



KPMG Tax S.à r.l.

## *VAT - Important Changes for Investment Funds*

# Agenda

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## ◆ Implementation of ECJ Cases in Luxembourg

- BBL Case
- Abbey National Case

## ◆ VAT implications for custody services outsourced by custodians

**BBL Case  
of October 21, 2004  
(C-8/03)**

# BBL Case: Conclusion

## ◆ SICAV = taxable person for VAT purposes

## ◆ Consequences

- Cross-Border management services in the context of Investment funds are subject to former Art. 9 2 e) of the 6th EC-Directive
  - **no foreign VAT chargeable**
- HOWEVER: Management of Investment funds is VAT exempt former Art. 13 B d) Nr. 6 of the 6th EC-Directive:
  - SICAV is not liable to pay VAT on these services

# BBL case / Circular 723

- ◆ 29 December 2006: Circular n ° 723 related to the ECJ cases BBL and Abbey National was published
- ◆ Entry into force of the circular: 1 April 2007
- ◆ Previous Luxembourg practice differed from the ECJ's decisions.
- ◆ Circular clarifies the practical consequences of these ECJ cases.

# Circular 723 – Impact on the VAT status of funds

- ◆ The circular states that the following investment vehicles listed in article 44, 1, d) of the Luxembourg VAT law (VATL) shall be regarded as taxable persons for VAT purposes:
  - SICAVs,
  - SICAFs
  - Management companies of FCPs
  - SICARs
  - Pension funds
  - Securitization vehicles
  - Special investment funds

# BBL Case – Administrative practice prior to Circular 723

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- ◆ Before Circular 723, difficulty to register investment funds in Luxembourg for VAT purposes
- ◆ Exception: real estate funds
- ◆ No standard registration

# BBL Case – Administrative practice pursuant to Circular 723

## ◆ The fact that investment funds have no input VAT recovery right, has the following consequences:

- A simplified registration is mandatory if the fund:
  - is liable to self-account for VAT on non VAT exempt services purchased from foreign suppliers (NO THRESHOLD)
  - carries out intra-Community acquisitions of goods (> 10'000 €)
  - carries out imports of goods
- VAT self-accounted for under reverse charge mechanism will not be recoverable
  - ➔ Luxembourg VAT cost

# BBL Case – Administrative practice pursuant to Circular 723

## ◆ Example 1: a Luxembourg SICAV purchases legal advisory services from Belgium

➔ A simplified VAT registration will be necessary in Luxembourg

➔ No Belgian VAT charged

➔ Luxembourg VAT cost: 15%

# BBL Case – Administrative practice pursuant to Circular 723

- ◆ **Example 2: a Luxembourg SICAV does not receive any reverse charge services and does not carry out any intra-Community acquisitions of goods or imports of goods**

**→ No VAT registration will be necessary in Luxembourg**

# BBL Case – Administrative practice pursuant to Circular 723

	Before BBL	After BBL	Risk
Invoice from foreign supplier	100	100	100
Belgian VAT	21	-	21
Luxembourg VAT	-	15	15
Total cost	121	115	136

# BBL Case – Administrative practice pursuant to Circular 723

## ◆ Example 3: a Luxembourg SICAV purchases investment advice from Belgium

- ➔ In principle, reverse charge mechanism should be applicable, but VAT-exempt service
- ➔ No obligation to register for VAT purposes
- ➔ **UNLESS** Belgian service supplier requires Luxembourg VAT ID number to zero-rate the supply

# BBL Case – Administrative practice pursuant to Circular 723

## ◆ In case of investment advice to funds from Belgium

	Before BBL	After BBL
Invoice from foreign supplier	100	100
Belgian VAT	21	0
Luxembourg VAT	-	0
Total cost	121	100

