



association of the
luxembourg fund industry



Institut Luxembourgeois
des Administrateurs

**VAT ON REMUNERATION
OF DIRECTORS OF UCIs AND
THEIR MANAGEMENT COMPANIES**
recommendations

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These joint recommendations have been prepared by representatives of ALFI and ILA's working group specifically dealing with VAT on the remuneration of directors of UCIs and their management companies.

The working group comprises independent directors, representatives of management companies, audit firms and law firms. ALFI and ILA hope that this document will serve their members as a reference document.

Given the large variety of situations encountered, these recommendations deal with the particular situation of independent directors of management companies of UCIs only as it would be practically impossible to cover all possible situations and set-ups.

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ALFI and ILA will publish amended copies of this document to their members, showing marked-up

changes from the immediately preceding copy. Members of ALFI and ILA are welcome to submit a question to the working group, who will review it and consider whether to respond to it in a future copy of this document. Please send your questions to info@alfi.lu and events@ila.lu. We will acknowledge receipt of each question but we regret that we may be unable to reply individually to each one.

These recommendations deal exclusively with considerations on VAT for the remuneration of directors of UCI management companies. They do not address any other regulatory obligations and other tax obligations that directors of UCI management companies may be subject to. These recommendations do not address the situation of vehicles other than UCIs benefiting from VAT exempt management services pursuant to article 44.1.d) of the Luxembourg VAT law, i.e. pension funds and securitisation vehicles.

Readers of these recommendations are further advised to supplement this document with the legal texts (law, decrees, FAQs and/or circulars).

The Luxembourg Indirect Tax Authorities (hereinafter the "VAT Authorities") have reminded in their Circular n° 781 of 30 September 2016 that independent directors are VAT-able persons. The concept of "independence" should be understood from a VAT viewpoint and not from a governance perspective. In this respect, the Circular indicates that an employee acting as a director on behalf of his employer is not a VAT-able person and thus does not have the obligation to register for VAT. The obligation to register for VAT (if any) lies with the employer.

The Circular is silent regarding the application of the exemption of article 44.1.d) of the VAT law to the remuneration of directors and managers of investment funds (in corporate form), to directors/managers of their management companies or of their general partners (save in the latter case in respect of corporate activities of the general partners).

Based on the jurisprudence of the Court of Justice of the European Union (CJEU), services of director in the context of investment funds should benefit from the exemption from VAT as per article 44 1. d) of the Luxembourg VAT law when such services qualify as "specific and essential", as defined in the Abbey National court case, for the management of the fund.

Because of the specificity of their roles, this means that the remuneration paid to directors/managers of UCIs set up as corporate entities (e.g. SICAV) is exempt from VAT.

Remuneration paid to directors of management companies should be exempt for the portion that relates to the management of the funds of the management company (common funds/FCPs but also corporate entities that have designated a management company) while the portion that relates to the management of the management company (the corporate entity) as such would be subject to VAT. Directors of management companies must be in a position to substantiate the application of the VAT exemption.

The VAT Authorities also insisted on the fact that the taxpayer who claims the benefit of an exemption must be able to demonstrate that the exemption is effectively applicable. The VAT Authorities have not and will not provide more detailed guidelines regarding the evidence to be used in this respect by a director and the potential pro-rata between taxable and exempt services (see hereafter). Against this background, these recommendations aim at providing some general guidance in the form of check lists detailing the tasks that will typically be performed by a director of a management company, stating whether those tasks would tend to be specific and essential to the management of funds (thus exempt) or rather related to the management company as such (thus subject to VAT).

Section 2) provides some general information on the roles and responsibilities of a fund director while Section 3) gives an indicative list of items on the agenda of the board of the management company, with two sub-sections dealing with the case of an FCP and the case of a SICAV designating a management company.¹

¹ The term *management company* is used in a broad sense to cover generally speaking both the situation of management companies of UCITS and Alternative Investment Fund Managers, or management companies managing both UCITS and AIFs.

