

VAT NEWS



VAT ON DIRECTOR FEES: END OF THE STORY? (Request for a preliminary ruling, C-288/22)

I. Introduction

The District Court of Luxembourg (“Tribunal d’arrondissement” or “the referring Court”) has recently requested a preliminary ruling from the ECJ on the topic of the VAT status of a natural person who is a member of the board of directors of a public limited company incorporated under Luxembourg law (“société anonyme”) and the VAT treatment applicable to the remuneration he receives in the form of percentage fees (“tantièmes”).

As the VAT Directive remains silent on the VAT issue of a company management, the various EU Member States (“MS”) have tried to address this challenge based on the general VAT rules laid down in articles 9 and 10 of the VAT Directive. Due to the different interpretations made by the EU MS, there is currently a lack of harmonisation on the applicable VAT treatment.

For illustration purposes, article 9 of the VAT Directive gives a broad definition of the “*taxable person*”, encompassing any legal or natural person carrying out an “*economic activity*”, whatever its purposes and results, as long as it is carried out “*independently*”. As regards the criterion of “*independence*”, article 10 of the VAT Directive excludes “*employed and other persons from VAT in so far as they are bound to an employer by a contract of employment or by any other legal ties creating the relationship of employer and employee as regards working conditions, remuneration and the employer's liability*”.

Furthermore, it should be noted that the ECJ did not yet have the opportunity to address the issue of the VAT treatment of company directors.

Thus far, only the activity of a member of a supervisory board of a foundation established under Dutch law has been put under scrutiny (C-420/18, IO case).

As it will be further explained, the ECJ ruling, in this case, could significantly impact the current Luxembourg VAT practice. In this respect, please find below a summary of the facts of the case and the parties’ arguments, as well as our VAT comments on the potential VAT implications.

II. Facts of the case

TP, a lawyer, is a board member of public limited companies incorporated under Luxembourg law, namely a bank established in Luxembourg and three holding companies belonging to a German and a French group. In this context, TP takes part in decisions concerning the accounts, risk management policy, and the strategy to be followed by these groups and in developing proposals to be put to shareholders’ meetings.

TP received, as director of these companies, percentage fees that the Luxembourg VAT Authorities (“AEDT”) considered as subject to VAT in a tax assessment on the ground that a company director independently carries out an economic activity and thus qualifies as a taxable person for VAT purposes. TP, however, considers that his director’s percentage fees shall not be subject to VAT, and he contested the final decision of the AEDT before the referring Court.

In essence, the latter asks the ECJ whether:
i) the percentage fees received by a board member of a Luxembourg public limited company shall be regarded as the remuneration paid in return for services supplied to that company and

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ii) a natural person who is a board member of that company carries out his activity independently within the meaning of articles 9 and 10 of the VAT Directive.

III. Arguments of the parties

TP argues that a board member of a Luxembourg company does not carry out his activity independently but rather as a member of a collective organ representing the company. Thus, the management service that the board of directors collectively provides is deemed to be provided by the company itself.

To support his position, TP claims that the condition of independence, as interpreted by the ECJ in IO case, is not met for the following reasons:

- ▶ the company bears the economic risk associated with the board members (which is held liable towards third parties). Directors can only be personally liable where they manifestly exceed the limits of acceptable conduct;
- ▶ as the board's decisions are taken collectively, any contribution to the management of the company should be regarded as a service provided by the collective organ itself, and not by its individual members.

Furthermore, TP considers that the percentage fees should not be seen as a remuneration for services agreed between a service provider and its client (i.e. subject to VAT) but as a compensation granted by the general meeting of shareholders (i.e. falling outside the VAT scope).

On the contrary, the AEDT considers that TP provides management services to the company that shall be subject to Luxembourg VAT on the following grounds:

- ▶ there is a direct link between the percentage fees received by TP and the services he provides as a director. This is because: i) the resolution of the general meeting of shareholders to pay higher or lower fees is intimately bound up with his expertise and the importance of the specific functions performed by him during the previous financial year ii) the payment of these fees is not dependent on the availability of distributable profits of the company;
- ▶ there is no employment relationship between Luxembourg directors/companies; thus, TP acts independently. In fact, i) a director procures and organises independently the staff/equipment required for his activity, ii) his remuneration depends, at least partially, on the success of the business, and thus on the economic risk attached to the company and, iii) he bears a civil liability vis-à-vis the company and third parties in the exercise of his activity as well as a joint liability in tax/VAT matters.

IV. Comments

This request for a preliminary ruling gives the ECJ a unique opportunity to express its position on the VAT status of company directors as well the VAT treatment applicable to their remuneration (notably the percentage fees where the direct and immediate link with the activity carried out by the directors appears more dubious, given that these fees could be

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seen as solely dependent on the arbitrary decision of the company's shareholders).

Pursuant to the Circular n°781 issued by the Luxembourg VAT Authorities on 30th September 2016, the current Luxembourg VAT practice could be summarised as follows:

- ▶ director mandates exercised independently by Luxembourg private individuals or legal persons constitute an activity falling within the scope of VAT. Thus, in principle, directors' fees are subject to Luxembourg VAT at the standard VAT rate of 17%;
- ▶ Luxembourg directors have the status of VAT taxable persons and shall register for VAT in Luxembourg, issue VAT compliant invoices and file Luxembourg VAT returns;
- ▶ Luxembourg companies that qualify as VAT taxable persons have to self-assess Luxembourg VAT under the reverse charge mechanism on directors' services received from foreign directors (B2B);
- ▶ a specific VAT exemption applies to the fees of Luxembourg VAT directors who fall under the small enterprise scheme (i.e. their annual turnover does not exceed the threshold of EUR 35.000,00) as well as to "honorary" director services;
- ▶ director services at the board of regulated funds may benefit from the fund management VAT exemption if certain strict conditions are met.

Should the ECJ decide that the criterion of independence of company directors is missing for VAT purposes and/or that there is no direct and immediate link between the activity performed by the directors and their remuneration, the current Luxembourg VAT landscape would drastically change. This implies, among others, that Luxembourg entities with zero or limited input VAT deduction rights would no more face an additional cost of 17% on the incurred directors' fees paid to private individuals/legal persons. Furthermore, company directors would no longer be subject to Luxembourg VAT compliance obligations.

Being of an interpretative nature, the ECJ findings could even apply retroactively, thus entailing a potential reconsideration of the VAT status of the Luxembourg company directors, who had to comply with the Circular n°781, in principle, since 1st January 2017.

It remains to be seen to which extent the much-awaited decision will affect the Luxembourg VAT practice, as well as whether useful guidelines that could pave the way for a unified approach across the EU will be provided.

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