THE NETHERLANDS

Supreme Court Decision of 18 February 2022
(ECLI:NL:HR:2022:282)

Employment status of managers – use of management companies – multiparty employment relationships – concept of employer

HEADNOTES

Facts

A and B were the sole shareholders and directors (DGAs) of respectively C Ltd and D Ltd, two English limited liability companies (referred to here as the personal holding companies). A had concluded an employment contract with C Ltd, and B with D Ltd. The personal holding companies each held 24 per cent of the shares in X BV, a Dutch limited liability company active in software sales and development. The other 52 per cent were held by two other shareholders. In 2008, C Ltd and D Ltd had concluded management contracts with X BV, on the basis of which they conducted the management of X BV. To this end, the personal holding companies posted A and B to X BV, whose personal expertise were essential to the operations of X BV. X BV paid management fees to the personal holding companies, from whom A and B received their respective salaries. The sole shareholders had concluded a shareholders' agreement which entailed that all decisions by the general meeting of shareholders of X BV would be taken by unanimous vote. Besides X BV, both personal holding companies held shares in other companies. In 2014, the Dutch tax authority considered that the construct used to manage X BV was a sham construct. It looked through the personal holding companies and classified A and B as employees of X BV. As a result, X BV was faced with an additional tax assessment for payroll taxes, penalties and interest owed for the past four years. The Dutch tax authority dismissed the formal objection made by X BV, which decision

was appealed by X BV before the District Court.

Decision

The District Court had granted X BV's appeal, but the Court of Appeal shared the Dutch tax authority's view and set aside the judgement of the District Court. According to the Court of Appeal, the DGAs had concluded employment contracts with X BV. As the sole employee of their respective personal holding companies, they performed the management work described in the management agreements independently and carried out the day-to-day management of X BV. They were invaluable to X BV's operations and could not be substituted. Furthermore, the payment of management fees by X BV to the personal holding companies qualified as the payment of wages by X BV to A and B, since A and B agreed to the payment of the management fees into the personal holding companies. Finally, A and B worked under the authority of X BV, as the general meeting of shareholders of X BV had statutory powers to issue instructions to directors and to appoint, suspend and dismiss directors. In line with an earlier decision of the Supreme Court (Supreme Court Decision of 22 March 2013, ECLI:NL:HR:2013:BY9295), the presence of A and B in the general meeting of shareholders and the existence of the shareholders' agreement – through which A and B could veto any decision of the general meeting of shareholders – was irrelevant in this regard. The Supreme Court therefore granted X BV's appeal for cassation. The Supreme Court ruled that, without further substantiation, it was not comprehensible that the Court of Appeal had found the existence of employment contracts between the DGAs and X BV rather than employment contracts between the DGAs and their respective personal holding companies.

Law Applied

Civil Code

Article 7:610.

(1) The employment contract is the contract under which one of the parties, the employee, engages himself towards the opposite party, the employer, to perform work for a period of time in service of this opposite party in exchange for payment.

JUDGEMENT

[…]

3.1 The interested party's [X BV] first complaint argues, inter alia, that the Court of Appeal was wrong to characterise the management agreements as employment contracts with the director-shareholders of the Ltds, even though the management agreements were concluded between the interested party and the Ltds.

3.2.1 The answer to the question whether there is an employment relationship is determined by whether the legal relationship between the parties involved is an employment contract within the meaning of Article 7:610 of the Civil Code. The content of the agreements made between the parties is relevant in that assessment, as is the manner in which the parties have implemented the agreement and thus given it substance. This assessment must show whether the requirements set out in Article 7:610 of the Civil Code have been met, namely an obligation to perform work personally, salary and a relationship of authority (cf. Supreme Court Decision of 25 November 2011, ECLI:NL:HR:2011:BP3887 and Supreme Court Decision of 22 March 2013, ECLI:NL:HR:2013:BY9295). The Court of Appeal applied the correct standard.

