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Briefing note April 2013

ECJ rules that outsourced investment advisory services are exempt from VAT

On 7 March 2013, the European Union Court of Justice (the "**ECJ**") released its decision in *GfBk Gesellschaft für Börsenkommunikation mbH v. Finanzamt Bayreuth* (C-275/11). The case concerned the VAT treatment of certain outsourced investment advisory services, and the ECJ held that such services were VAT exempt.

Facts

- GfBk supplied services to an investment management company (an "**IMC**").
- The fund managed by the IMC was a "special investment fund" according to the German KAGG (i.e. a fund open to the general public). This meant that the management services supplied by the IMC to the fund were VAT exempt.
- The services supplied by GfBk to the IMC were not management services but advisory services.

The question was whether the services supplied by GfBk would benefit from the VAT exemption applicable to the management of "special investment funds" (the "**Fund Management Exemption**") provided for in article 13B(d)(6) of Directive 77/388/EEC[1].

ECJ Decision

(i) The test, according to the ECJ, was whether the services supplied by GfBk were "intrinsically connected to the activity characteristic of an IMC, so that it has the effect of performing the specific and essential functions of management of a special investment fund".

(ii) The ECJ considered that giving recommendations to an IMC to purchase and sell assets was intrinsically connected to the activity characteristic of an IMC.

(iii) A service does not need to be listed in Annex II to the UCITS Directive[2] ("Annex II") to be included in the Fund Management Exemption. That advisory and information services were not listed in Annex II was, therefore, immaterial.

(iv) That advisory and information services do not (in themselves) alter the fund's legal and financial position was also immaterial.

(v) The principle of fiscal neutrality dictates that the choice between an IMC with its own (in-house) investment advisors and an IMC which outsources to a third party investment advisor must not be distorted by the incidence of VAT in one case but not the other.

Impact

(1) The decision in the GfBk case only affects the VAT treatment of investment advisory services supplied in the context of a "special investment fund". Each Member State has discretion over what amounts to a "special investment fund" in its jurisdiction, and although such discretion is not absolute (see Claverhouse; C-363/05), there is significant divergence across the various Member States (a securitisation vehicle is treated as a "special investment fund" in Luxembourg, for example, but not in France or the United Kingdom).

[1] Sixth Council Directive of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (77/388/EEC); now article 135(1)(g) of Directive 2006/112/EC.

[2] Council Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (85/611/EEC).

(2) Where a fund is a "special investment fund" in Member State A but not Member State B, and an IMC or an investment advisor is supplying services to the fund from Member State B, no VAT is chargeable in either Member State A or Member State B on the services supplied by the IMC or investment advisor, but the IMC or investment advisor is nevertheless entitled to full deduction of its input tax. This advantageous arrangement is unlikely to be affected by the decision in the GfBk case absent a change to the definition of "special investment fund" in Member State B (but note our comments in (5) below).

(3) In those Member States where investment advisory services supplied in the context of a "special investment fund" have been treated differently from the management of such a fund (e.g. Germany), an IMC should, following the decision in the GfBk case, consider reclaiming overpaid VAT from the third party investment advisor. The question might arise as to whether the IMC may be entitled to reclaim such VAT directly from the tax authority. The third party investment advisor needs to consider whether it is liable to repay input tax previously deducted back to the tax authority (and the question arises as to whether it must bear the cost of any such repayment itself or if it can pass such cost to the IMC; the parties should review the relevant agreements). The investment advisor would not be able to avail of the option for taxation provided for in article 137(1)(a) of Directive 2006/112/EC to waive the exemption (and thus retain its entitlement to deduct input VAT) because fund management is excluded from the scope of this option.

(4) Following from our comments in (iii) above, the impact of the decision in the GfBk case may not be limited to investment advisory services. If any other service (the provision of which is currently subject to VAT) can be shown to be "intrinsically connected to the activity characteristic of an IMC, so that it has the effect of performing the specific and essential functions of management of a special investment fund", then it too should be exempt, especially bearing in mind the fiscal neutrality considerations summarised at (v) above.

(5) The Fund Management Exemption has been under increasing judicial scrutiny (see Abbey National, C-169/04; Claverhouse, C-363/05; Wheels, C-424/11). The divergence between different Member States of what amounts to a "special investment fund", and its unusual consequences (see (2) above), cannot last forever. Further, although the purpose (as stated by the ECJ in a number of cases) of the Fund Management Exemption is to ensure neutrality between direct investment in securities and investment through UCITS, the effect of the decision in the GfBk case is to place investment in securities through UCITS on a better footing than direct investment (in that investment advisory services supplied in the context of UCITS may now be exempt whereas the same services supplied to a natural or legal person who invests their money in securities directly remain subject to VAT; see Deutsche Bank, C‑44/11). In light of all this, one can envisage greater pressure to harmonise the definition of a "special investment fund" across the EU, and further controversy over the VAT treatment of "investment management".

(6) The VAT treatment of outsourced financial services has always been difficult. The decision in the GfBk case (and, in particular, (i), (iv) and (v) above) suggests that there may now be greater scope to argue for exemption of such services.

