for a discount of cheques was quite distinct from money lending: there was no loan of money and no promise of repayment. What was central to the decision was the outright nature of the transaction whereby once a purchase had been made of the bills, there was no recourse to the seller for the full amount should it not be collected. At pp. 215-217 Lord Devlin offered these observations:-

> "The business of buying bills at a discount, that is, for their value at the date of purchase, is well known and is quite distinct from moneylending. Nowadays the buyer is usually a bank or a discount house, but the fact that he cannot be put into either of these categories does not alter the nature of the transaction, neither does the designation of the discount as interest. There is here no loan of money and no promise of repayment. Their Lordships conclusion on this point is in accordance with the decision of Branson J. in *Olds Discount Limited v. John Playfair Limited* [1938] 3 All E.R.

> 275 that a purchase of book-debts for a specific sum was not a money lending transaction … the fundamental error that underlies the defendant's case on both groups of cheques is that because they were, so they say, in need of ready cash, and because the plaintiff supplied them with it and made, if he did, a profit out of doing so, therefore there was a loan and a contract for its repayment. There are many ways of raising cash besides borrowing. One is by selling book-debts and another by selling unmatured bills, in each case for less than their face value. Another might be to buy goods on credit as against a post-dated cheque and immediately sell them in the market for cash. Their Lordships are, of course, aware, as was Branson J., that transactions of this sort can easily be used as a cloak for moneylending. The task of the court in such a case is clear. It must first look at the nature of the transaction which the parties have agreed. If in form it is not a loan, it is not to the point to say that its object was to raise money for one of them or that the parties could have produced the same result more conveniently by borrowing and lending money. But if the court comes to the conclusion that the form of the transaction is only a sham and that what the parties really agreed upon was a loan which they disguised, for example, as a discounting operation, then the court will call it by its real name and act accordingly."

18. Crucial to the definition of factoring is that the risk of the payment not being made should be passed from the seller to the factor. If there is recourse to the seller in the event of default, the arrangement cannot be described as factoring. Salinger treats this at para. 1-44 by stating:-

> "For those clients who need finance for the trade credit requirements of their debtors but no administrative service or protection, another service is provided extensively by factors. By the [simple] expedient of releasing the client from the need to notify the debtors to pay direct to the factor and by providing that all debts sold to the factor should be subject to full recourse, factoring is changed to a purely financial service sometimes referred to as "confidential factoring" or, more commonly, "invoice discounting"."

19. In this case it is claimed by the applicant that they have no recourse to the seller of the debt. Those debts, however, continue to be collected by the seller. Salinger at p. 16 gives a useful description of what he calls "factoring in its full form". This he describes as:-

> "…a continuing relationship between a factor and supplier (the client) of goods to trade customers in which the factor purchases substantially all the trade debts of his client arising from such sales of goods or the provision of such services as they arise in the normal course of business. The client in turn for agreed fees and finance charges is thereby relieved:-
>
> (a) from the need to administer and control a sales ledger and collect amounts payable from the debtors; and
>
> (b) from losses arising from the inability of the debtor to pay; and
>
> (c) from the provision of trade credit to debtors, to a substantial
>
> degree."

**The Reality of Transactions**

20. The court, in analysing transactions must bear in mind that the parties may have reason to disguise their nature. The fundamental concern of the court is therefore to uncover their true effect. The basic principle under Articles 2 and 4 of the Sixth VAT Directive is that all economic activity, unless exempted, should be liable to VAT and that all persons and undertakings pursuing an economic activity should pay that tax. Dealing with an issue as to whether a particular kind of economic activity was exempt under the Sixth VAT Directive, the European Court of Justice in Case C-2/95 *Sparekassernes Datacenter (SDC) v. Skatteministeriet* [1997] ECR I-03017, emphasised that the provisions defined exempt transactions according to the nature of the service provided and not according to the persons supplying or receiving such service, or according to the specific manner in which the service was performed. At para. 7 of its judgment the court stated:-

> "In order to be characterised as exempt transactions for the purposes of points 3 and 5 of Article 13B(d) and of Annex F, points 13 and 15 to the Sixth Directive (77/388) on the harmonisation of the laws of the Member States relating to turnover taxes, the services provided by a data-handling centre in the context of transactions concerning transfers and payments, those concerning shares, interests in companies and associations, debentures and other securities and those concerning the management of deposits, purchase contracts and loans must, viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions of the said services."