# BBL Case - Implications

## ◆ Practical issues for day to day business :

- Accountants should be familiar with the reverse-charge mechanism (i.e. recipient liable to pay the VAT due, no foreign VAT on the service supplier's invoice)
- Scope of VAT exemption should be known by accountants
- The accounting software should be adjusted accordingly in order to accurately compute the input VAT on services falling within the scope of the reverse-charge mechanism
- NAV impact further to an incorrect accounting application

**Abbey National Case  
of May 04, 2006  
(C-169/04)**

# Situation prior to Abbey National / Circular 723

## ◆ VAT exemption without input VAT recovery right:

- former Art. 13 B d) Nr.6 of the 6th EC-Directive:
  - Management of special investment funds as defined by Member States:
- Art. 44 1 d) VATL):
  - Management of investment funds (UCITS), including SICAR, securitization vehicles under the supervision of the CSSF

# Management of investment funds PRIOR to Abbey National / Circular 723

- ◆ daily management of the portfolio;
- ◆ research and consulting in investment;
- ◆ accounting;
- ◆ calculation of the net asset value of the portfolio;
- ◆ issue and repurchase of the shares and other administrative services like domiciliation;
- ◆ **activities of the depositary bank and custody of the securities held by the investment funds, i.e.:**
  - liquidation of the investment operations of the fund;
  - collection of dividends and interests;
  - reconciliation of the positions with the correspondents;
  - supervision as defined by the law of March 30th, 1988.

# Abbey National

## ◆ Term of « Management » of investment funds:

- No specific definition
- Reference to Appendix II of Directive 85/611

➔ Covers portfolio management / administrative duties

➔ NOT: Marketing

# Abbey National

## ◆ Directive 85/611: Appendix 2 - Administrative duties:

- legal and fund management accounting services;
- customer inquiries;
- valuation and pricing (including tax returns);
- regulatory compliance monitoring;
- maintenance of unit-holder register;
- distribution of income;
- unit issues and redemptions;
- contract settlements (including certificate dispatch);
- record keeping.

# Abbey National

## ◆ « Management » of investment funds:

- administration and accounting services performed by a **third-party manager** (outsourcing – of specific administrative duties to a third party manager) are covered
- defined according to the nature of the services provided and not according to the person supplying or receiving the services:
  - must, viewed broadly, form a distinct whole and
  - fulfill in effect the specific, essential functions of a management of an investment fund service

# Abbey National

## ◆ « Management » of investment funds:

- Depository services not covered by « management »
- What are depository services?
- Supervision and control according to articles 7 and 14 § 3 of Directive 85/611 are NOT VAT exempt.

# Abbey National – services rendered to UCITS

## Supervision and Control

## Other functions

## Central Administration

## Portfolio Management

<b>Monitoring and control</b>	<b>Transactions in shares</b>
<b>Compliance with legal requirements</b>	<b>Transactions in securities</b>
<b>Carrying out instructions of ManCo</b>	<b>Safekeeping</b>
<b>Other services</b>	<b>Other services</b>

<b>Accounting - NAV</b>
<b>Shareholder Register</b>
<b>Subscription &amp; Redemption</b>
<b>Other services</b>

# Consequences

## ◆ Narrower scope of the VAT exemption

- Additional costs for UCITS through VAT charged on depositary services
- Lowest rate in comparison to EU-Member States (average 20%)
- Banks acting as depositaries may increase their input VAT recovery right through output VAT charged on depositary services

# Circular 723

# Circular 723

- ◆ On 29 December 2006, the Luxembourg VAT Authorities issued circular n ° 723 related to the European Court of Justice cases BBL and Abbey National.
- ◆ The ECJ's decision in these cases diverged from the current practice in Luxembourg. The circular, which will enter into force as from 1 April 2007, clarifies the practical consequences of these case laws.

# Circular 723 – Impact on the VAT exemption of management of investment funds

- ◆ The scope of the exemption covers the operations which are specific to the activities of the investment funds such as investment management and administration activities of such funds as covered by the appendix II of Directive 85/611.
- ◆ The concept of “accomplished services” is confirmed.