2. Application of the VAT exemption of article 44.1.d) of the VAT law for independent directors

Roles and responsibilities of a fund director

1. The primary legal basis applicable to directors is to be found in the Law of 10 August 1915 on Commercial Companies (hereafter the “Law of 1915”) as amended which reads as follows (excepts thereof):

“§4 Management and supervision of *sociétés anonymes* and *sociétés européennes*”

a) “*Sociétés anonymes* are managed by agents appointed for a specific period (...)” [art. 50].

b) “The board of directors shall have the power to take any action necessary or useful to realise the corporate object, with the exception of the powers reserved by law or by the article to the general meeting (...). It shall represent the company *vis-à-vis* third parties and in legal proceedings” [art. 53].

c) “The board of directors may decide to create committees, the composition and duties of which it shall determine and which shall exercise their activities under its responsibility” [art. 54].

d) “The directors (...) shall be jointly and severally liable towards the company or any third parties for damages resulting from the violation of this law or the articles” [art. 59].

Similar provisions apply to other corporate forms².

2. In addition, the various “product laws” state that “the exclusive object of which [the SICAV] is to invest their funds in assets in order to spread the investment risks and to ensure for their investors the benefit of the results of the management of their assets”³.

3. Furthermore, concerning management companies, the 2010 UCI Law state that the exclusive activity of management companies shall be the management of investment funds/UCIs, potentially also as alternative investment managers, as well as restricted other management activities.

4. A fund shall be managed exclusively for the realisation of its object as described above.

In the case of investment funds and as stated herebefore, the role of directors is more specifically to ensure that the fund is managed in the interests of the investors and, among others, to take all measures necessary to protect the investors.

In the case of a management company, the role of the directors is (i) to manage the management company itself, but also (ii) to realise its corporate object which is to manage investment funds.

5. In Luxembourg, investment funds may typically be established:

a) In contractual form as a common fund (“*Fonds Commun de Placement*” or FCP). A common fund is defined as an undivided collection of assets made up and managed according to the principle of risk spreading on behalf of unitholders who are liable only up to the amount contributed by them. An FCP does not have a legal personality and must be managed by a management company.

b) In corporate form as an investment company:

- With variable capital (“*Société d’Investissement à Capital Variable*” or SICAV) ;
- With fixed capital (“*Société d’Investissement à Capital Fixe*” or SICAF).

Investment companies (SICAVs and SICAFs) may be self-managed or they may designate a management company. In Luxembourg, most SICAVs/SICAFs have designated a management company.

6. As far as contractual fund structures/FCPs are concerned, there are only a few management companies managing only one FCP.

7. The most common business model is therefore a management company (of UCITS) managing several SICAVs and FCPs, possibly acting as alternative investment fund manager (AIFM), with some of the functions delegated to different specialised service providers (portfolio managers or advisers, central administration, distributors etc.). Some management companies however prefer to perform also central administration services and may thus have a large number of staff. Lastly, some management companies perform also investment advisory or management services to non-fund beneficiaries such as individuals or pension funds.

8. Circular No 781 of the VAT Authorities on the VAT treatment applicable to the remuneration of directors is silent about the specific case of directors of investment funds and management companies.

² Article 107 for *sociétés en commandite par actions*, article 191 and 191 bis for *sociétés à responsabilité limitée*, article 17 for *sociétés en commandite simple*, and article 22-3 for *sociétés en commandite spéciale*.

³ Article 25 of the Law of 13 February 2007 related to specialised investment funds, as amended and article 93 of the law of 17 December 2010 related to undertaking for collective investments (the “2010 UCI Law”), article 25 of the 2010 UCI Law provides for UCITS that their “sole object is to invest their funds in transferable securities and or other liquid financial assets referred to in Article 41(1) of this Law in order to spread the investment risks and to ensure for their unitholders the benefit of the result of the management of their assets”, article 1 of the Law of 15 June 2004 related to the *Société d’investissement en capital à risque* (SICAR).