21. Where a transaction comprises a bundle of separate but related obligations or contracts, then regard should first of all be had to the circumstances in which that transaction takes place; Case C-349/96 *Card Protection Plan Limited (CPP) v. Commissioners of Customs and Excise* [1999] ECR I-00973 at para. 28. As the European Court of Justice stated in Case C-150/99 [2001] ECR I-00493 at para. 26:-

> "According to the case-law of the Court of Justice, in order to determine the nature of a taxable transaction, regard must be had to all the circumstances in which the transaction in question takes place in order to identify its characteristic features."

22. I must therefore attempt to closely analyse the salient features of the standard bundle of transactions to which Hagemeyer Ireland Limited PLC (hereafter Hagemeyer) commits itself in order to decide whether they are subject to an exemption from VAT, as providing a financial service, or whether the true nature of the standard arrangements entered into by them constitutes factoring or debt collection. In this regard, I am reading the exclusion to the exemption provided in Article 13B(d)(3) when it refers to "but excluding debt collection and factoring" as involving two separate exclusions, one involving debt collection and the other factoring; and not that factoring is required also to encompass debt collecting. I infer that whereas factoring and debt collecting can often be pursued by the one entity, they can also be pursued entirely separately: as where a company purchases debts and then uses specialist debt-collecting firms to ensure a return on its investment.

**The Contracts**

23. Before turning in detail to the contracts involved, a brief description is appropriate. For this purpose, one will assume that there are two companies, which I shall call A and B. A is a company providing goods and services on the general open market. B purchases those goods and services and, in consequence, becomes indebted to A. No doubt, at some particular point in time, A has supplied the goods and services to B but is, as is common, awaiting payment. It can have no notion as to how long it will have to wait, whether the companies to whom it has supplied its goods and services, including B, will remain liquid, or whether, as has happened, a destabilising event may occur in the country where B is situated whereby for reasons of ideology, war or weather, B can no longer

pay A. In the ordinary course of events, in addition, B may become insolvent, or seek to stretch out its credit to tide it over a difficult trading period. Cash is rarely paid on delivery: almost always A will grant B credit terms, be it the usual 30 days or three months, or whatever. It is therefore to the advantage of A to be paid immediately. This is where Hagemeyer comes into the picture. It purchases the debts of A, owed to it by B and other companies. It may then, according to the contract, pursue B for its debts to A through any agency. If the debts are not paid, it is argued by the applicant, then Hagemeyer has no recourse against A for it to make up the balance of the money unpaid by B, and other undertakings, to the apparent value of the debts as they appear on A's books.

24. This, it is argued by the applicant, is factoring. It arises, however, not on the basis of one, but of two contracts, which I shall refer to as contract 1 and contract 2. The Revenue Commissioners argue, fundamentally, that the major provisions of these contracts, when read together, mean that the applicants are not involved in factoring but in an exempt financial service under the VAT Act, 1972, as amended. They claim that, by contract 2, Hagemeyer require A, having bought its debts, to collect on their behalf from company B and then remit the proceeds to them. The Revenue Commissioners regard this as the provision of credit, which is exempt from VAT under the Sixth VAT Directive: what is being done by Hagemeyer is not debt collection, because this is done by A who are already owed the debts, but the provision of a financial service involving the granting of credit, an exempt transaction under Article 13B(d)(1) which excludes "the granting and the negotiation of credit and the management of credit by the person granting it". Further, the Revenue Commissioners argue, Hagemeyer is not supplying a service to the client, who I continue to call A, relieving it of both the debt recovery operation from B and the risk of the debt not being paid. Both, they argue, are of the essence of factoring. Finally, the Revenue Commissioners argue that there has not been a true purchase of the debts of A because the applicants, under the relevant contracts, have not assumed the entire risk of debt default.

25. In answer to this, the applicant has argued that they have assumed the total risk of debt default and that they are at liberty to outsource the actual debt collection in itself to A, from whom they purchased the debts in the first instance, or to any other entity. This activity, it is claimed, is a taxable activity and is not within any of the exemptions. They have no recourse to A, the seller of the debt, in the event of default and are therefore assuming that risk. They have no right, it is argued, to return to A, the seller of the debt, to ask it to make up the full amount and there are no conditions, in the event of a default, where they can require the 100% book value of the debts to be collected by the seller. The fact that A, as seller, is also collecting the debts, having assigned the value of those debts absolutely to Hagemeyer makes no difference, it is asserted.

