Director Fees: VAT or no VAT? Experiences from Luxembourg and other selected EU Countries

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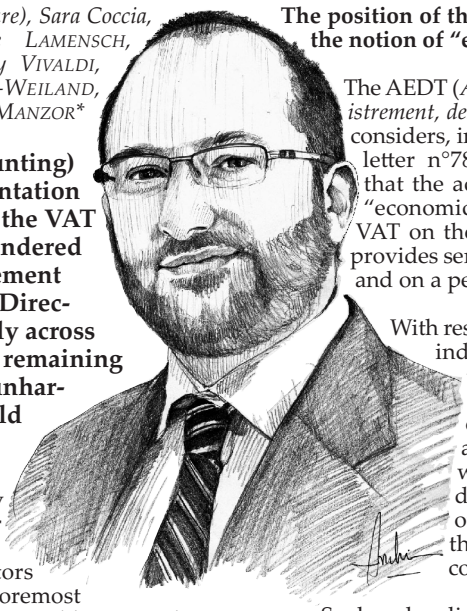

Fifty years (and counting) after the implementation of VAT in the EU, the VAT treatment of services rendered by members of management boards (hereafter, the "Directors") still differs greatly across the EU Member States, remaining one controversial and unharmonized area in the field of VAT.

In practice, the discrepancy across the EU Member States poses a number of challenges both for Directors and businesses, first and foremost complying with different VAT obligations depending on the jurisdictions where the Directors and companies receiving their services are established.

On 29 April 2022, the Luxembourg District Court made a referral to the Court of Justice of the European Union ("**CJEU**" or the "**Court**") for a preliminary ruling in the case of the VAT treatment of activities carried out by a natural person as a member of the board of directors of a public limited liability company (the "***TP* Case**").

Following that referral, the CJEU will have to determine whether Directors' fees are subject to VAT or fall outside of the VAT scope. In case the CJEU were to conclude that Director's fees do not fall within the scope of VAT, the current Luxembourg VAT treatment would be fundamentally altered. The purpose of this article is to provide an overview of the potential VAT implications of the *TP* Case, with a specific focus on the VAT treatment applicable to Director fees in our neighboring countries.

THE TP CASE – BACKGROUND FACTS

The position of Mr TP

Mr. TP, an individual, is a Luxembourg lawyer and member of the board of directors of several Luxembourg companies. As a member of the management board, Mr. TP earned percentage fees (*tantièmes*) in consideration for his activities. According to Mr. TP, the activities performed as a member of the board of directors did not constitute an "economic activity" carried out independently for VAT purposes and therefore did not fall within the scope of VAT. As such, he did not charge any VAT on his percentage fees.

Mr. TP considers that, in order to fall within the scope of VAT (and to be subject to VAT), the director activity should be performed independently. The notion of independence should be assessed in light of the CJEU case *IO*[1], where the CJEU ruled that the activity of a member of a supervisory board is carried out independently if he renders his services in his own name, on his own behalf and under his own responsibility, and if he personally bears the economic risk linked to his activity. An employee, for instance, does not meet the independence condition due to the fact that he acts in the name, on behalf, and under the responsibility of his employer when he performs his tasks.

Mr. TP took the position that, in the specific case of a Director, the condition of independence is not met based on the duties and responsibilities of Directors[2]:
(i) the board takes decisions collectively: the administration function is performed by the board as a whole and not by its individual members. This position reflects the 'theory of the organ', according to which the activity of a Director is exercised as a member of a collective organ representing the company, and therefore the administration function is performed by such collective organ towards the company and not by the members of the organ taken individually;
(ii) a Director does not hold any personal liability towards third parties for the results of his work (except in rare cases of wrongdoing): the economic risk associated with the activity of the board members is therefore borne by the company; and
(iii) percentage fees are granted by the general assembly of shareholders and not agreed by the Director himself and his client.

The position of the VAT authorities and the notion of "economic activity"

The AEDT (*Administration de l'enregistrement, des domaines et de la TVA*) considers, in line with the Circular letter n°781 published in 2016, that the activity of Mr. TP is an "economic activity" subject to VAT on the basis that a Director provides services for consideration and on a permanent basis.

