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Advocate General of the Supreme Court: management of individual assets via investment profiles is subject to VAT

On September 23, 2020 Advocate General to the Supreme Court, Ms. C.M. Ettema, issued Opinions in two interesting asset management cases.

The main question in these cases is whether the VAT exemption for the management of a special investment fund can also apply to individual asset management services whereby investments are pooled on the basis of investment profiles. Both the Amsterdam and the Arnhem-Leeuwarden Court of Appeal had ruled in these two cases that the exemption applied. The Advocate General (hereinafter: AG) did not follow those judgments. The AG believes both Courts of Appeal failed to sufficiently assess whether the assets of individual investors pooled in a central account is a 'fund' that is comparable to an undertaking for collective investment in transferable securities (hereinafter: UCITS), which qualifies for VAT purposes as a special investment fund. According to the AG, the VAT exemption moreover only applies if the 'fund' qualifies as a VAT taxable person (i.e. a VAT entrepreneur). She gives the Supreme Court in consideration to refer the cases to a Court of Appeal for further assessment.

Another question that is addressed in the AG's Opinions is whether the taxpayers meet the requirement of specific state supervision arising from the Fiscale Eenheid X case (no. C-595/13) of the Court of Justice of the European Union (hereinafter: CJEU). This is another requirement for applying the VAT exemption. The AG sees sufficient connecting factors for there to be specific state supervision.

1. Background and points of law

The taxpayers in these two cases are asset managers that offer an investment product under an individual asset management license. The investment product works as follows. Investors can have their assets invested according to a number of investment profiles (in the present cases 4 to 5), each of which is linked to a model portfolio. The choice of investment profile depends on the risk appetite of the investor. The assets of all the investors within a particular investment profile are invested in the same proportion and in the same financial instruments, from which (individual) deviations are not possible. Apart from the choice of investment profile, investors can exercise no further influence on the choice of investments.

Investors deposit the assets to be invested in a central account that is held by a securities depositary foundation (*stichting*) (hereinafter: Foundation) at a (custodian) bank. The Foundation was incorporated by the asset manager with a view to the separation of assets obligation arising from the Financial Supervision Act (hereinafter: FSA). The Foundation administers an 'investor giro account' for each investor. This giro account records the investor's claims on the Foundation expressed in (fractions of) securities and other financial instruments. The Foundation is the legal beneficiary to the purchased securities and other financial instruments in the central account at the (custodian) bank.

The taxpayers charge the fees for the management services directly to the investors by crediting these against the balance of the individual investment account. In dispute is

whether the management services can share in the VAT exemption for the management of special investment funds pursuant to Section 11(1)(i)(3) VAT Act 1968 (hereinafter: VAT Act).

The AG dealt with both cases simultaneously and identified two points of law:

(i) Can the assets of various investors pooled in the bank account of an investor giro account or other securities depositary, or another pool, suffice to assume a fund, or must a fund be an entity that may even have to be a VAT taxable person as referred to in Section 7 VAT Act?
(ii) Can the requirement that the managed assets are under specific state supervision also be met if the manager provides its services under an individual asset management license?

2. AG Ettema's Opinions

In dealing with the first point of law, the AG addresses the interpretation of the exemption for the purposes of the management of a special investment fund. It follows from CJEU case law that the goal of the VAT exemption is to make the choice between directly investing in securities and collectively investing via funds tax-neutral. That the end justifies the means does not apply here, because the VAT exemption must be interpreted strict. To be able to speak of a special investment fund, as referred to in the VAT exemption, there must be a UCITS or a fund that has the same characteristics and thus performs the same actions, or that is at the very least comparable to a UCITS in such a way that it is in competition with it.

The essential characteristic of a UCITS is that assets of the various investors are pooled. The text of the VAT exemption states that this pooling of assets must take place in a 'fund', which, according to the AG, requires a legal entity governed by private law or de facto corporate independence. According to the AG, to be sufficiently comparable with a UCITS, the fund must also qualify as a VAT taxable person. Based on the CJEU judgment in the BBL case (no. C-8/03), the AG seems to assume that a UCITS generally qualifies as a VAT taxable person. In the present cases, the AG appears to question that status. The AG concludes that a fund does not qualify as a VAT taxable person if it only performs services for investors for no consideration, for example, because investors directly purchase all the management services from a third-party asset manager.

The AG subsequently observes that the Courts of Appeal did not establish whether the assets in the central account qualify as a 'fund' and whether there is a fund that manages investments in its own name and for its own account. Moreover, according to the AG it is unclear whether the assets in the central account, the alleged fund, qualify as a VAT taxable person. The taxpayers in these cases have acknowledged that neither they, as asset manager, nor the Foundation are a fund. The AG does not completely rule out that the assets in the central account qualify as a fund and asks the Supreme Court to consider referring the cases for reassessment.

In theory, we believe it is also possible to assume a special investment fund at the level of the investment profiles. Unfortunately, the AG does not address this and only explores the possibilities of assuming there is a fund at the level of the central account of the Foundation or the Foundation itself.