26. In turning to examine these contracts between Hagemeyer and the seller to them of debts, A, from third parties, B, based on the authorities I believe that I should search as to the true nature of the transactions based on certain issues:-

1. whether the entire risk of default on the debt has been passed from the seller to the factor;

2. whether the factor is free to collect the debts through its own agency;

3. whether the service provided by the factor is an economic service or merely a disguised loan; and

4. whether the transfer of the debt collecting activity by the factor back to the seller destroys the underlying nature of the transaction as factoring and instead transforms it into a mere financial service.

27. I have been given two contracts to examine. The first contract is an involved document running to 21 pages of multiple clauses. In fact, it describes itself in the following term: "Memorandum of Offer". When Hagemeyer treat with any commercial entity they do so in circumstances where this document, and the second contract, have already been furnished to them. Hagemeyer are entitled to accept or reject the transfer of any particular debt. This negotiation is done orally but, when it is concluded, the terms of the agreement will be those of the Memorandum of Offer. There seems to be no room for express variation on an individual basis. The purpose of the negotiation is to choose the debts and, no doubt, to choose the rate of discount in respect of the purchase of same. The second contract, which would be entered into at the same time as the oral contract based on the Memorandum of Offer if concluded, must be read together with that contract. The general definitions clause of the second contract makes it obvious that both are to be read together since it states that all terms that are not defined in the second contract have the meanings ascribed to them in what is called "the Purchase Agreement"; this is a reference to the oral contract that is concluded on the basis of the Memorandum of Offer. The second contract engages the seller of the debt, A, on behalf of Hagemeyer, to collect those debts from third parties, B, and to transfer the payments received, if any, to Hagemeyer.

28. The first contract provides at clause 2.1 that on the basis of the Memorandum of Offer the seller of the debts and Hagemeyer may, at their respective sole discretion, agree to the sale and purchase of same. These are book debts are called "Receivables". Once this agreement is made, each party must account for the transactions as purchases and sales of receivables, in other words debts, and cannot take any action which is inconsistent with that characterisation. The first contract goes on to deal with the mechanisms of how an agreement is to be made in relation to the purchase and sale of each individual debt. At the end of clause 2.2 it states:-

> "The Seller and the Purchaser (the latter by its Acceptance) (if ever)) acknowledge that –
>
> (i) The purchase of any Receivable (and the Related Security in respect thereof) under the agreement is entirely at the Purchaser's discretion and will be based on the Purchaser's independent analysis of such Receivables; and
>
> (ii) All Receivables (and the Related Security in respect thereof) will be sold without warranty or guarantee by the seller except for those expressly set forth in this memorandum;
>
> in particular the Seller does not guarantee the collectability of any purchased receivable, and all receivables sold under the agreement shall be sold without recourse of any kind to the Seller on account of non-payment or delayed payment by the related Obligor."

29. Under clause 4.2 of the first contract, the seller A does not transfer to Hagemeyer the ledgers wherein it writes up its debts from B and others. Instead, there is a general right to attend at the place of business of the seller and to inspect the relevant books and records, including the operating procedures. Under that clause and under clause 2.3(a) there is a duty to maintain records so as to ensure the honest performance of the obligations under the contract.

30. Clause 2.2 operates so as to transfer the debt of the seller to Hagemeyer without recourse. Under clause 5.2 Hagemeyer apparently becomes the owner of the debts. That clause provides:-

> "As the owner of the Purchased Receivables, the Purchaser may forgive, extend, amend or otherwise modify the terms of

any Purchased Receivable, or pledge or transfer any Purchased Receivables to any Person, or take any other action with respect to the Purchased Receivables, without the consent of the seller (except as required by clause 2.3(b)).”

31. Further, under clause 7.5 the seller of the debts may not assign any rights under the Agreement to any other party without the prior written consent of Hagemeyer.

32. This latter clause refers to a situation where Hagemeyer, having purchased those debts of A, that they were owed by B, find themselves in a situation where B exercises a set-off against A or a lien over the property of A. In those circumstances, the full amount of the debt excluding that contingency is transferred, and any balance must be made up by A, as seller of the full debt, to Hagemeyer.

