VAT NEWS

AG OPINION: DUTCH PENSION FUNDS ARE NOT ELIGIBLE FOR A VAT EXEMPTION

I. Introduction

As opposed to Luxembourg VAT legislation, which recognizes pension funds as Special Investment Funds ("SIFs") that qualify for the fund management VAT exemption, in the Netherlands such VAT matter still gives rise to a strong debate. In the joined cases referred by the Dutch Court to the ECJ, several employee defined benefit pension funds argue that they are similar to collective investment funds, which would allow management services to be exempt from VAT.

In her Opinion, (AG) Kokott of the Court of Justice of the European Union ("CJEU") concluded that the pension funds at hand are not sufficiently comparable to Undertakings for Collective Investment in Transferable Securities ("UCITS") and therefore do not qualify for the VAT exemption for asset management services.

It is now up to the CJEU to render a final judgement. This ruling is primarily of interest to Dutch employee defined benefit pension funds and service providers supplying management services to them. However, should the CJEU follow the AG's reasoning on the one-to-one comparability test of pension funds with UCITS, this could potentially raise questions regarding the VAT treatment of pension funds and/or other funds qualifying as SIFs in Luxembourg.

II. Factual background of the Dutch cases

According to the current Dutch practice, pension funds executing a benefit agreement (average earnings or final earnings scheme) do not qualify as a collective investment fund, because when operating these schemes, the pension beneficiaries do not bear the risk of the investments. Such practice is also supported by the Dutch case-law.

Several affected pension funds argued before a local court that the investment risk condition to qualify for the VAT exemption for collective asset management is interpretated too strictly.

The CJEU is asked whether the investment risk could be borne by the group of participants rather than on an individual basis, how great the risk must be and whether it is relevant that the amount of the pension benefit depends also on other factors (e.g., the number of years of pension accrual, salary level, actuarial interest rate, etc.). Furthermore, the CJEU is asked to rule whether the pension funds could rely on the principle of fiscal neutrality to argue that they should be treated as SIFs where they were comparable to other funds, which are not UCITS or comparable with UCITS but are still treated as SIFs under Dutch law.

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III. Opinion of the Advocate General

AG Kokott examines whether the pension funds at hand display identical characteristics as UCITS or are at least sufficiently comparable for them to be in competition with UCITS. In the absence of specific conditions in the existing CJEU case-law, the AG performs such comparability test by reference to the features of UCITS as defined in the UCITS Directive.

For several reasons, she concludes that these pension funds and UCITS are not comparable, taking into consideration that: i) the Dutch pension funds are not publicly accessible, ii) there is no redemption or repurchase obligation (or this is only possible in exceptional cases) and iii) most importantly, the beneficiaries do not assume an investment risk comparable to participants in a collective investment fund within the meaning of the UCITS Directive.

Notably, AG Kokott acknowledges that beneficiaries bear some risk (e.g. favorable or unfavorable investment results can lead to a high or low coverage ratio, eventually leading to indexation of pension benefits). Nevertheless, there is still a guaranteed pension commitment that primarily depends on the length of service and the level of employment income.

In addition, the AG found that the pension funds at hand have significant differences with some other pension schemes that are treated as SIFs under Dutch law (i.e. compulsory character, no investment risk) and thus the applicable VAT treatment is not contrary to the principle of fiscal neutrality.

IV. Comments

Undoubtedly, the interpretation of the concept of SIFs that AG Kokott suggests with her Opinion is very narrow. It implies that only those pension funds which pass the one-to-one comparability test with UCITS could qualify as SIFs.

In Luxembourg, pension funds governed by the law of 13 July 2005 subject to the supervision of the CSSF as well as pension funds governed by the law of 7 December 2015 subject to the supervision of the Commissariat aux assurances are considered as SIFs and qualify for the VAT exemption. Should the CJEU follow the AG's Opinion, a further assessment of whether the above Luxembourg pension funds meet such conditions may be required.

A key question is also whether such development could have an impact on the interpretation of SIFs outside the pension sector, given that several funds which currently qualify as SIFs for Luxembourg VAT purposes may not meet the comparability requirements set out by the AG (notably the requirement to be "open to an unlimited number of investors").

Since these developments could create a definitive VAT burden on management costs for Luxembourg funds and may trigger reporting obligations (i.e. European Sales Lists) for Luxembourg companies providing management services to foreign funds, they should be closely monitored.

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