KPMG Meijburg & Co Tax & Legal

Court of Justice of the European Union: Luxembourg member of Board of Directors does not have to pay VAT on profit-dependent directors' fees

On December 21, 2023 the Court of Justice of the European (CJEU) rendered judgment in the *TP* case (C-288/22) concerning the VAT consequences of performing director activities for a profit-dependent fee. The CJEU ruled that a member of the Board of Directors does not perform their activities independently and therefore no VAT is payable if they are not personally liable for the debts of the managed company and do not otherwise run an economic risk. The judgment partly removes existing ambiguities and may have consequences for Dutch board members who still charge VAT on their invoices.

In addition, of broader importance for, for example, profit-dependent agreements or hedging arrangements is that the CJEU ruled that profit-dependent fees do not constitute a consideration if they are also reduced to nil when there is no profit and are therefore not foreseeable.

Facts of the case

This case concerned a Luxembourg lawyer who, as executive director, sits on four Boards of Directors of various public limited companies. In doing so, he contributes to the decision-making on financial and strategic matters within the company. At two of the companies, besides a Board of Directors, there is a management committee that carries out the day-to-day management of the company and represents the company to the outside world. At the other two (passive) companies, such a management committee for the day-to-day management is not required under Luxembourg law. For the director activities, the lawyer receives remuneration in the form of fixed amounts and/or percentage fees (profit-dependent fees).

Under Luxembourg law, a director is in principle not personally liable for the activities of the company, unless the director has committed unlawful acts. Moreover, the Board of Directors always takes decisions collectively. Directors receive a separate fee for any individual tasks they perform that are not on behalf of the board.

Context and questions referred for a preliminary ruling

The question in this case is whether the fees the lawyer received for his activities as director are subject to VAT. For this to be the case, economic activities must be performed independently and in the long-term. Because the Board of Directors always acts collectively and there is no personal liability, the lawyer was of the opinion that he does not act independently. Moreover, the lawyer believed that the fact that his fees are profit-dependent means there is no service for a consideration.

The CJEU had ruled on the same questions in a previous judgment regarding a member of a (Dutch) Supervisory Board (CJEU June 13, 2019, C-420/18 (IO)). In those proceedings the CJEU ruled that such a supervisory board member does indeed perform economic activities, but that they do not act in their own name, on their own behalf and under their own responsibility and furthermore do not bear any economic

risk. According to the CJEU, the activity is thus not performed independently. We wrote about this case in a previous tax alert.

According to the Luxembourg referring court, it is however unclear whether that same judgment also applies to a member of the Board of Directors who receives a profit-dependent fee and can also exert more influence on daily policy (and thus the results and their own remuneration derived from that).

CJEU judgment

Firstly, the CJEU ruled that a director who is appointed for a certain period of time generally performs an economic activity if they are remunerated for the services they supply as director. Only if profit-dependent fee agreements are arranged in such a way that a director is not awarded any remuneration at all if the company incurs a loss and the remuneration is therefore unforeseeable, the direct connection between the services supplied by the director and the remuneration received is missing and there would be no economic activity.

Secondly, the CJEU addressed the question of whether the services supplied by a director are performed independently. The CJEU used the same assessment framework as in the aforementioned IO judgment and examined whether the director is not hierarchically subordinated to the company, acts in their own name, on their own behalf, under their own responsibility and bears an economic risk. This must be assessed on the basis of civil-law legislation for directors in the relevant country.

The CJEU noted that although the lawyer-director acted freely and in their own name and is not hierarchically subordinate to the company, he nevertheless did mainly act on behalf of the company and is not personally liable for the debts of the company and does not otherwise run any risk on personal losses. As such, the lawyer does not perform the director activities independently and there is no VAT-taxed activity.

The CJEU did however make an important reservation in that, in this case, the lawyer cannot cast a decisive vote in the Board of Directors, does not represent the company to the outside world and is not responsible for the day-to-day management. It is unclear to what extent this would have made a difference if things had been otherwise.

Unlike the Advocate General concluded in her Opinion, the CJEU did not address the fact that the lawyer performed director activities for several (four) boards and that those activities were a natural corollary of his regular business activities (the legal profession). We infer from this that these are not relevant facts for establishing the VAT treatment (as is already the practice in the Netherlands).

Practical Dutch consequences

In Dutch practice, the policy statement published in response to the IO judgment had already made clear to many supervisory board members and directors that they are not a VAT taxable person for these activities (see our previous tax alert). However,

ambiguity about this still remains for some directors who do not perform their activities under an employment contract (for example, for a public limited company or for certain foundations, such as a trust office foundation or a Continuity Foundation or on an ad interim basis).

The present judgment has removed some of this ambiguity.

Most directors with no or only limited external representative duties do not appear to be a VAT taxable person. This becomes less clear if a director can push through their wishes by a decisive vote or if a director legally (and actually) represents the company to the outside world and/or is responsible for the day-to-day management of the company. We therefore believe it is still possible for some directors to argue that there is VAT entrepreneurship (which can be advantageous due to the right to recover input VAT).

Our advice to directors without employment contracts is to contact their tax advisor and together with them re-examine the VAT treatment of their director activity in light of this judgment, certainly if the directors' remuneration is invoiced with VAT.

The conclusion that a profit-dependent fee that is automatically reduced to nil if there is no profit and therefore the receipt thereof is unforeseeable, cannot be regarded as a consideration for VAT purposes, may also have important practical consequences. For example, with regard to the VAT treatment of profit-sharing agreements or certain hedging arrangements. For these types of variable fee agreements we also recommend that you and your advisor re-examine the VAT treatment.

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December 2023