In dealing with the second point of law, the AG examined whether the asset manager, or the 'fund' or the pooled assets, is subject to specific state supervision that is sufficiently comparable to the supervision of (a manager of) a UCITS. The requirement of specific state supervision arises from the CJEU judgment in the Fiscale Eenheid X case and was included in the Specific State Supervision Decree last year. In the present cases, the asset managers offer individual management services under an individual asset management license pursuant to Section 2:96 FSA; this in contrast to (managers of) UCITS who, in principle, are subject to collective asset management supervision. After an extensive examination of the various supervisory regimes, the AG concluded that there is sufficient comparability. However, that does not help the asset managers, given that, as explained above, the AG has doubts about whether there is a 'fund'.

3. Practical consequences

If the Supreme Court follows the AG's Opinions, the cases will be referred to a Court of Appeal for reassessment. We consider it likely that the fund requirement and VAT entrepreneurship introduced by the AG will be too great a hurdle for applying the VAT exemption to individual asset management via investment profiles.

With regard to the qualification of investment fund, the AG seems to attach great importance to the comparability with a UCITS. The CJEU also used this comparison in, for example, the Wheels (no. C-424/11) and ATP (no. C-464/12) cases. The VAT Committee, comprising representatives of the European Commission and the Member States, regards comparability as (a separate) requirement. Also, the comparability test used by the AG is far too strict. It ignores the developments in EU regulations for investment funds and also the confirmation given by the CJEU in its judgment in the Fiscale Eenheid X case that alternative investment funds (hereinafter: AIFs) also qualify as special investment funds for VAT purposes. The point is not that other funds must be completely identical to a UCITS in order to be regarded as a special investment fund. This strict interpretation by the AG may have a wider impact, which we see, in particular, with regard to:

Investment funds that are not a VAT taxable person
For example, the AG sees the requirement of comparability as a requirement that the 'fund' must qualify as a VAT taxable person. As such, the AG appears to be limiting the application of the Dutch VAT exemption and the exemption is thus possibly being interpreted more narrowly than in other EU Member States.

As previously stated, the AG refers to the CJEU judgment in the BBL case to arrive at the conclusion that a UCITS qualifies as a VAT taxable person. However, in practice this judgment is often questioned. In questioning the judgment, mention is often made of the

fact that the UCITS in the BBL judgment charges entry and exit commissions . This would then be the payment for an economic activity, which makes the UCITS a VAT taxable person. We believe that a UCITS could also perform economic activities on the basis of actions related to its investments, for example, in the case of trading securities on a commercial basis. However, in practice, this is subject to different views. The AG's Opinions do suggest that it is now more important to ensure that funds qualify as a VAT taxable person. This also impacts AIFs that do not charge any entry and exit commission, and therefore do not qualify as VAT taxable persons according to the Dutch tax authorities. Following the reasoning of the AG, the management of these AIFs cannot take place under the VAT exemption, thus resulting in VAT expenses.

Qualifying as a VAT taxable person means, in principle, that an investment fund must also register for VAT purposes. As far as we are concerned, a VAT registration helps to prove that there is indeed a VAT taxable person and this can, if the AG is followed, be used in discussions with asset managers about the application of the exemption.

Costs directly charged to the investor
A valid question is whether the VAT exemption can also be applied if the costs for managing an investment fund are directly charged to the investor. We believe that in that situation the exemption can still be applied as long as the nature of the services entails the management of the investment fund. This is also standard practice in the Netherlands. However, the AG seems to question this with her remark that a fund does not qualify as a VAT taxable person if investors directly purchase all management services from a third-party asset manager. The question is whether paying an invoice is alone sufficient to assume the purchase of management services, but we believe this remark is an additional reason for critically assessing such cost arrangements.

Pension funds
The Opinions issued by the AG are also at odds with the CJEU judgment in the ATP case and call into question whether a pension fund can qualify as a special investment fund within the meaning of the VAT exemption. It follows from CJEU case law that in order to be sufficiently comparable to a UCITS investors must acquire rights of participation in the fund. The AG argues that individual participants in pension funds do not participate in the equity of a pension fund and that the CJEU ignored this point in the ATP case. This can put further pressure on the VAT discussions with respect to pension funds.

Interpretation of specific state supervision
The AG's Opinions also show that she found it particularly difficult to make a regulatory comparison and, in that context, to identify differences between collective and private asset management. That is why she agrees with the judgments of the Courts of Appeal: licenses for collective or individual asset management are broadly comparable but differ in detail. The AG in any case does not consider it implausible that the supervision does not fundamentally differ. If the Supreme Court follows this, the Specific State Supervision Decree may have to be supplemented with licenses for private asset management. In our view, the AG's Opinions also offer perspective for a broader interpretation of 'specific state supervision'. It seems that the supervision requirement can also be met with regard

to the management of other types of funds, such as CDOs, CBOs or CLOs and Dutch exempt investment funds *(vrijgestelde beleggingsinstellingen)*, provided the supervision of the manager is of a sufficient level.

If you would like to exchange thoughts on these Opinions, feel free to contact the advisors of Meijburg & Co's Indirect Tax Financial Services Group or your usual tax advisor.

Meijburg & Co
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