

Tax Alert

Luxembourg

Investment funds and VAT exemption of advisory services

Introduction

On 3 June 2011, the German *Bundesfinanzhof* referred to the European Union Court of Justice (ECJ) a question for a preliminary ruling in the case C-275/11 *GfBk Gesellschaft für Börsenkommunikation mbH v Finanzamt Bayreuth*. By this reference the German Court seeks clarification with respect to the interpretation of the term "management of special investment funds" as defined in Article 135 1 (G) of Directive 2006/112/EC (VAT Directive) in the context of management services provided by third party managers. In this alert we will briefly present the question addressed to the ECJ as well as the potential consequences of the ruling for the Luxembourg fund industry.

Question referred

The question raised by the German Court has been defined as follows:

For the purpose of interpreting the term "management of special investment funds", is the service provided by the third-party managers of a special investment fund sufficiently specific and hence exempt from taxation only if:

- (a) The manager performs a management function and not only an advisory function.*
- (b) The service differs in nature from other services by reason of a characteristic feature that qualifies for tax exemption under this provision.*
- (c) The manager operates on the basis of a delegation of functions under Article 5g of Directive 85/611/EEC¹, as amended.*

Background

In the landmark case, "Abbey National" (C-169/04), the ECJ ruled that management of special investment funds shall be defined according to the nature of the services provided and not according to the person supplying or receiving the services. According to the ECJ, portfolio management and administration services are covered by the exemption even when supplied by a third party, providing that they form a distinct whole, and are specific to and essential for, the management of the investment funds. This is in line with the principle of fiscal unity which precludes economic operators carrying out the same transactions being treated differently in relation to levying of VAT.

This principle has been confirmed by the Luxembourg VAT authorities in the Circular n° 723 dated 29 December 2006, underlining the fact that providing certain conditions are met, outsourced fund management services are covered by the VAT exemption laid down by Article 135 1 (G) of the VAT Directive.

¹ Directive 2001/107/EC of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to Undertaking for Collective Investment in Transferable Securities (UCITS) with a view to regulating management companies and simplified prospectuses.

Luxembourg and EU VAT treatment of advisory services

Even though the term “management” is not defined in Luxembourg VAT Law, the document issued by the Association of Banks and Bankers Luxembourg (ABBL) and approved by the Luxembourg VAT authorities in the early nineties is part of the commonly applied doctrine and provides Luxembourg funds professionals with a non-exhaustive list of services covered by the VAT exemption provided by Article 44, §1, d) of the Luxembourg VAT Law. This list should remain applicable, as confirmed earlier this year by the Association for the Luxembourg Funds Industry (ALFI). Hence, services provided by an external manager in the form of advisory within the scope of its management of investment funds are in principle covered by the VAT exemption provided for in Article 44, §1, d) of the Luxembourg VAT Law (i.e. article 135 1 (G) of the VAT Directive). This would be the case even if the service is limited solely to the advisory function. However, there are clear discrepancies in the VAT treatment of such advisory services throughout the European Union, for example, in the United Kingdom such type of services which are limited to the advisory function would be treated as subject to VAT.

In case of subcontracted services, the services must “form a distinct whole” and be “specific to and essential for” the management of investment funds². While admitting these essential characteristics of the advisory services, the German Court asks whether the service provided by the third-party manager is sufficiently specific if the manager only operates on the basis of a delegation of functions as defined in the UCITS Directive.

As a matter of fact there is no definition of management of special investment funds in the VAT directive, and therefore the UCITS directive, which harmonizes national provisions regarding investment funds and could be seen as very useful in providing such a definition. More precisely, the second subparagraph of Article 5 (2) of the UCITS directive refers to a description of the management of common funds and investments companies to the non-exhaustive list

of functions in its Annex II. Please note that the ECJ has already ruled on the relationship between these two pieces of community legislation in the case of JP Morgan Claverhouse (C - 363/05). According to the Court the provisions of the UCITS directive cannot be relied upon to derive a restricted interpretation of the term “special investment funds”. With reference to the UCITS directive and its relation to the VAT directive, the Advocate General observed that, at the time when the VAT directive was adopted, community terminology with regards to special investment funds was not yet harmonized and the community definition of collective investment undertakings was not adopted until 1985.

Consequences for Luxembourg's industry

The ruling of the ECJ in the case at hand shall be of the highest importance to the Luxembourg funds industry considering the impact the taxation of the advisory services could have on the Total Expense Ratio (TER) of the funds. Hence the ECJ's decision confirming the exemption of the advisory functions would be most welcome from the perspective of the Luxembourg fund industry.

Ernst & Young will keep you informed on further developments as well as the final decision taken by the ECJ.

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² Abbey National Case (C-169/04)