With respect to the condition of independence, the AEDT takes the position (following settled case-law of the CJEU) that the activity of the Director would not qualify as independent only if a subordination link between the Director and the company exists.

Such subordination link should be characterized by (i) a subordination of the Director towards the company with respect to the remuneration and working conditions, (ii) the absence of personal liability of the Director towards third parties with respect to the results of the activity performed, and (iii) the consequent absence of economic risk borne by the Director in the context of his activity.

When assessing the existence of the independence criterion in the activity performed by a Director in light of the above conditions, the AEDT considers that the subordination link between TP and the companies for which he is part of the board of directors does not exist, and thus that the condition of independence is met, on the basis that:
(i) Directors are free to determine their working conditions (autonomous organization of their time),
(ii) the remuneration of a Director depends, at least in part, on the success of the business (an employee would not bear a similar risk), and
(iii) Directors can be civilly liable towards both the company and third parties for their actions, while employees would not.

QUESTION REFERRED TO THE CJEU

On 29 April 2022, the District Court of Luxembourg has requested a preliminary ruling to the CJEU and referred two questions with respect to the VAT status of Directors. The Court will therefore have to assess whether, in first instance, an individual acting as a Director for a limited liability company carries out an "economic activity" for VAT purposes, and, in case the first question is answered positively, whether such activity is carried out "independently".

POTENTIAL FUTURE LUXEMBOURG IMPACTS

Under the current practice of the Luxembourg VAT authorities[3], fees paid to independent Directors are subject to Luxembourg VAT[4]. The AEDT has confirmed that the provision of directorship services qualifies as an economic activity for VAT purposes, conferring to the Director the status of "taxable person" for VAT.

In case the CJEU were to conclude that Director's percentage fees do not fall within the scope of VAT due to the lack of "independence" in the activity performed by Directors, the Luxembourg VAT environment would experience a true Copernican revolution. In such a case:
(i) Luxembourg Directors (at least those acting as natural persons) would no longer be considered as VAT taxable persons and would be relieved from the obligations to register for VAT and to file VAT returns, and,
(ii) Directors' percentage fees would no longer be subject to VAT. Such a change would benefit companies with no or limited VAT recovery right for which VAT charged or self-assessed on directors' fees constitutes a final cost.

However, as the VAT status of Directors varies significantly across the EU Member States, the potential consequences of the *TP* case are not limited to Luxembourg.

The Netherlands: home of the *IO* case

Further to the *IO* case, the Dutch Ministry of Finance issued a Decree clarifying that executive and non-executive Directors acting within a one-tier (or monistic) management model cannot be considered independent taxable persons as they form part of one management committee.

All situations concerning management other than one-tier board management, on the other hand, must be assessed against regulations and case law on the basis of the specific facts and circumstances of the case. Since the position for independent Directors operating outside of a one-tier board model is not specifically addressed by the Dutch Authorities, it remains open for debate.

In the view of the Author there are elements supporting the qualification of the activity of Directors as not "independent", especially considering that it could be argued that Directors bear insufficient economic risk since (i) fees of Directors of companies organized by shares are generally subject to approval of the annual shareholders meeting, and (ii) all actions carried out by company Directors for the company (except those qualifying as willful misconduct) are typically covered by a director liability insurance taken out by the company, under reference of all directors appointed by the company at any given time, unspecified by name.

Where a Director would act independently, services provided would be subject to Dutch VAT.

France

There are no specific rulings or official position from the French Tax Authorities (the "**FTA**") addressing the VAT treatment of Director fees. According to the general French definition of a VAT "taxable person", one cannot be a taxable person for VAT purposes where a subordination link exists with its counterparty.

Since a Director is in a state of dependence with respect to his working conditions (objectives defined for/by the company) or remuneration conditions (subject to the tax regime of salaries and wages when less than 90% of the turnover of the company is subject to VAT) with regards to the company which has entrusted him with his mission, the remuneration received by the Director for the normal exercise of the management, administration or control functions is not subject to VAT in France.