# Circular 723 – Impact on the VAT exemption of management of investment funds

- ◆ However the circular confirms the decision of the ECJ concerning supervisory services, which are **not** covered by the exemption.
- ◆ The supervisory services shall be subject to VAT at the rate of 12% as from 1 April 2007.
- ◆ Safekeeping and transactional services should remain covered by the VAT exemption

# Next steps – Taxable basis

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- ◆ **The supplier will have to determine the taxable basis of the supervisory services based on objective criteria.**
- ◆ **In theory, this change does not imply an amendment of the custodian agreements currently in place but in practice?**

# Next steps – Taxable basis

- ◆ A review of these documents should be performed to determine the taxable basis subject to VAT and to assess whether amendments to the agreements will be required.
- ◆ All services rendered within the 1st quarter 2007 should be invoiced before March 31st, 2007 at the latest to benefit from the VAT exemption for supervisory services.

# Next steps – taxable basis

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- ◆ **No binding guidelines how to determine the taxable basis of the supervisory activities.**
- ◆ **A supervisory service supplier should ideally determine a policy to allocate a certain amount of the fees to the supervisory activities.**

# Next steps – taxable basis

## ◆ Methods

- cost basis;
- commission basis;
- supervisory activity workload;

## ◆ Variables

- type of fund (e.g. money market, fund of fund);
- type of assets (e.g. derivatives);
- investment policy.

# Next steps – taxable basis

◆ **Whichever policy for the calculation of the taxable basis is elaborated,**

→ the Luxembourg VAT authorities should be capable of understanding, verifying and following the computation of the taxable basis for these supervisory activities.