33. It is argued that Hagemeyer have a complete discretion as to who to appoint to collect the debts; that they may collect the debts themselves or appoint anyone, not limited to the seller of the debts, as their debt collectors. This argument is made on the basis of clause 5.1 which provides:-

> “At any time when it owns Purchased Receivables, the purchaser may, in its sole discretion (acting directly or through the Collecting Agent) notify the Obligors under any or all of the Purchased Receivables that the Purchaser is the owner of such Purchased Receivables, and direct that payment of all amounts payable under any related Contracts be made directly to the Purchaser or to the Collection Agent. At the request of the Collection Agent or the Purchaser, the seller will cooperate in the giving of the notice described in clause 5.1 and will join in such notice if requested.”

34. It is also argued that this discretion given to Hagemeyer under the contract, as to what to do with collection of the debts once purchased, is indicative that what is involved in these transactions is a true factoring arrangement. In particular, reliance is placed on clause 5.2, already quoted.

35. It has being urged that the presence of certain safeguards in these contracts operates so as to nullify same as a factoring arrangement and make it into a financial service. Under clause 2.3(e) VAT that is repaid to A in respect of bad debts due but not paid by B has to be transferred, in addition to the debt as purchased, if and when same is received, from the seller to Hagemeyer. Under clause 2.4 the amounts paid to the seller of the debts must be transferred promptly to Hagemeyer. Where there is a delay, then interest is chargeable on that delay.

36. The argument against this being a factoring transaction is made with further reference to the second contract, which is described as the “Receivables Servicing Agreement”. Under clause 4.1(c) the party collecting the debts must pay everything that is received or, where it is to be written off as uncollectable at the discretion of Hagemeyer, assist in determining whether to write off the debt as uncollectable. The basic purpose of this second contract is to appoint A, the seller of the debt from B, as the party that collects the money from B. Hagemeyer therefore does not collect the money but owns the debt that was once owned by A, the company that has sold that debt to Hagemeyer. An interest provision is included in that contract under clause 3.2. Where an amount is received by A, the seller of the debt, acting as collector for Hagemeyer, and not paid, interest is payable in respect of that non payment. Under clause 4.5 the seller of the debt, A, as collector of the debt for Hagemeyer, can perform its duties as collection agent through one or more agents but is not entitled to make such appointment so as to absolve it of the responsibility to Hagemeyer of collecting the debts from B.

37. I have considered the clauses in relation to the obligations of the seller of the debt acting as the debt collector for Hagemeyer and the interest provisions relating thereto. They are of importance because they are said to nullify ostensible purpose of the entire transaction so that it is not a factoring agreement.

38. It seems to me that it would be foolish were Hagemeyer to be appointing A, the seller of the debt, or any other company, if it were not to provide in such a contract that the debt collector would have obligations both to work to collect the debt and to pay over to Hagemeyer in the event that a collection is made. Therefore, requiring the performance of the debt collecting contract, whether entered into with A, as the seller of the debt or with any other undertaking, does not, of itself change the essence of the transaction as one of factoring. Legal consequences emerge from any arrangement whereby a company requires another undertaking to collect its debts. I note that in *International Factors v. Rodriguez* [1979] QB 351, [1978] 3 WLR 877, a standard factoring agreement was entered into between the plaintiff and the company of which the defendant was a director. This involved the purchase of debts. Under that agreement, it was a term that if, contrary to the machinery of their agreement, any payment in respect of a purchased debt was made to the seller, then the seller was to hold that payment on trust for the factor and immediately hand same over to them. In breach of such term, four cheques were sent to the seller and were paid, not to the plaintiff as factor, but into the seller’s bank account. The plaintiff then sued the defendant for conversion, he having paid in the cheques, and obtained judgment to the face value of the cheques. It was held on appeal that there was a trust in favour of the plaintiffs which arose as soon as the cheques came into the possession of the company which had sold the debts to the factor. This gave the factor, as assignee of the debts, a sufficient propriety right to sue in conversion; which the disposition of the cheques had amounted to.

39. I understand from the argument so ably presented to me, that this debt collection service is subject to VAT in the place where the service is received. I do not read these clauses as undermining the fundamental principle of the first and second contracts that on entering into these arrangements, Hagemeyer becomes the owner of the debts without recourse to the seller. Any potential come-back that Hagemeyer has to the seller does not undermine its purchase of the debt of A, in that regard. It can sue A where the seller, as its collection agent, does not promptly pay the money that it has collected. A, as seller, is therefore obliged to pay a sum of interest by reason of that delay. Where A as seller of the debt receives a repayment of VAT in respect of a bad debt it is obliged to pass on that sum to Hagemeyer. These provisions do not change the fundamental nature of the contract that in the event of insolvency, war, natural catastrophe or simple refusal to pay, the collection agents obligations do not go beyond doing its best to collect and that the liability of the collection agent, as the original seller, to Hagemeyer can never be for it to pay the full amount of the debt to Hagemeyer unless, and until, it has actually received it. Rather, in the event of default it is Hagemeyer that bears the burden of the loss.