Luxembourg

From the Luxembourg perspective, the decision in the GfBk case confirms the current Luxembourg VAT treatment of advisory services supplied to investment funds[3]. Despite the absence of the term "management" in the Luxembourg VAT Law, a document dated 15 January 1993 issued by the Association of Banks and Bankers Luxembourg (the "ABBL") and approved by the Luxembourg VAT authorities has provided Luxembourg funds professionals with a non-exhaustive list of services covered by the Luxembourg Investment Management Exemption (under article 44, §1, d) of the Luxembourg VAT Law).

The decision will also affect assimilated investment vehicles, such as SICARs, securitisation vehicles and (as of the transposition of the AIFM Directive[4] into national law) any entity qualifying as an Alternative Investment Fund (AIF).

United Kingdom

From the United Kingdom perspective, the decision in the GfBk case will have a narrow impact because of the narrow definition of a "special investment fund". Investment advisory services have been treated in the United Kingdom as subject to VAT irrespective of whether they are supplied in the context of a "special investment fund", so certain investment advisors will be affected (to whom our comments in (3) above in particular will be relevant).

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[3] Ministry of Finances' Decision of 11 October 1996; Circular n° 723 of 29 December 2006 and Circular of 30 April 2010.
[4] Council Directive of 8 June 2011 on Alternative Investment Fund Managers (2011/61/EU).

France

From the French perspective, the decision in the GfBk case will also have a narrow impact because of the narrow definition of a "special investment fund", as article 261 C-1-f of the French tax code is limited to UCITS, i.e. "organismes de placement collectif en valeurs mobilières" (OPCVM) and the former securitisation vehicle , the "fonds communs de tritrisation" (FCC). It should be noted that the FCC is now replaced by the "société de titrisation" and the "fonds commun de titrisation" (FCT), and the Fund Management Exemption does not apply to them (although VAT exemption is achieved by other means).

Investment advisory services have been treated in France as subject to VAT irrespective of whether they are supplied in the context of a "special investment fund", so a French investment advisor needs to consider whether it is liable to repay input tax previously deducted back to the tax authority. In analysing the VAT impact of this decision, if its service is now VAT exempt, the investment advisor will need to take into account also any potential impact on its wage tax liability if it is not subject to VAT on at least 90% of its turnover.

Germany

From the German perspective, the decision is important. The German tax authorities apply the decision of the ECJ in the Abbey National case to outsourced fund management services. However, they have interpreted this decision narrowly. In particular, they have viewed investment advisory services with or without precise recommendations to purchase or sell as not being VAT exempt (sec. 4.8.13 para. 18 of the Implementation Decree to the German VAT Code). Furthermore, the German tax authorities took the view that preparatory activities by a third party where the IMC is freely entitled to reject the advice, would not, viewed broadly, form a "distinct whole" (as considered in the Abbey National case; sec. 4.8.13 para. 18 of the Implementation Decree to the German VAT Code) and would, therefore, not be VAT exempt. In light of the GfBk case, this view is likely to change at least with regard to investment advisory services.

The Netherlands

From the Dutch perspective, the decision in the GfBk case basically confirms the recent general practice. In the recent past the tax authorities have been prepared to give advance clearance on the application of the VAT exemption for investment advisory services, be it that there were always voices within the tax authorities that argued that in order to qualify for the exemption the recommendations by the adviser should have a binding character on the fund manager. It is a positive development that the GfBk case has now removed the uncertainty on this point.

Belgium

From the Belgian perspective, the decision in the GfBk case mainly confirms the current position of the Belgian VAT authorities in respect of outsourced investment advisory services, which is that outsourced services may also benefit from the Fund Management Exemption (included under article 44, §3, 11° of the Belgian VAT code) provided these are not isolated services (for example the supply of solely accounting services) but cover a range of services which, as such, are intrinsically connected to the management of an investment fund or the assets owned by such fund.

It is worth mentioning also that the Belgian Fund Management Exemption applies to a wide range of collective investment vehicles, including UCITs and non-UCITs investment companies and mutual funds, securitisation vehicles and pension funds.

Spain

From the Spanish perspective, article 20.1.18º n) of the Spanish VAT Law includes a broad list of entities which benefit from the Fund Management Exemption. In particular, the Spanish Law states as VAT exempt the management and deposit of Collective Investment Institutions, Private Equity entities managed by management companies duly authorised and registered in the Special Administrative Registries, Pension Funds, Mortgage Market Regulation Funds, Mortgage Securitisation Funds and Collective Retirement Institutions, formed in accordance with their specific legislation.

Investment advisory services have been treated in Spain as subject to VAT irrespective of whether they were supplied in the context of the entities defined in the said article 20.1.18º n), except where such services were rendered as a result of a full delegation of the management services in relation to the relevant "special investment fund". The

decision in the GfBK case may change the interpretation of the Spanish Tax authorities in this regard, declaring as VAT exempt the investment advisory services rendered to an IMC regardless of whether such services are provided within the framework of a full delegation.

Italy

Under the Italian VAT legislation, the VAT exemption applies to the management of both special investment funds and pension funds. Indeed, in Ruling of 30 November 2011, n° 114, the Italian Tax Authority expressly confirmed that the VAT exemption identified in Abbey National is to apply to pension funds as well.

Following the same logic, the conclusions of GfBK case could affect the VAT regime of advisory services provided by third parties to pension funds as well.

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