

VAT NEWS

DIRECTOR FEES: ECJ RULING PROMISES A REFORM OF THE LUXEMBOURG VAT RULES

I. Introduction

The long-awaited decision of the European Court of Justice (“ECJ”) on the VAT treatment of director fees (C-288/22, TP case) has been issued and promises a significant change in the Luxembourg VAT landscape!

Since 1 January 2017, directorship services, with very specific exceptions, have been subject to Luxembourg VAT at the standard VAT rate of 17% (either locally or under the reverse charge mechanism for recipient companies that qualify as VAT taxable persons). As a result, Luxembourg directors have also borne certain Luxembourg VAT compliance obligations (i.e. VAT registration, compliant invoices, VAT returns).

Following a rather economic approach, the ECJ ruled that the key criterion to confirm if directors act independently and, thus, whether their fees should be subject to VAT is whether they assume personal responsibility and economic risks. Although such interpretation may raise some practical questions that should be assessed on a case-by-case basis, in most cases in Luxembourg directors should not be regarded as independent and their fees should not be subject to VAT.

The Luxembourg VAT authorities (“AEDT”) already published the Circular No 781-1 of 22 December 2023, which suspends with immediate effect the application of the Luxembourg VAT rules on director fees (i.e. the Circular n° 781 of 30 September 2016) until the Luxembourg referring court (i.e. “Tribunal d’arrondissement”) issues its decision on the merits of this case.

Furthermore, on 15 January 2024 the AEDT provided some guidelines in relation to the refund of any unduly paid VAT to those directors that are impacted by this ECJ ruling.

You will find below a summary of the ECJ’s conclusions as well as the key VAT consequences triggered and the assistance that BDO can offer in this respect.

II. ECJ conclusions in the TP case (C-288/22)?

As a reminder on the facts of this case, a Luxembourg lawyer, who is also a board member of public limited liability companies incorporated under Luxembourg law, decided to challenge the position of the AEDT that the remuneration he receives is subject to Luxembourg VAT.

Among others, TP’s tasks included taking part in decisions concerning the accounts, risk management policy, the strategy to be followed by these companies and developing proposals to be put to shareholders’ meetings.

This dispute was brought before the Luxembourg Court which decided to refer the case to the ECJ asking in essence whether i) a director performs an economic activity for VAT purposes when it provides services to the company for remuneration and ii) such director can be considered to act independently for VAT purposes.

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Regarding the first question, the ECJ's conclusions do not come as a surprise, given that they are in line with the settled ECJ case law. Notably, the ECJ ruled that TP does engage in an economic activity because the following conditions are met:

- ▶ he supplies services in return for a remuneration (i.e. there is a legal relationship that establishes a direct link between that supply and the consideration);
- ▶ the supply is of a permanent nature (i.e. the mandate is agreed to cover an extensive period). The fact that this mandate may be revoked or that the director may relinquish it is irrelevant;
- ▶ the remuneration is foreseeable. This is notably relevant where the remuneration is allocated on the basis of the profits made by the company concerned (i.e. it should be allocated even if the company has not made any profits).

Nevertheless, the ECJ found that TP does not act "independently" for VAT purposes because, despite certain freedoms in its role and lacking an employer-employee relationship (i.e. no subordination link), he does not act on its own behalf or under his own responsibility. More importantly, TP does not bear the economic risk linked to his activity, given that the company itself is responsible for the consequences of decisions made by the board of directors. This is also because, pursuant to the Luxembourg legislation, directors do not assume any personal obligation in respect of the companies' debts.

III. How directors and companies may be affected?

Based on the criteria set out by this ECJ ruling, in most cases in Luxembourg directors should not be regarded as acting independently for VAT purposes and, thus, their fees should not be subject to VAT. A review of the specific characteristics of each director's mandate may be required to confirm this approach. It is however anticipated that the vast majority of mandates will no longer be subject to VAT.

A notable exception that should remain is the case of an independent director put at the disposal by a corporate service provider, this remaining a service in the scope of VAT.

Directors and companies should therefore revisit their VAT situation. A key point for the adjustment of the past situation will also be the procedure that directors and companies should follow for the refund of the unduly paid VAT.

You will find below a summary of the key VAT implications at the level of the

directors and companies as well as the recommended actions to take.

i. I am an independent director, what do I have to do?

The matter of interest is obviously the refund of the unduly paid VAT. In a communication dated 15 January 2024, the AEDT stated that directors (who consider themselves as impacted by the ECJ ruling) may already issue corrective invoices to the companies and file a refund request with the AEDT.

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Nevertheless, the AEDT has also announced that a specific online procedure via myGuichet should be launched for such refund (a valid Luxtrust card/token should be required). Thus, a detailed Circular will be released once the Luxembourg court issues its decision on the merits of the TP case on a local level. Unfortunately, the timing of the release of this court decision is unknown for the moment.

It was however already confirmed that the 5 years statute of limitations for the year 2018 is exceptionally waived and therefore directors and companies can still recover the unduly paid VAT for this year.

In light of these developments, directors who will not apply the simplified online refund procedure are recommended to:

- ▶ issue credit notes and new invoices without VAT for the period from 2018 to 2023;
- ▶ to the extent directors need to issue invoices/request for payment for the year 2024, no VAT should be added;
- ▶ keep a VAT registration for as long as it takes to adjust the past VAT situation;
- ▶ communicate with the companies to which they provide(d) directorship services about the timing of the refund of the unduly VAT paid to them to mitigate any cash flow impact;
- ▶ once they receive the VAT refund from the AEDT, pay back this VAT amount to their customers/companies.

- ▶ file the necessary VAT returns to report the credit notes and new invoices (a relief may be granted as the VAT Authorities are willing to adopt a “non-bureaucratic” approach). At the same time, input VAT recovered for the period from 2018 to 2023 should be repaid.
- ▶ to the extent that directors impacted by this ECJ ruling do not perform any other economic activities, they will have to apply for a VAT de-registration and fulfil their outstanding VAT filings/payments within the applicable deadlines.

ii. Companies

This ECJ ruling is a significant development for companies with zero or limited input VAT deduction right, given that they will no longer face an additional cost of 17% on the incurred directors' fees.

For companies managed by independent directors residing in Luxembourg, in principle directors will issue credit notes and new invoices without VAT. Independent directors will then refund VAT charged for the years 2018 to 2023 (most likely after having received the refund of VAT from the Luxembourg VAT authorities).

For companies having received directorship services from foreign directors and therefore having declared VAT under the reverse-charge mechanism, this should be corrected in their own VAT returns.



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IV. How could BDO help you?

Our VAT team stays at your disposal to discuss this ECJ ruling and navigate you through its potential impact in more detail. Our assistance may include the following:

- ▶ review of the VAT treatment of director's mandate based on the independence criteria set out by the ECJ;
- ▶ advice on current situation and next actions to address any short-term implications of this ECJ ruling and the recent Circular/guidelines from the AEDT;
- ▶ assistance with respect to the adjustment of the past situation (i.e. invoicing matters, VAT returns, refunds of unduly paid VAT, VAT deregistration).

Please feel free to contact our VAT experts.

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