

news

THE ECJ, VAT AND INVESTMENT TRUSTS

The European Court of Justice (ECJ) recently ruled on the VAT treatment of management services to UK investment trust companies (ITCs). In this Newsletter, we consider the essential parts of the case and its potential impact on occupational pension schemes.

Background

- The EC VAT Directive¹ exempts the “management of special investment funds as defined by Member States” from VAT.
- UK legislation² limits the scope of this exemption to the management of:
 - an authorised unit trust scheme (AUT) or of a trust based scheme; and
 - the scheme property of an open-ended investment company (OEIC).
- The management of other types of investment vehicles (including ITCs) is subject to VAT.

The exemption

What does this mean in practice?

- When a fund manager charges an AUT or an OEIC for its management services, it does not charge VAT.
- However, when a fund manager supplies similar services to an ITC, VAT must be charged.

The ECJ case

Facts

- An ITC challenged the validity of this aspect of UK VAT legislation³. (In the 10 years ending on 31 December 2003, the ITC had paid £2.7 million in non-recoverable VAT on management services.)
- The ECJ was asked to consider whether:
 - “special investment funds” could include closed-ended investment funds, such as ITCs;
 - if so, whether Member States had discretion to select which type of fund should benefit from the exemption; and
 - if there was such a discretion, how this should be exercised in the light of EU principles of “fiscal neutrality, equal treatment and the prevention of distortion of competition”.

¹ EC Directive 77/388/EEC

² The Value Added Tax Act 1994

³ JP Morgan Fleming Claverhouse Investment Trust plc; The Association of Investment Trust Companies -v- The Commissioners of HM Revenue and Customs

The ECJ's decision

- “Special investment funds” can include ITCs.
- Although Member States have discretion over which types of vehicle fall within this definition, when exercising that discretion they must consider the purpose behind the VAT exemption.
- A key component of the exemption is that it is designed to facilitate investment in securities, whilst ensuring that vehicles in competition for this business are treated equally for tax purposes.

What does this mean?

For ITCs

- The UK VAT and Duties Tribunal now has to interpret and apply the ECJ ruling.
- If the Tribunal agrees with the ECJ's decision, this will mean that ITCs should not pay (or historically have paid) VAT on management fees.
- It is therefore likely that ITCs will consider lodging protective claims with the Tribunal.

What does this mean?

For occupational pension schemes

- The ECJ deliberately steered clear of extending its conclusions beyond the types of fund specifically identified in the case.
- The main purpose underlying pension schemes (and the funds held in them) is to fulfil benefit promises.
- However, unlike ITCs, it is unclear whether one of the main purposes is also to promote investment in securities.
- It therefore seems unlikely that the case opens the door for defined benefit pension schemes⁴ to mount similar VAT claims and a test case is probably required to clarify this.

What should schemes do?

- It is possible to reclaim up to 3 years of overpaid VAT.
- Pending any test case and the Tribunal's judgment, schemes with a material amount of money at stake may wish to seek advice regarding the possibility of protecting their position.

⁴ It could be said that defined contribution schemes are closer than defined benefit schemes to special investment funds. However, most defined contribution schemes invest via insurance wrappers where management fees are not subject to VAT.