**Transparency**

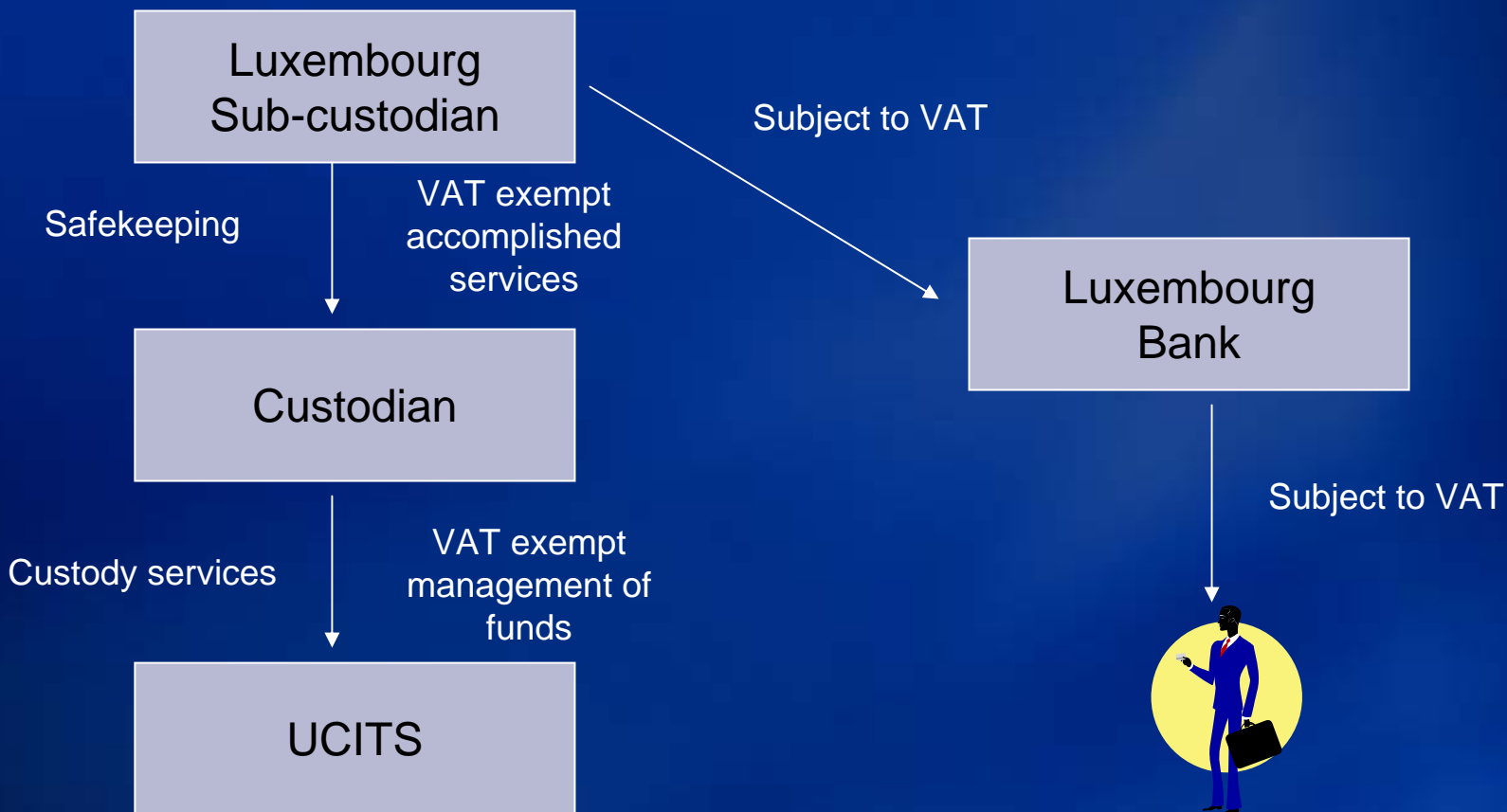
# Next steps - funds

- ◆ Invoiced amounts should be split between taxable and VAT exempt services
- ◆ Additional discussions about the potential input VAT recovery right of investment vehicles such as SICAFs or SICARs, which cannot be considered as performing services exempt under 44,1,d) LVAT may be expected in the near future.