9. However, it is generally accepted that services of directors in the context of investment funds should benefit from the exemption of article 44.1.d) of the Luxembourg VAT law when they meet the criterion of being “specific and essential” (as defined in the Abbey National court case), for the management of the fund. The sole role of a director of an investment fund being the protection of the assets of the investors, all its tasks should be considered as “specific and essential” for the activity of the fund and as a consequence as fully VAT exempt under article 44.1.d) of the Luxembourg VAT law.

Services of directors of management companies, may benefit from the exemption of article 44.1.d) of the Luxembourg VAT law if they meet the criterion of being “specific and essential” in which case a pro-rata between exempt and taxable services must be determined when relevant.

10. Based on the precedent of the depositary bank services⁴, neither the VAT Authorities nor the trade associations are in a position to issue a recommendation regarding such percentage to be used.

11. The Board is a collegial body and has overall and joint responsibility. Therefore, the determination of the taxable and the exempt part of director services shall be appreciated at board level as a whole. This should take into account the particularities of the role of directors when they are in charge of special functions such as the responsibility of the audit committee or the responsibility of the relationship with the CSSF, and receive eventually a specific remuneration for these functions. In this case, the percentage between taxable and exempt part of the services might be different from the other directors. It will be then up to each director established in Luxembourg to issue an invoice with the appropriate VAT amount. On the other hand, Luxembourg companies are obliged to self-assess the VAT on services received from directors which are not established in Luxembourg for VAT purposes (“reverse-charge” principle).

12. The services of a director are essential and specific to the management of investment funds. Indeed, these services are intrinsic to the corporate object of a fund, i.e. to invest subscription monies of investors in assets in order to spread the investment risks and to ensure for those investors the benefit of the management of their assets.

13. Each director must determine which portion of its activity is subject to VAT and which portion is exempt based on reliable elements, which can be duly evidenced in order to be checked easily by the VAT Authorities, taking into account the above

mentioned criteria. These evidences could be, for example:

- An agreement between the fund and the director and/or any document outlining the roles and responsibilities of board members;
- Powers delegated by the board;
- Time sheet or a system of points attributed to the importance of the different tasks of the director (as detailed in paragraph 14. below);
- Agenda of the meetings, attendance records to the meeting, list of documents circulated before the meeting;
- Regulatory documentation specifying the role of a given person (CSSF application, etc.).

14. The most straightforward and easiest method seems to determine the time spent for each function. However, the time spent could not always be the most appropriate key allocation, depending of the specificity of each fund and the particularities of the role of some directors. As an alternative method, it might be envisaged that the board of directors agrees on a system of points attributed to each of the functions. This weighting could be, eventually, discussed with and validated by a third party such as an auditor, a lawyer or a director who is not a member of the board.

15. Agendas might not be sufficient and minutes of the meetings may also serve as evidence of time spent on these agenda items. The VAT authorities may request copies of minutes and more generally reserve the right to request the delivery of any additional document as deemed appropriate and appropriate in that context.

16. The tasks listed in the table in section 3) is purely indicative and must be adapted to the situation of each individual board. It is taking into account the above mentioned legal principles.

17. It is important that these tasks, their execution and the pro-rata, if any, between taxable and exempt services are reviewed regularly.

18. In the case of management companies of FCP(s), a director could execute tasks linked to the management of the management company and of the FCP(s). The first ones will be taxable, and the second ones will be exempt to the extent they are deemed specific and essential to the management of those FCP(s). It is important to allocate properly the time between taxable and exempt services for VAT purposes and in coherence with the principles applicable to a proper functioning of the management company.

⁴ Circular n° 723 of 29 December 2006 regarding the implementation of the Abbey National case.

19. The position of each director should be envisaged individually. It would be however expected that the pro-rata of exempt and taxable services for directors of a given management company servicing an identical number of funds should be largely consistent.

20. The Court of Justice of the European Union has developed its case-law on different cases dealing with UCITS and more recently with pension funds and real estate funds. Consequently, it does not seem appropriate, *prima facie*, to establish a distinction based on the categories of funds (UCITS, AIFs, RAIFs, etc.) or the type of the amount of assets but rather to focus on the nature of the services instead. However, these criteria (categories of funds, type and amount of assets) may influence the importance and complexity of some tasks to be performed by directors and the time devoted to the performance of these tasks.