40. It should also be noted that under the second contract, consideration is payable by Hagemeyer to the seller of the debt in respect of the collection service which it provides to Hagemeyer. This consideration is small, amounting to 0.25% of debts.

**European Decisions**

41. The European Court of Justice has given considerable guidance as to the proper approach to the construction of the Sixth VAT Directive. Article 4 describes taxable persons as those who independently carry out, in any place, any economic activity, whatever the purpose or results of that activity. This, in turn, is specified in clause 4.2 as comprising:-

> "All activities of producers, traders and persons supplying services, including mining and agricultural activities and activities of the professions. The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity."

42. In case C-305/01, *Finanzamt Groß-Gerau v. MKG-Kraftfahrzeuge-Factoring GmbH* [2003] ECR I-06729, the court at paras. 41 to 44 explained that the fundamental principle of the Directive is that economic activity is subject to VAT, and that economic activity includes all the activities of producers, traders and those who supply services, and includes the exploitation of tangible and intangible property for the purpose of obtaining an income therefrom on a continuing basis. The settled case law of the European Court requires that Article 4 of the Sixth Directive should be construed in a wide way so as to uphold the fundamental principle that economic activity is subject to VAT; case C-186/89 *Van Tien v. Staatssecretaris van Financiën* [1990] ECR I-04363, para. 17. The mere acquisition of shares in a company does not involve economic activity where there is no involvement, directly or indirectly, in the management thereof. The reasoning is that when one owns shares in an enterprise, one does no more than purchase an asset and then enjoy the result of ownership through being conferred with the benefit of a dividend. This is organised independently of the mere fact of ownership, through the undertaking first of all striving to make a profit and actually achieving this, and secondly by it declaring and paying out a dividend. The entitlement to such payment arises not as a result of any work with, or involvement in running, a firm but merely from the fact of the investment; case C-333/91 *Sofitam SA v. Ministre chargé du Budget* [1993] ECR I-03513, paras. 12 and 13. It is otherwise where the act of holding shares involves direct or indirect involvement in the management of the company in which the holding has been acquired. That activity is subject to VAT; case C-60/90 *Polysar Investments Netherlands BV v. Inspecteur der Invoerrechten en Accijnzen* [1991] ECR I-03111 para. 17. Direct or indirect involvement in a company involving management can operate as a service and therefore falls within the principle that it is a taxable activity under Article 4 of the Sixth VAT Directive.

43. In contrast to the wide definition given for the purpose of catching economic activity within the VAT net, the exceptions to the Directive are to be construed strictly within their own terms since they derogate from the general principle that VAT is to be levied on all goods and services supplied for a consideration by a taxable person; case C-409/98 *Commissioners of Customs & Excise v. Mirror Group Plc* [2001] ECR I-07175 para. 30. Where an exception is made part of an exemption, then that exception, being a declaration that VAT should be payable in respect of a particular form of economic activity excluded from the general exemption, is in itself required to be construed broadly. In the MKG case, the court held at para. 58:-

> "As will be elaborated upon in greater detail when considering the second question submitted for a preliminary ruling, the term factoring referred to there must be interpreted broadly, covering both true factoring and quasi factoring, given that, as an exception to a rule derogating from the application of VAT, it must be understood as applying to all possible forms of that operation."

44. In case C-18/92 *Chaussures Bally SA v. Belgian State* [1993] ECR I-02871, the issue concerned deductions of net amounts in respects of VAT where payment had been made by credit card. The issue was whether the guarantee of payment between *Bally* and the customer, made through the intervention of the customer using a credit card which would then pay on the amount, subject to a 5% deduction, to *Bally* constituted a service for consideration. At para. 9 the court held:-

> "The documents submitted to the court show that, when the purchaser pays the price of the goods by means of a credit card, there are two transactions: on the one hand the sale of the goods by the supplier, who calculates in the total price demanded the VAT which will be paid by the purchaser as the final consumer and which is charged by the supplier on behalf of the revenue authorities, and on the other hand the service preformed for the supplier by the organisation issuing the credit card. The latter service is that of guaranteeing payment for the goods purchased by means of the card, the promotion of the supplier's business by enabling him to acquire new customers, possible publicity on his behalf or the like."