# **VAT implications for custody services outsourced by custodians**

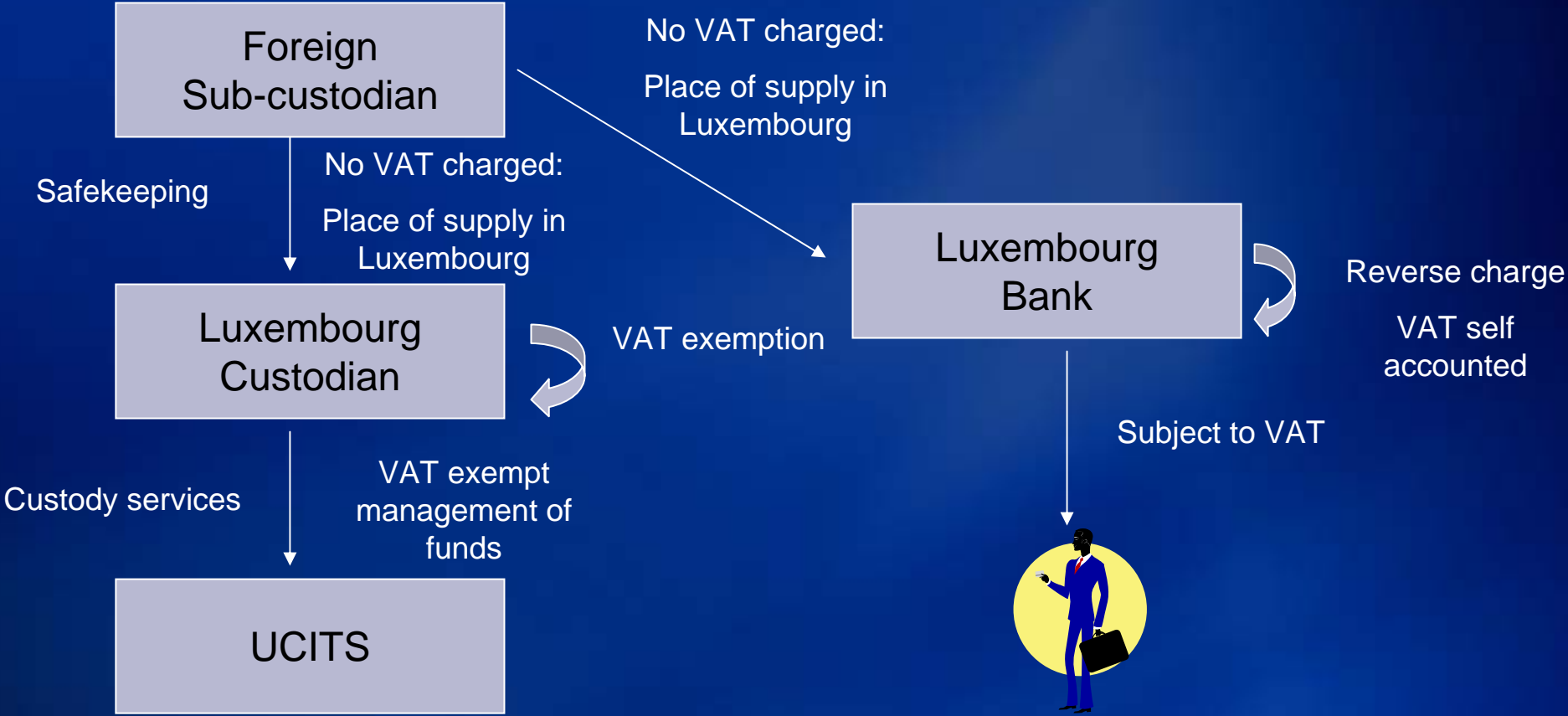
# VAT implications for custody services outsourced by custodians