21. Based on the case-law of the Court, it is also possible to consider in certain circumstances that taxable services are ancillary to a main supply which is exempt. However, this principle should be applied in a careful and consistent manner. It should not be applied to consider that tasks relating to the administration of the management company of an FCP could be seen as ancillary to tasks relating to the

administration of the FCP. Tasks intrinsically linked to the management of the management company should be considered separately and therefore as taxable.

22. An exception might however be found in the situation of some GPs of AIFs that are set up exclusively for legal reasons and where an AIFM is the effective manager of the AIF. In such situation, the tasks of the director might be considered as fully dedicated to the AIF and therefore the exemption could apply to his remuneration save for tasks that relate to the corporate activities of the GP itself such as the review and approval of annual accounts. This analysis could thus apply to the remuneration paid to the directors/managers of the general partners of investment funds set up as partnership limited by shares, whether incorporated, i.e. *société en commandite par actions* (corporate partnership limited by shares) or not, i.e. *société en commandite simple* (limited partnership) or *société en commandite spéciale* (special limited partnership).



3. Indicative list of items on the agenda of the board of the management company

This indicative list of items on the agenda of the board of the management company with two sub-sections dealing with the case of an FCP and the case of a SICAV designating a management company is based, on the one hand, on samples of agendas of board of management companies that have been merged, and on the other hand, on the “2016 Luxembourg fund governance” published jointly by ILA and PwC.

It thus provides a comprehensive list of usual tasks of directors but could however not cover all situations. Consequently, should other tasks be performed, their VAT treatment should be considered based on the principles reminded above in order to determine if they could be considered as “specific and essential” for the fund activity (Y = Yes, N = No, N.A. = not applicable and neutral means both responses could be valid or a combination/ split might be justified).

Activities	Examples of corresponding Board Agenda items		FCP	SICAV having designated a ManCo	
			ManCo of FCP Specific & Essential Y/N	ManCo of SICAV Specific & Essential Y/N	Board of SICAV Specific & Essential Y/N
AML/KYC of the fund	Policies, country risk assessment matrix New countries/new distributors approval (KYD), or delegation matrix for it Specific cases, remediation exercises		Y	Y	Y
			Y	Y	Y
			Y	Y	Y
AML/KYC of the ManCo	Policies, country risk assessment matrix		N	N	N.A.
Budget and other fund costs (TER)	Regular review of TER Ad-hoc decisions related to funds' costs Benchmarking exercises of services providers' costs		Y	Y	Y
			Y	Y	Y
			Y	Y	Y
Central Administration Report	KPIs and other quality level indicators' review NAV error analysis Report from Central Administration on activities		Y	Y	Y
			Y	Y	Y
			Y	Y	N.A.
Compliance Report	ManCo Compliance reports (policies, Suspicious Transactions Reporting, significant holdings, market timing/frequent trading, etc.) Investment Managers reports Status of regulatory filings		Y	N	Y
			Y	Y	Y
			Y	Y	Y
Conflicts of interest	Declaration from Directors of potential conflicts Review of Investment Managers' policies and reports on Conflicts of Interest Commissions sharing agreements		N	N	N.A./Y
			Y	Y	Y
			Y	Y	Y
Depositary	Selection (due diligence), appointment and monitoring of depositary KPIs and other quality level indicators' review Reports from depositary Custody breaches and reconciliation Confirmations and reconciliation for non-custodial assets		Y	N.A.	Y
			Y	Y	Y
			Y	Y	Y
			Y	Y	Y
			Y	Y	Y
Distribution Report	Results - sales by products/geographies/channels Ongoing analysis of trends and investors' needs in specific markets Ad-hoc matters - trail fees rebates/delegation matrix, waivers, etc.		Y	Y	Y
			Y	Y	Y
			Y	Y	N.A.
External Audit of the ManCo	Selection and appointment of auditor Audit Report Control matters/audit findings ISAE 3402 (ManCo)		N	N	N.A.
			N	N	N.A.
			N	N	N.A.
			N	N	N.A.