45. Since the Revenue Commissioners first of all apparently decided that the *MKG* case applied to the activities of Hagemeyer and then, some years later, issued a briefing document indicating that it did not, my decision in this case is strongly influenced by my interpretation of what the European Court held in that particular case. There, the factoring company agreed to purchase, as in this case, within a framework laid down in advance, the debts owed to a particular company as a result of it selling vehicles. The factoring company assumed the risk of default without a right of recourse. The factoring company agreed under that framework contract to recover the debts to the vehicle supplier but in addition, agreed to manage the debtor accounts providing the vehicle supplier with ongoing records as to the state of indebtedness. The court, referring to the relevant case law, decided that a taxable relationship existed between the factoring company and the company selling them the debts where a service was supplied for consideration. That is also a crucial issue here. The court held that this required reciprocal performance: namely the remuneration received by the factoring company consisting of "the value actually given in return for the service supplied to the recipient"; para. 47 of the court's judgment.

46. The questions referred to the court in the *MKG* case, at para. 32, were as follows:-

> "1. Can a factoring company which buys debts and assumes liability for the risk of loss in relation to those debts be said to be using goods and services received by it for the purpose of its transactions?
>
> 2. Do such activities involve taxable transactions or at any rate transactions for the purposes of Article 13B(d) of the [Sixth Directive] which may be taxed to the extent that the Member States have conferred on taxable persons a right to opt for taxation? Which of the transactions listed in Article 13B(d) of the [Sixth Directive] are involved."

47. The analysis by the European Court in relation to these questions involved it considering whether the factoring company was relieving the seller of the debts, whether it was taking on the debt recovery operation itself, whether the full risk of the debt was transferred to the factoring company and whether the guarantee of payment, through purchase and assumption of risk, was an economic activity consisting of the exploitation of property for the purpose of obtaining an income. This approach differs only in emphasis on the issue of economic activity from the questions that are helpful at common law in aid of distinguishing a loan from factoring. At paras. 49 and 50 the court held as follows:-

> "49. First, where, as in such a case, the factor engages in true factoring by purchasing debts owed to his client without enjoying a right of recourse against the client if debtors default, he indisputably supplies a service to the client, consisting essentially in relieving him of the debt-recovery operations and of the risk of the debts not being paid. Second, in return for his service received by him, the client owes payment to the factor, corresponding to the difference between the face value of the debts which he has assigned to the factor and the amount which the factor pays him for the debts. It is clear from the documents available to the Court that, in the main proceedings, Factoring KG retained, in accordance with the terms of the contract entered into with M-GmbH, factoring commission of 2% and a *del credere* fee of 1% of the

face value of the debts purchased.

50. The making of such a payment therefore does not result from the mere fact that the debts are included amongst the factor's assets, but constitutes actual consideration for economic activity engaged in by the factor, namely the services which he has provided to the client. There is thus a direct link between the factor's activity and the amount which he receives in return by way of payment, so that it cannot be maintained that a factor who engages in true factoring does not make a supply for consideration to the client and, therefore, that he does not pursue an economic activity for the purposes of Articles 2 and 4 of the Sixth Directive, but that he should be regarded as merely a recipient of assignments by the client of debts owed to him. The factor's guaranteeing to the client of payment of the debts by assuming the risk of the debtors' default must be considered to be exploitation of the property in question for the purpose of obtaining income therefrom on a continuing basis, within the meaning of Article 4(2) of the Sixth Directive, where that operation is carried out, in return for payment, for a given period, as was the case in the main proceedings."

48. In consequence, the court held that a business which purchases debts, and therefore assumes the risk of default by the debtors, in turn invoicing the seller in respect of the debts purchased, does in fact pursue an economic activity for the purposes of articles 2 and 4 of the Sixth VAT Directive. Because that makes one liable for VAT, there is also therefore a right to deduct tax under Article 17: the exemption in Article 13B(d) in respect of financial services does not apply. The two questions posed to the court were answered as follows:-

"1. On a proper construction of the Sixth Council Directive J(77/388/EEC) of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, a business which purchases debts, assuming the risk of the debtors' default, and which, in return, invoices its clients in respect of commission pursues an economic activity for the purposes of Articles 2 and 4 of that directive, so that it has the status of taxable person and thus enjoys the right to deduct tax under Article 17 thereof.