3.2.2 However, the Court of Appeal's ruling that, despite the management agreements between the interested party and the Ltds […] and the employment contracts between the Ltds and [B] and [A], under civil law, employment relationships between the interested party and [A] and [B] respectively must be assumed instead of employment relationships between the Ltds and [B] and [A], without further substantiation, is not comprehensible.

3.2.3 In this context, the indispensability of [B] and [A] identified by the Court of Appeal does not answer the question of whether the latter themselves undertook an obligation towards the interested party to perform personal labour. The circumstance that [B] and [A] agreed to pay management fees to the Ltds sheds no light on the answer to the question of whether the interested party assumed towards [B] and [A] the obligation to pay wages to them. Finally, without further substantiation, it is not comprehensible why the Court of Appeal assumed that [B] and [A] performed their work under the authority of the general meeting of shareholders of the interested party. The provisions in a Shareholders' Agreement referred to by the Court of Appeal cannot support the view that, with regard to the authority over the performance of employment

contracts at the interested party, a statutory arrangement has been made which deviates from what follows from the statutory system (cf. Articles 2:217 and 2:239 of the Civil Code). In addition, it is hard to see where that general meeting of shareholders would derive the power to exercise direct authority with regard to the work to be performed by [B] and [A], as long as no more has been established than that the interested party has a contractual relationship with the Ltds.

[…]

3.4 In view of the foregoing, the judgement of the Court of Appeal cannot stand. Reference must follow. […]

ANNOTATION

This 2022 case concerns the legal qualification of the construct involving the use of a so-called 'management company' by directors: the construct in which a director manages a company on the basis of a management agreement concluded between his personal company (which may or may not be a holding company of the other company) and the company. This construct is quite popular in the Netherlands, as it enables directors to largely exclude themselves from the scope of labour law (statutory labour law and collective agreements), social security law and tax law. By extension, the judgement of the Supreme Court is relevant for all three legal fields. From a broader perspective, the judgement sheds light on the regulation of multiparty employment relationships in the Netherlands.

In short, in this case the Supreme Court rules that the construct involving the use of a management company cannot be pierced easily. According to the Supreme Court, the Court of Appeal's establishment of employment contracts between X BV and the DGAs was insufficiently motivated with regard to each of the three criteria that are necessary to establish the existence of an employment contract (namely, personal labour, salary and a relationship of authority). According to the Supreme Court:

(1) the indispensability of the DGAs was insufficient to conclude that they had undertaken to perform labour for the operating company;
(2) the fact that the DGAs had agreed to pay the management fee to their personal holding companies was not sufficient to classify the

management fee as salary paid of the DGAs; and

(3) the contractual relationship between the personal holding companies and the DGAs was not sufficient to establish a relationship of authority between X BV and the DGAs.

The approach of the Supreme Court fits in with the legal approach to multiparty employment relationships and the concept of 'employer' in the Netherlands. In Dutch law the 'employer' is the entity in whose service the employee undertakes to perform work for a certain period of time (Article 7:610 of the Civil Code). This definition was adopted in 1907 and assumes – as a corollary of the relationship between 'master' and 'servant' – the existence of a two-party relationship. In other words, the definition was not written to address the situation where the identity of the employer is unclear due to the involvement of third parties.

The Dutch legislator has subsequently left it up to case law to identify the employer in multiparty employment relationships. To that end, the Supreme Court applies the standard for the conclusion of a contract in general contract law. In Dutch contract law a contract can only come into being after the parties have agreed to commit themselves to each other. By extension, the Supreme Court has held on a number of occasions that only when the 'employer' and the 'employee' have committed themselves to each other, can a contract come into being between them and the question of whether that contract is an employment contract can then be addressed (see, for example, Supreme Court Decision of 5 May 2000, ECLI:NL:HR:2002:AD8186 (ABN Amro/Malhi case)). The question whether parties have committed themselves to each other depends on the intention of the parties, that is to say, on their mutual statements and conduct and what they were reasonably entitled to infer from each other's statements and conduct (Supreme Court Decision of 13 March 1981, ECLI:NL:HR:1981:AG4158 (Haviltex case)).

