

Luxembourg Tax Alert

Director fees: Circular of the Luxembourg Tax Authorities published

21 February 2017

On 14 February 2017, the Luxembourg tax authorities (Administration des contributions directes) issued a new tax circular concerning fees paid to directors.¹ This circular follows the publication of VAT Circular N° 781² and seeks to clarify the interaction between the VAT and direct tax treatments of the fees of independent directors, to give an overall view of how those fees should be subject to tax in Luxembourg.

Further guidance was provided on the e-notification system already available in English on the webportal guichet.lu ("MyGuichet").

VAT considerations

As a reminder, on 30 September 2016, the Luxembourg VAT authorities (Administration de l'enregistrement et des domaines) published VAT Circular N° 781 and a comprehensive list of frequently asked questions, which together seek to clarify the Luxembourg VAT treatment applicable to fees paid to independent directors. Both the VAT circular and the FAQs are available, in French, on the website of the Luxembourg VAT authorities.³

In summary, the Luxembourg VAT authorities confirmed that independent persons who supply directorship services for consideration are undertaking an economic activity within the scope of VAT and, therefore, have the status of taxable persons for VAT purposes.⁴ This position, which is strictly applied from 1 January 2017, means that any Luxembourg-resident independent director will be obliged to register for Luxembourg VAT and to file VAT returns reporting their supplies of directorship services.

¹ Circular L.I.R. n° 45/2 – 152/1 – 168/1 of 14 February 2017

² http://www.aed.public.lu/actualites/2016/09/Circ-781/Circ_-N_781-du-30_09_2016.pdf

³ <http://www.aed.public.lu/actualites/2016/09/Circ-781/Administrateurs-FAQ/index.html>

⁴ For further details, we refer to our alert "[Director fees: Circular of the Luxembourg VAT authorities published](#)"

Furthermore, to the extent that any directorship services are supplied in the scope of Luxembourg VAT, Luxembourg VAT of 17 percent will be applicable thereto unless a VAT exemption could be applied (either charged by a Luxembourg-resident independent director or, self-assessed by taxable companies on services received from non-residents). The VAT taxable basis will be the gross income received by the director (see hereafter). The Luxembourg VAT charged on these services would then be deductible by the company subject to the activities it carries out. For example, banks, insurance companies, and other financial services providers generally have a limited VAT deduction right while an industrial or trading company should have a full VAT deduction right.

The Tax Circular

In this context, the circular published on 14 February 2017 seeks to further clarify the impact of the application of VAT to the fees of independent directors from a direct tax perspective.

The circular recalls the principle that gross income received by non-executive directors (i.e., those that are not involved in the day-to-day management of the company) is considered self-employed income subject to withholding tax of 20 percent per Article 152 of the Luxembourg Income Tax Law (LITL). Taking into account the newly clarified VAT treatment of these fees, however, the circular explains that the direct tax implications of director fees are as follows:

I. In the hands of the independent directors:

- the 20 percent withholding tax is calculated on the gross income payable, i.e., not taking into account the VAT applied; and
- on a tax assessment basis (i.e., where the withholding tax is not the final tax,⁵ but the director reports the fees received on a Luxembourg income tax return), the director must report the gross income increased by the VAT charged as a gross amount (i.e., including any VAT charged by the independent director), but VAT is deductible as a professional expense, so that only the gross income will be considered for personal income tax purposes.

II. In the hand of the debtor:

- it is recalled that gross director fees are not deductible for income tax purposes by the company paying the fees;
- the proportion of the VAT incurred on these fees that is non-deductible for VAT purposes is equally non-deductible for income tax purposes; thus,
- neither the gross director fees nor any final VAT costs can be deducted from the tax base of the company.

⁵ The 20 percent withholding tax is the final tax when the net director fees do not exceed €1,500 for a resident taxpayer and €100,000 for a non-resident taxpayer, provided the non-resident director does not derive other professional income from a Luxembourg source.

The combination of the VAT and income tax rules may therefore result in a double non-deduction, i.e., a total or partial non-deduction of the VAT for VAT purposes and the addition of this non-deductible VAT to the gross director fees, representing a non-deductible income related cost.

We have sought to illustrate this double non-deduction with the following example:

1. A company pays a director fee of €50,000 to a non-resident independent director
2. This company self-assess Luxembourg VAT of 17 percent on this fee, i.e., €8,500
3. The company has an input VAT deduction right of 40 percent
4. The company withheld 20 percent of the net director fee, i.e., €10,000
5. The non-deductible cost for corporate tax is composed of the non-deductible director fees (€50,000) increased by the non-deductible VAT ($€8,500 * 60 \text{ percent} = €5,100$), and is thus €55,100

We remain at your disposal for any further questions you may have regarding the tax implications of director fees, as described above.

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