2. An economic activity by which a business purchases debts, assuming the risk of the debtors' default, and, in return, invoices its clients in respect of commission, constitutes debt collection and factoring within the meaning of the final clause of Article 13B(d)(3) of the Sixth Directive (77/388) and is therefore excluded from the exemption laid down by that provision."

**Conclusion**

49. This court is obliged to look at the nature of the transaction objectively and, in the case of doubt, apply the rules of construction referred to above where an ambiguity appears in the Sixth VAT Directive. I would hold that this is a case where Hagemeyer have purchased a debt and that this is to the benefit of the seller of those debts. I would hold that the involvement by Hagemeyer goes beyond the mere provision of a financial service since it has assumed the risk of the debtors default, relieving it of the relevant trade credit waiting time before payment and, in so doing, caused the seller of the debts to be invoiced in respect of a sum which involves a discount from the total value of the debt as it appears on the books of the seller company. Reading the answers of the European Court to the two questions, the second paragraph indicates, to this court, that the purchase of debts, in assuming the risk of default, constitutes factoring and the collection of those debts involves the process of debt collection. My decision is based, in part, on the disjunctive reading of the words "debt collection and factoring", as I hold these to be separate. Logically, that must be so. A company which offers the service of invoicing clients, sending follow up letters to those mildly in default and perhaps facilitating the collection of debts by holding meetings, and other activities, is a debt collection company. On the other hand, a factoring company is one which purchases the debts and then assumes the risk that human and natural disasters, as well as simple default, may result that the investment in book debts will fail either in whole or in part. That, in my analysis, is a real service and one which it is to the benefit of the seller company. The consideration is the discount from the value of the book debts. The service, which I hold amounts to an economic activity for consideration, is that A, as seller, is relieved of two aspects of work: firstly, the risk of default, and relieved without recourse, and secondly, the requirement to grant credit, for however long, to B those to whom it sells its goods or services. Instead Hagemeyer takes on the burden of whatever credit has been granted and A is paid straight away.

50. Hagemeyer are at liberty to implement the debt collecting relationship, under the second contract, with the seller of the debts. My reading of the two contracts involves Hagemeyer being able, at any time, to withdraw from that relationship whereby the seller of the debts is obliged to collect on behalf of Hagemeyer. It can, at its option, then go elsewhere to have the debts collected; or do that itself. The applicant, Hagemeyer, never changes from being the assignee of the debts. A difficulty might be seen to arise, by reason of the fact that two VATable transactions are now taking place. The first is the factoring transaction whereby Hagemeyer, assume the risk of the debt. The second is the debt collection service which the seller of the debts offers to Hagemeyer.

51. In many situations, however, two VATable transactions take place when undertakings interact with each other. This is what the Sixth VAT Directive was designed to achieve, subject to the exemptions therein contained. I do not read the clauses in contract 2 as to interest being payable for late payment, on the collection by A, the seller of the debts, to Hagemeyer, as owner of the debts, as being anything other than a commercial safeguard. The debt collection responsibility conferred as a matter of the contracts onto the seller of the debts should be performed properly. This does not involve, in my view, a nullification of the presence of the factor in the two contracts. Here, the risk has passed to Hagemeyer. If Hagemeyer were not at large, retaining, as it does, the discretion to withdraw the debt collection service from the seller of the debts, one might question whether there was any real transfer. But it is at large and this weakens the argument that the transactions are a disguised financial service. Finally, I am influenced by the fact that there has been a real benefit conferred, for consideration, by Hagemeyer onto the seller of the debts. The debt has passed: trade credit is relieved by a third party's purchase. That is worth purchasing for Hagemeyer, though there is a risk, and worth selling for A because the risk of non-payment has been passed and because that payment is immediate. Mutual consideration is thereby exchanged in respect of a real economic activity. In the second contract, appointing the seller as collector, further mutual consideration is exchanged: the service of debt collecting and the consequent payment for it. Both are VATable transactions.

