

## **CJEU's K and DBKAG judgment: right to use software can qualify as VAT-exempt asset management**

On June 17, 2021, the European Court of Justice ('CJEU') ruled on the scope of the term 'management' within the meaning of the exemption for the management of special investment funds. In short, according to the CJEU, both the right to use software as well as specific administrative services could qualify as a VAT-exempt management service. The fact that the right to use software can itself fall within the VAT exemption is a welcome clarification for Dutch practice in light of the increasingly automated asset management market. The CJEU's judgment is also relevant for parties that provide specific administrative services to asset managers, as well as asset managers that purchase such services from abroad.

### **1. Background and points of law**

These (joined) cases concern the question whether the VAT exemption for the management of special investment funds can be applied to the following two services provided to managers of such funds:

- The K case concerns certain services for the calculation of the taxable income of unit-holders of an investment fund to ensure that this income is subject to income tax in accordance with national law;
- The DBKAG case concerns the granting of a right to use software used exclusively for calculations essential for the risk management and performance measurement of an investment fund. The software is specifically tailored to investment funds.

For the exemption for the management of special investment funds to apply, the service must qualify as 'management' and this management must relate to a 'special investment fund'. In the present cases, the question is only whether the services qualify as 'management'. The referring Austrian court has doubts about the interpretation of the concept of 'management', and whether the aforementioned service could fall within its scope.

### **2. When is there 'management' within the meaning of the exemption?**

The term 'management' is not defined as such in the VAT Directive. It can be derived from the case law of the CJEU that the exemption for the management of special investment funds applies to outsourced acts of management when such acts:

- i. viewed broadly form a distinct whole, and;
- ii. fulfill the specific and essential functions of the management of special investment funds.

In principle, this is the case if the task in question is listed in Annex II of the European Directive on undertakings for collective investment ('UCITS Directive'). This Annex describes a number of activities relating to the management of a UCITS, including administration and reporting. The exemption for the management of special investment

funds is not limited to the tasks referred to in Annex II of the UCITS Directive. Other services may also qualify as management to the extent that they are intrinsically related to the services performed by a fund's asset manager.

### **3. CJEU judgment**

The CJEU ruled that the services in the present cases may fall under the exemption for the management of special investment funds. According to the CJEU, it is not necessary for specific services to be outsourced in their entirety.

#### *Overall form a distinct whole*

The CJEU first addresses the condition that the outsourced services must, viewed broadly, form a distinct whole. In both the K case and the DKBAG case, certain functions were outsourced to a third party, but some of the responsibilities remained with the fund manager. In addition, the outsourcing did not release the fund manager from its legal obligations. Given the objective of the exemption, the CJEU ruled that there is no requirement for a particular task be outsourced in its entirety. If this were the case, it would mean that the VAT exemption is only open to specific tasks that are outsourced in their entirety, which, according to the CJEU, limits the practical scope too much.

#### *Specific and essential*

The CJEU subsequently addresses the requirement that the outsourced service must be specific and essential to the activities of a fund manager. As mentioned above, the typical tasks of a manager listed in Annex II of the UCITS Directive are in principle eligible for the exemption, insofar as these are specific and essential.

According to the CJEU, outsourced administrative services fulfilling a tax task can be regarded as VAT-exempt management insofar as they are specific and essential to fund management. It is up to the referring court to determine whether this condition is met.

The software license that allows calculations to be performed for risk management and performance measurement may also fall under the exemption for the management of special investment funds. The CJEU reiterates from previous case law that mere material or technical services are not covered by the exemption for the management of special investment funds, but emphasizes that not every service performed by means of software qualifies as such. The decisive factor is what the service actually consists of.

It follows from the CJEU's judgment that services used only by managers of investment funds are, as a starting point, specific and essential to fund management, because it can be assumed that such services are specifically tailored to the management of investment funds. In practice, it is sometimes suggested that a service provided in similar form to both investment funds and others may be too generic in nature to qualify for fund management exemption. The fact that services could theoretically be provided to parties other than special investment funds is not, in our view, decisive. For example, services

such as portfolio management and investment advice can by their very nature be provided to parties other than investment funds. We believe that the CJEU applies this test primarily to exclude mere material or technical services, as well as more generic services, from the application of the exemption for the management of special investment funds. Outsourced services are not specific and essential if a single service is actually used by a fund manager to manage both special investment funds and other funds. It is not possible to partially apply the exemption for the management of special investment funds for that outsourced service. In the K and DBKAG cases, this is not an issue.

Although the CJEU appears to follow the reasoning of K and DBKAG, the case has not yet been finally won because the CJEU has instructed the referring court to determine whether the outsourced services are intrinsically related to and thus are specific and essential to the management of special investment funds. The referring court will therefore still have to reach a final decision.

#### **4. Practical consequences**

The CJEU's judgment provides more clarity on the scope of the term 'management'. Of importance is the fact that both cases concern independent services. In practice, the outsourced tasks may also be incorporated in a wider range of services and for that reason may be treated differently for VAT purposes.

In our view, the ruling that the exemption for the management of special investment funds does not require specific tasks to only be partially outsourced is not new, as this already follows from the GfBk judgment. The fact that the CJEU has confirmed that this also applies to administrative tasks in the tax field is a welcome clarification for the Dutch practice. This also implies that a fund manager can (partially) outsource several tasks to different parties without losing the application of the VAT exemption, provided that each of these services withstand the specific and essential test.

An important aspect of the ruling is that a software license for a one-off license fee may be intrinsically related and thus subject to the exemption for the management of special investment funds. In practice, the distinction between (VAT-taxed) IT services and (VAT-exempt) financial services is not always clear. To some extent, the current practice is that the granting of a software license in itself is subject to VAT. The tax authorities are not always willing to look at the functions of the software. There is, however, room for the application of a VAT exemption to the extent that the performance of financial services is fully automated. This sometimes means that a service provider must charge VAT when supplying software while the use of the same "*software as a service*" is VAT-exempt. However, many software suppliers may be unable to provide their services in the form of software as a service because, for example, a license from the Netherlands Authority for the Financial Markets ("AFM"; Dutch regulator) would be required. The difference in the VAT treatment between software and software as a service may now have been eliminated by the CJEU, since the functions of the software should be examined. Because the CJEU determines that the calculations made by the software are essential

to risk management and performance measurement and form a distinct whole in that regard, a software license without any additional services could qualify as management. The fact that the CJEU ruled that a software license may be specific and essential is, in our view, favorable in the light of fiscal neutrality. The CJEU's judgment specifically addresses the exemption for the management of special investment funds, but we believe it has a broader impact. This is because the question of whether automated services qualify for the VAT exemption also often arises with respect to other VAT exemptions. The doctrine that the assessment whether a software license can fall under a VAT exemption should be based on functionalities is, in our view, a correct approach giving consideration to the technological developments in the financial sector.

## **5. Your options**

The CJEU's judgment is important for the fund management market. For parties providing services to fund managers, it is important to consider whether their services are specific and essential. There may be more scope for applying the VAT exemption in those cases, which will be beneficial to clients. In addition, the ruling is also important for fund managers in the Netherlands who purchase services abroad and currently report and pay reverse-charged VAT that is not or hardly recoverable.

It is important to determine as quickly as possible whether there is scope to apply the VAT exemption for the management of special investment funds so as not to lose any rights. If that is the case, then we recommend, where possible, to submit a notice of objection with respect to Dutch VAT soon.

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

KPMG Meijburg & Co  
June 2021

*The information contained in this memorandum is of a general nature and does not address the specific circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.*