## ◆ Situation prior to Circular 723 / Abbey National



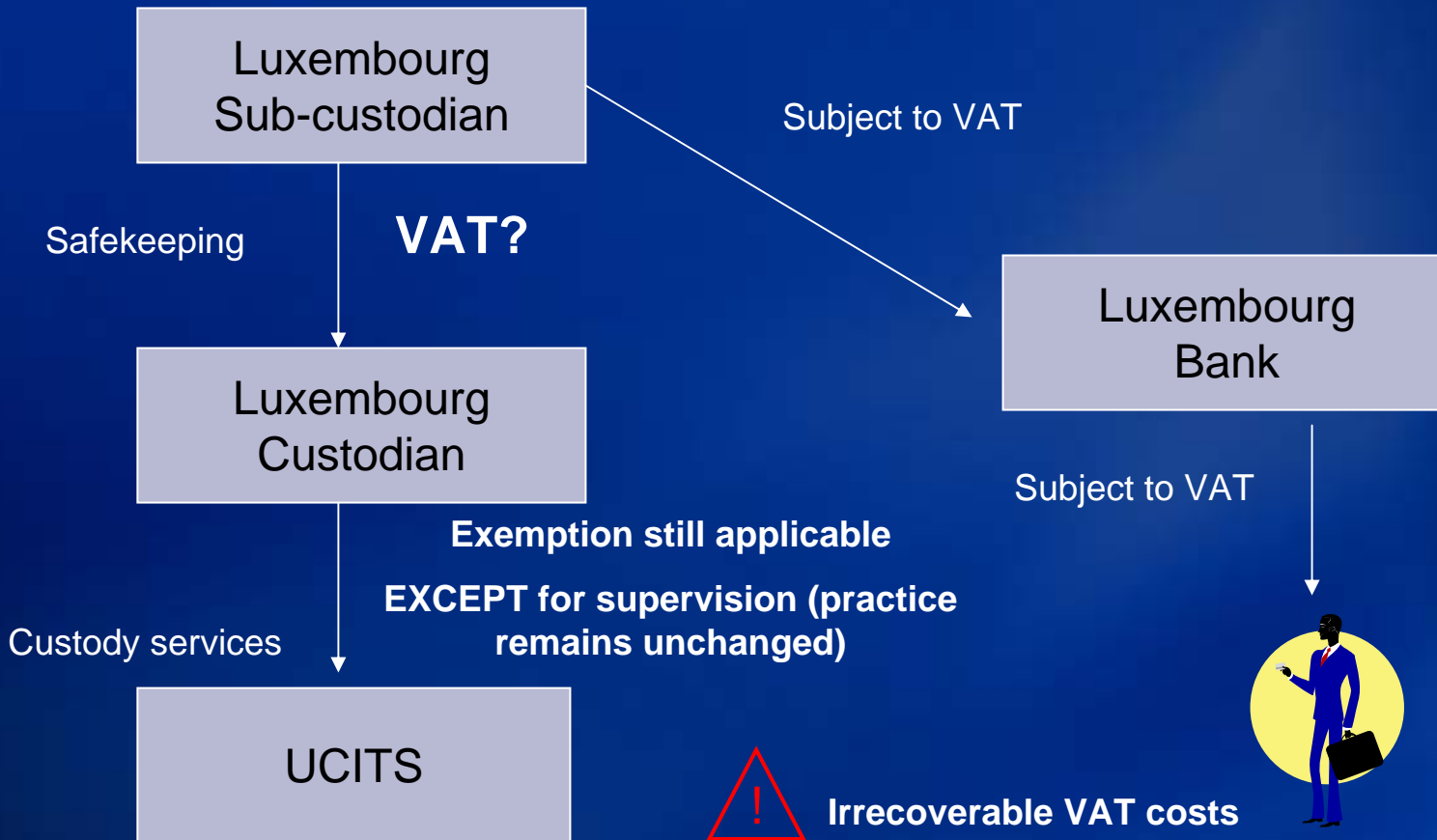
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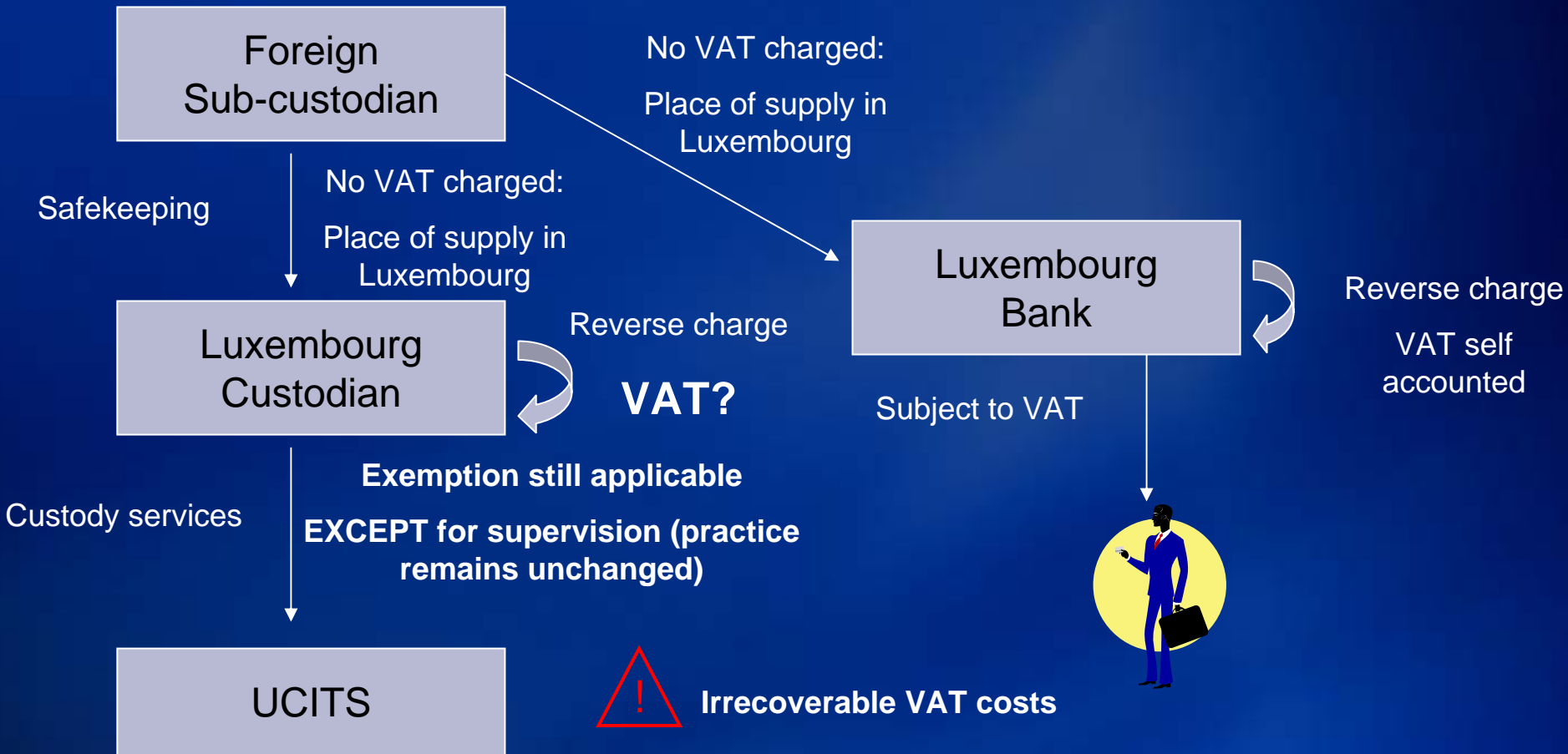
# VAT implications for custody services outsourced by custodians

