

Flash News

Potential VAT obligations for independent directors

In February 2016, a press article of Paperjam News with respect to the VAT treatment of director's fees attracted great attention. Mr. Romain Heinen, Director of the Luxembourg VAT authorities, confirmed in an interview to Paperjam News that irrespective whether the independent director is an individual or a legal entity, the director's fees (tantièmes or service fees) are subject to VAT at the standard rate of 17%. He emphasized that this does not represent a change in the position of the VAT authorities.

This view complies with the Luxembourg VAT law and the case-law of the European Court of Justice which has ruled that the involvement in the management of companies constitutes an economic activity giving an independently acting third-party manager the status of a taxable person.

However, the position of the VAT authorities contrasts with a widespread practice which deems the director's services provided by an individual in the course of his corporate mandate as falling outside the scope of VAT.

Given that the director's fee is paid upon decision of the Ordinary General Meeting of shareholders, it is argued that the board member finally participates in the profit of the company. When the director's fee is profit-linked, it can be assimilated to a distribution of profits which does not fall within the scope of VAT.

VAT treatment of the supply of director's services

The Luxembourg VAT authorities seem to consider the supply of director's services provided by independent directors as falling into the scope of VAT, regardless whether the director's services are provided by an individual or a legal entity, in the course of a corporate mandate or on the basis of a service agreement.

The Ministry of Finance has announced to install a working group in order to include clarifying guidelines in the VAT law in the course of the tax reform 2017.

It cannot be expected that these guidelines will result in an overall VAT exemption of the management and supervision services provided by an independent director, because the VAT directive 112/2006/CE does not contain a VAT exemption for management services as such. Furthermore, the provided VAT exemptions need to be interpreted restrictively.

The VAT exemption of article 44.1.w) VATL may apply if the director performs a voluntary activity for which he receives an attendance fee only. This exemption applies to the rare cases, where the managed company is a non-profit making organization and the director receives an attendance fee for each attended board meeting.

The VAT exemption for the management of an investment fund as defined in article 44.1.d) VATL applies to all services which are specific and essential for the management of the investment portfolio itself, which is separate from the management of the company. The question whether the director's services meet the conditions of this VAT exemption has to be analyzed on a case-by-case basis.

Hence, directors providing management and representation services for which none of the above mentioned VAT exemptions apply should be prepared that as from January 2017, the provision of these services will be subject to Luxembourg VAT at the standard rate of 17%

Although the VAT authorities expressed their willingness not to return to previous tax years, the directors should reconsider their VAT situation as soon as possible.

In this context, we would like to draw your attention to VAT issues and reporting obligations arising from the fact that the provision of director's services to Luxembourg companies is a taxable supply of services.

Who qualifies as a taxable person for VAT purposes?

A taxable person is a person who, **independently**, carries out, on a regular basis, an **economic activity**, whatever the purpose or the results of that activity and whatever the place.

A director who is bound to a company by an employment contract or other legal ties constituting the relationship of employer and employee as regards working conditions, remuneration and the employer's liability, does not qualify as a taxable person, because he is not acting independently. Management services within a dependent relationship fall outside the scope of VAT.

A director who provides management and representation services to several companies on a regular basis usually retains control over his working schedule, the accepted mandate and his service performance. He acts independently and therefore qualifies as a taxable person. The taxable person status triggers his obligation to register for VAT, to issue VAT invoices and to submit VAT returns.

Where is the place of supply of the director's services located and who is liable for VAT?

The place of supply of management services is determined pursuant to the general rules regarding the place of supply of services. The place of supply of services depends on the VAT status of the recipient, i.e. the managed company. The independent director needs to know whether he renders management and representation services to a taxable person, a legal person identified for VAT purposes or a non-taxable person.

Supplies of services in a business-to-consumer relationship – recipient is a non-taxable person

In case the managed company is a pure holding company, i.e. a company whose only activity is the mere holding of shares in its subsidiaries, it does not perform any economic activity and in principle cannot register for VAT purposes. The director provides his services in a business-to-consumer relationship (B2C). In a B2C relationship, the place of supply of the management services is where the supplier of the services is usually residing or established.

If both the independent director and the company receiving the management services are established in Luxembourg, the place of supply of the director's services is located in Luxembourg.

The director is liable for VAT and has to invoice his taxable supplies of services with Luxembourg VAT at a standard rate of currently 17%.

If an EU or third-country independent director renders director's services to a Luxembourg holding company, i.e. a non-taxable legal person not identified for VAT purposes, the place of supply of the services is located in the country of establishment of the director.

As supplier, the EU or third-country director is liable for VAT in his country of establishment. He will invoice his management services by charging local VAT, if any, under the local VAT rules.

If, according to the VAT law of the director's country of establishment, the director's services fall outside the scope of VAT or are VAT exempt, the director will not account for VAT. In Belgium, for instance, director's services provided by individuals fall outside the scope of VAT.

Supplies of services in a business-to-business relationship – recipient is a taxable person or a non-taxable legal person identified for VAT purposes

In case the Luxembourg company receiving the director's services is a taxable person or a non-taxable legal person identified for VAT purposes, the independent director provides his services in a business-to-business relationship (B2B).