**Legitimate Exception**

52. I wish to offer some brief observations in relation to the legitimate expectation asserted to have been created as a result of the letter from the Revenue Commissioners dated 28th August, 2003. In that respect, it is argued that for the period from 28th August, 2003, to a period shortly after the Revenue resiled from that position by letter dated 1st June, 2005, it would be unfair to allow the Revenue to apply the law as to VAT were it to be as they assert. Since I have ruled against the respondents a brief comment only is called for. In *Glencar Exploration v. Mayo County Council* [2002] 1 I.R. 84 at 162-3, Fennelly J. set out the constituent elements of a claim to legitimate expectation as follows:-

"In order to succeed in a claim based on a failure of a public authority to respect legitimate expectations, it seems to me

> to be necessary to establish three matters. Because of the essentially provisional nature of these remarks, I would emphasise that these propositions cannot be regarded as definitive. Firstly, the public authority must have made a statement or adopted a position amounting to a promise or representation, express or implied as to how it will act in respect of an identifiable area of its activity. I will call this the representation. Secondly, the representation must be addressed or conveyed either directly or indirectly to an identifiable person or group of persons, affected actually or potentially, in such a way that it forms part of a transaction definitively entered into or a relationship between that person or group and the public authority or that the person or group has acted on the faith of the representation. Thirdly, it must be such as to create an expectation reasonably entertained by the person or group that the public authority will abide by the representation to the extent that it would be unjust to permit the public authority to resile from it. Refinements or extensions of these propositions are obviously possible. Equally they are qualified by considerations of the public interest including the principle that freedom to exercise properly a statutory power is to be respected. However, the propositions I have endeavored to formulate seem to me to be preconditions for the right to invoke the doctrine."

53. As against that it has been forcibly argued by counsel for the Revenue that the doctrine of legitimate expectation applies only to situations involving an administrative decision as to procedures only or circumstances where a discretionary power vests under a statute in an official. Such an official cannot set up an estoppel that contradicts a statute. Authority, in the context of taxation, is to be found in Kieran Corrigan, *Revenue Law* (Dublin, Round Hall Press, 2000) at 3.189 – 3.220; see also *Power and Others v. The Minister for Social and Family Affairs* [2006] IEHC 170. In a judgement of the European Court in joined cases C-31/91 to C-44/91 in *SpA Alois Lageder and Others v. Amministrazione delle Finanze dello Stato* [1993] ECR I-01761, was stated at paras. 33 and 34 as follows:-

> "33. The principle of the protection of legitimate expectations forms part of the Community legal order (see judgment in Case 112/77 Toepfer v Commission [1978] ECR 1019). The general principles of Community law are binding on all authorities entrusted with the implementation of Community provisions (see judgment in Case 230/78 *Eridania v Minister for Agriculture and Forestry* [1979] ECR 2739). Consequently, the national authorities entrusted with the implementation of the provisional arrangements for accompanying certificates for wines awarded the designation 'quality wines p.s.r.' is required to observe the principle of the protection of the legitimate expectations of traders
>
> 34. However, the Court has held that a practice of a Member State which does not conform to Community rules may never give rise to a legitimate expectation on the part of a trader who has benefited from the situation thus created (see judgment in Case 5/82 *Hauptzollamt Krefeld v. Maizena* [1982] ECR 4601, paragraph 22)."

54. In the field of taxation it has been held in *Hauptzollamt Hamburg-Jonas v. Firma P. Krücken* in Case 316/86 [1988] ECR 02213 at page 5 as follows:-

> "It follows that the principle of the protection of legitimate expectations cannot be relied upon against a precise provision of community law and that the conduct of a national authority responsible for applying community law, which acts in breach of that law, cannot give rise to legitimate expectations on the part of an economic operator that he will benefit from treatment which is contrary to community law."

55. It might be argued that this ought to be the principle applied here. In joined cases C–181/04 to C-183/04 *Elmeka NE v. Ypourgos Oikonomikon* [2006] ECR 00000 it might be thought that the principle was either overturned or ignored. I do not need to resolve this controversy.

56. Out of respect to the argument presented by the parties, however, I would hold in relation to legitimate expectation, that if I had not ruled in favour of Hagemeyer on the first issue, and held that as a factoring company it is liable to VAT, that I would not regard it as possible to rule that a legitimate expectation could arise through a representation which would contradict the terms of the Sixth VAT Directive by conferring on the applicant a right to be taxed, and hence to set off allowable losses for VAT purposes, making an input credit.

**Result**

57. In the result, the activities of Hagemeyer under contracts 1 and 2, as an overall transaction are subject to VAT. This will allow them under Article 17 of the Sixth VAT Directive, and the Value Added Tax Act, 1972, as amended, to claim an input credit where it arises.