## ◆ Situation after Circular 723 / Abbey National



# VAT implications for custody services outsourced by custodians

## ◆ Situation after Circular 723 / Abbey National



# Other fund related cases before the ECJ

# J.P. Morgan Fleming Claverhouse (C-363/05)

- ◆ Are the words "special investment funds" in Article 13B(d)(6) of the Sixth Directive capable of including closed-ended investment funds, such as ITCs?
- ◆ Are Member States to identify those funds within their jurisdiction which fall within the definition of "special investment funds" and that the benefit of exemption should extend to all such funds?

# J.P. Morgan Fleming Claverhouse

## ◆ Opinion of the Advocate General:

- Article 13B(d)(6) of the Sixth Directive confers on Member States the power to determine the special investment funds whose management is exempt from VAT. In exercising that power, Member States must have regard to the wording and objectives of the provision and to the principle of fiscal neutrality which requires all similar and therefore competing special investment funds to be treated equally as regards the levying of VAT.

# Ludwig C-453/05

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- This case relates to the exemption for negotiation services of credit
- Could impact negotiation services of shares and securities and thus distribution of funds

# Conclusion

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- ◆ **Assessment whether VAT registration is necessary**
  - Duration: appr. 3 -6 weeks
  - No threshold for services subject to the reverse-charge mechanism
  - Threshold for intra-Community acquisition of goods or imports > 10'000 €

# Conclusion

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## ◆ Determination of taxable basis

- Valuation method
- Quantifying supervisory services

# Conclusion

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◆ BBL Case

Abbey National Case



**Accounting systems need to be upgraded**

# Conclusion

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## ◆ After VAT registration of the fund

- Please be cautious regarding foreign VAT charged to the fund!

***Thank you***  
***Discussion***  
***Q&A***  
***Wrap Up***

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