Where, on the other hand, the Director would be considered as performing an "economic activity" within the scope of VAT (i.e. "independently"), his services should be subject to French VAT. According to French national case law (prior the *IO* case), this should be the case notably for companies (corporate entities) acting as a Director (with SIREN and VAT numbers). In such situation, the corporate entity Director is deemed to perform a supply of services falling within the scope of the VAT to the company.

Ireland

The Irish Revenue Commissioners treat Directors of Irish incorporated companies, including non-executive directors and even non-resident directors, as holding an Irish 'public office' for tax purposes.

This means that all remuneration payable in respect of a person acting as an independent Director for an Irish incorporated company falls within the scope of Irish income taxes and social security deductions at source under Ireland's payroll taxes system for employers and employees (the PAYE system).

As independent directors are deemed to be holding a public office for income tax purposes and in the opinion of the Author, they would not meet the requirements for carrying out an economic activity independently for VAT purposes in Ireland. In practice natural persons acting as directors do not typically charge VAT to the company in the same way that salaries paid to employees are not subject to VAT.

Germany

Under the current practice of the German tax authorities[5], further to the *IO* Case and the subsequent decision of the German Federal Tax Court, a supervisory board member is only an independent entrepreneur if he bears a remuneration risk[6].

However, the German tax authorities are clear on the fact that these principles apply only to controlling bodies. The Author assumes that the current German VAT treatment of supervisory bodies does not apply to Directors acting for a management body.

Thus, it would have to be assessed according to the general German VAT principles whether the Director is an independent VAT entrepreneur or not, on the basis of an overall view of relevant criteria, such as acting on one's responsibility (as opposed to being bound by instructions), entrepreneurial risk, entrepreneurial initiative, fixed working hours, holiday entitlement, etc. Only if the assessment resulted in the Director being considered a self-employed person for VAT purposes, the Director would be considered a VAT taxable person.

In practice, in Germany directors of management bodies can qualify as VAT taxable persons under German VAT law and, subsequently, their services are subject to German VAT.

Belgium

The Belgian VAT Code does not contain any specific provision for Directors. Under the current practice of the Belgian administration, Directors who are natural persons are not considered as VAT taxable persons because they act towards third parties as an organ of the legal person they represent and, henceforth, they do not act independently. Their transactions are therefore not subject to VAT (out of scope)[7].

Conversely, the same services rendered by a company (and not directly by a private individual) are in any case subject to VAT in Belgium. Indeed, the theory of the organ does not apply when the Director is a corporate entity because such an entity is always distinct from the company the management board is a part of.

CONCLUSION

The *TP* Case represents a good opportunity to shed light on the VAT status of Director fees and on the VAT treatment of the "services" they provide.

Where the CJEU would determine that the activity carried out by Directors does not meet the condition of independence, this outcome would have positive consequences for both Directors and businesses, as the Luxembourg VAT obligations (and, in many cases, the VAT costs) triggered by Director fees would be removed. This outcome would change the Luxembourg administrative practice and would also have consequences in other EU jurisdictions.

Conversely, where the CJEU would determine that Directors carry out their activities independently, and therefore qualify as VAT "taxable persons", this outcome would confirm the position of the Luxembourg VAT authorities but would lead to massive changes in the administrative practices of those EU jurisdictions where Director fees are currently considered to fall outside the scope of VAT.

The position of the Court is therefore eagerly awaited and will have to be closely monitored.

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1) C-420/18 dated 13/06/2019.
2) As regulated in the Luxembourg Law of 10/08/1915 on commercial companies.
3) Circular n°781 dated 30/09/2016.
4) This is a general rule subject to limited exceptions (VAT exemptions for honorary activities as well as for management of qualifying investment funds).
5) German VAT Application Decree, Section 2.2 (3a).
6) According to the German tax authorities, a supervisory board member is considered to bear a remuneration risk if at least 10% of his remuneration is variable.
7) Decision n° E.T. 79.581 dated 27/01/1994.