In practice, the Haviltex formula gives parties considerable leeway over the identity of the employer in multiparty employment relationships. In most multiparty employment relationships, the intention relating to the identity of the employer is clear from the text on paper and the way it is communicated to the employee: the hiring company (like a management company) intends to commit itself towards the employee, whilst the user company does not. The fact that the user company is subsequently involved in the employment relationship gives the employee – and the same goes for public authorities like the tax authority – insufficient reason to assume that it was not the hiring but the user company that intended to commit itself towards him.

At the same time, however, it should be noted that Dutch courts often apply the two tests – 'which parties have committed themselves to each other' and 'is the subsequent contract an employment contract within the meaning of Article 7:610 of the Civil Code' – simultaneously, especially where it concerns the use of a management company (see, for example, Court of Appeal Decision of 20 February 2018, ECLI:NL:GHAMS:2018:637). By extension, it cannot be said that the criteria for establishing an employment contract do not play a role in assessing the identity of the employer. For and under whose authority the employee performs work and from whom he receives wages are elements/criteria that play a role in interpreting the parties' intention to commit themselves to each other. However, these elements do not outweigh a clear written agreement. In other words: the factual exercise of employer powers is placed in light of the transparent agreements that were made at the start of the working relationship. The fact that the user undertaking usually exercises authority over the employee and sometimes even pays the wages will normally be in line with the agreements made; it is clearly communicated to the employee beforehand that it is the hiring company who, despite delegating certain employer powers to the user company, wants to contract with the employee. The exercise of employer powers by the user company therefore merely confirms the agreements made. In short, Dutch law accepts the delegation of employer powers to third parties without this leading to an employment contract with the third party. A clear agreement is therefore the decisive factor.

The judgement at hand confirms the abovementioned approach. The Supreme Court considers that the Court of Appeal, by applying the criteria of Article 7:610 of the Civil Code, applied the correct standard (paragraph 3.2.1). At the same time, the Supreme Court interprets these criteria in light of the parties' commitment towards each other (paragraph 3.2.3). The Supreme Court makes clear that a high(er) burden of proof is imposed to show that in reality the DGA – and not the management company – committed itself to perform work (under authority and in return for wages) as a director for the user company. In other words, the Supreme Court applies the criteria of Article 7:610 of the Civil Code (the actual performance) in light of the contractual relationships between the user company and the management companies and between the management companies and the DGAs (the written agreement).

The follow-up question is, then, what arguments the Court of Appeal could have used to bypass the management company and find the existence of an employment contract between the DGAs and

the user company. For example, would the situation be different if the management companies would not have been shareholders in the user company or would not have held shares in multiple companies (neither of which are standard practice)? It can be argued this is not the case. These circumstances do not change that the management companies – and not the DGAs – had a clear intention to commit to X BV. Specifically, these circumstances would not change that, on the basis of the judgement of the Supreme Court, the contractual relationship with the management company makes it hard to establish a commitment of the DGA towards the user company to perform work under authority and – especially if the user company does not pay the DGA directly – in return for wages.

One can argue this outcome is not problematic at present. Managers who perform their work through a management company usually have a strong social position. As a result, they arguably do not need the protection of labour law. The situation is different, however, if user companies start moving low-skilled employees to perform their work through a management company. After all, since 2012 a Dutch BV can be founded for as little as one Euro (Staatsblad 2012, 299). However, in such circumstances it could be argued that the use of a management company constitutes abuse. The notion of abuse entails that a business model with the sole purpose of undermining the protection of employees as designed by the legislator is not recognised by Dutch law.

Put differently, constructs that lack any reality value are pierced (see, for example, Supreme Court Decision of 21 February 2020, ECLI:NL:HR:2020:312 (Taxi Dorenbos case), discussed in 40 ILLR pages 31 to 38). Arguably, such reality value is present with regard to managers with a strong social position who choose to use a management company of their own volition, but not with regard to low-skilled employees who are forced to perform their work through a management company. This way, the minimum level of protection of employees as designed by the legislator can be upheld.