In a B2B relationship, the place of supply of the management services is where the VAT registered recipient of the services is established.

If both the independent director and the VAT registered recipient of the management services are established in Luxembourg, the place of supply of the director's services is located in Luxembourg.

The director carrying out a local supply of services remains liable for VAT. He has to invoice his services by charging Luxembourg VAT at a standard rate of currently 17%.

If a EU or third-country independent director renders director's services to a Luxembourg company identified for VAT purposes, the place of supply of the services is located in the country of establishment of the recipient, hence in Luxembourg.

For a cross-border supply of services, the reverse charge procedure applies and the VAT liability is shifted to the B2B recipient, who has to account for VAT in his country of establishment.

Example: A German independent director renders director's services to a Luxembourg company, which provided its VAT identification number to him.

The place of supply of the director's services is where the B2B recipient is established, thus in Luxembourg.

The German director issues an invoice without showing VAT, indicating the VAT identification number of the Luxembourg company and referring to the reverse charge procedure. He reports this transaction in his EC sales list regarding intra-Community supplies of services, as it is taxable in Luxembourg.

As recipient, the Luxembourg company is liable for VAT under the reverse charge mechanism and has to account for Luxembourg VAT.

A third-country director invoices his director's services according to the VAT law applicable in his country of establishment. He is not required to observe the European VAT and invoicing rules.

Nevertheless the Luxembourg B2B recipient has to account for VAT under the reverse charge procedure, if, in the light of the European VAT rules, the third-country director has to be considered as a taxable person providing services which are taxable under Luxembourg VAT law.

What VAT obligations arise for a Luxembourg director qualifying as a taxable person and providing management and representation services to companies established in Luxembourg or abroad?

The Luxembourg director qualifying as a taxable person is obliged to register for VAT purposes, to issue VAT invoices to the managed companies as well as to submit VAT returns and, where appropriate, EC sales lists regarding intra-Community supplies of services.

Turnover below EUR 25,000: Registration for VAT purposes under the small enterprises scheme

In case the director achieves an annual turnover of less than EUR 25,000, the small enterprises scheme (régime de franchise) applies, which means that the director is required to register for VAT but is dispensed from various VAT compliance and reporting obligations. He is not required to charge VAT on his outgoing invoices and to account for VAT on his output supplies. Provided he does not perform cross-border transactions, he does not submit VAT returns.

A small entrepreneur maintaining business relationships with suppliers or customers abroad has to meet further VAT compliance requirements. He has to submit an annual VAT return, when

- he receives services from foreign B2B suppliers and has to account for Luxembourg VAT under the reverse charge mechanism; or
- he renders taxable services to a B2B customer established abroad. Additionally he needs to file quarterly EC sales lists regarding intra-Community supplies of services to EU taxable persons.

Under the small enterprises scheme, the entrepreneur is not entitled to deduct input VAT. Hence, the VAT paid on input supplies represents a final cost. There may be situations where it is more

advantageous for a small business to opt for VAT registration under the normal taxation regime and to deduct incurred input VAT.

Turnover of more than EUR 25,000: Registration for VAT purposes under the normal taxation regime

An independent director performs a taxable business activity giving him the right to deduct input VAT due or paid on input supplies received from other suppliers. Thus, he has to apply for VAT registration under the normal taxation regime when he commences a taxable business activity and expects an annual turnover of more than EUR 25,000.

He has to comply with all VAT accounting and reporting obligations.

Invoicing rules

An independent director has to issue VAT invoices with regard to his provision of management and representation services to taxable persons or non-taxable legal persons.

Apart from the information that every invoice should contain, the director should include additional information, where appropriate.

A director providing management services to B2B customers established within the EU shall invoice without Luxembourg VAT, indicate his and his customer's VAT identification numbers and the words "Reverse charge".

A director applying the small enterprises scheme shall invoice without Luxembourg VAT, mention that no VAT applies under article 57.1 VATL and include a reference to the small enterprises scheme.

VAT compliance

Depending on the achieved annual turnover, the independent director has to submit VAT returns on an annual, quarterly or monthly basis.

A director managing companies established within the EU territory needs to file quarterly EC sales lists regarding intra-Community supplies of services, if such services are taxable under the VAT law of the recipient's country of establishment.

What are the obligations arising for the Luxembourg companies performing a VAT exempt business activity if they receive management services from a EU or third-country director?

Luxembourg taxable persons whose only economic activity is the performance of a VAT exempt business giving no deduction right, e.g. provision of medical, insurance or financial services, are not obliged to register for VAT as long as they do not receive B2B supplies of services from suppliers established abroad, for which they have to account for Luxembourg VAT.

Considering that director's services are taxable supplies of services under Luxembourg VAT law, the companies which are taxable persons without deduction right have to register for VAT under the simplified taxation regime, when they appoint a director residing in the EU or in a third-country.

Please do not hesitate to contact us should you have queries with regard to the above or require advice regarding Luxembourg VAT matters.

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