Activities	Examples of corresponding Board Agenda items		FCP ManCo of FCP Specific & Essential Y/N	SICAV having designated a ManCo	
				ManCo of SICAV Specific & Essential Y/N	Board of SICAV Specific & Essential Y/N
External Audit of the fund	Selection and appointment of auditor		Y	N.A.	Y
	Long Form Report		Y	Y	Y
	Control matters/audit findings (funds)		Y	Y	Y
Fair Valuation Report	Pricing Committee Matters		Y	Y	Y
	Swing Pricing application (if any)		Y	Y	Y
	Fair valuation on specific days/holdings		Y	Y	Y
Financial Statements of the ManCo	Financial Statements		N	N	N.A.
	Dividend distribution		N	N	N.A.
	Group Reporting/Consolidation statements		N	N	N.A.
	Budget		N	N	N.A.
Financial statements of the fund	Annual and Semi-Annual Reports		Y	N.A.	Y
	Wording/disclosures (see also “regulatory”)		Y	N.A.	Y
Internal Audit Report of the ManCo	Internal audit reports (related to activities impacting on fund)		Y	Y	N.A.
	Internal audit reports (related to activities not impacting on fund)		N	N	N.A.
	Audit plan, methodologies, policies		N	N	N.A.
Breaches Report	Compliance Report (see also Compliance)		Y	Y	Y
Investor complaint Report	Compliance or distribution report (specific sections)		Y	Y	Y
	Ad-hoc correspondence on investors’ complaints		Y	Y	Y
New Product Approval	Product design and target markets identification		Y	Y	Y
	Approval of KIID and Risk Profile		Y	Y	Y
	Pricing, countries of registration, legal documentation		Y	Y	Y
Prospectus Update	Revision - compliance with new regulatory requirements		Y	Y	Y
	Revision - compliance with new tax requirement		Y	Y	Y
	General reviews/improvements - plain language, etc.		Y	Y	Y
Regulatory and Legal Updates	Presentation from internal functions/external experts (fund related)		Y	Y	Y
	Presentation from internal functions/external experts (not fund related)		N	N	N
Risk Manager Report	Annual or ad-hoc review of Risk Management Process, risk policies (fund related)		Y	Y	N.A.
	Limits utilisation and breaches		Y	Y	Y
	Operational Risk reports (fund related)		Y	Y	N.A.
Regulatory correspondence (CSSF and others)	On-site visits and follow-up (fund related)		Y	Y	Y
	On-site visits and follow-up (not fund related)		N	N	N
	Risk-related surveys/reports		Y	Y	N.A.
	Ad-hoc correspondence (follow up on LFRs)		Y	Y	Y
	Ad-hoc correspondence (Directors’ or COs related)		Y	N	Y
Tax updates	WHT reclaim (Aberdeen/Fokus Bank)		Y	Y	Y
	Tax matters related to funds and investors (say FATCA, CRS, German Tax reporting)		Y	Y	Y
	Corporate Tax matters		N	N	N.A.

Activities	Examples of corresponding Board Agenda items		FCP	SICAV having designated a ManCo	
			ManCo of FCP Specific & Essential Y/N	ManCo of SICAV Specific & Essential Y/N	Board of SICAV Specific & Essential Y/N
Other Board activities, recurring and not	Minutes and matters arising/follow-up		Neutral	N	Y
	Self-appraisal or external assessment		N	N	Y
	Due diligence on delegates (investment managers, central administration, distributors)		Y	Y	Y
	Due diligence on delegate (management company)		N.A.	N.A.	Y
	Investments' performance		Y	Y	Y
	Securities Lending		Y	Y	Y
	Conducting Officers (or ManCo) reports		Y	N	N.A.
Remuneration policies		N	N	N.A.	
Other Corporate matters	Capital Adequacy		N	N	N.A.
	HR/Recruitment		N	N	N.A.
	Risk policies (not fund related)		N	N	N.A.
	Other policies (not fund related)		N	N	N.A.

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