VAT on professional fund management costs – further extension of transitional period

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Introduction

On 5 September 2016, HMRC issued Brief 14 (2016), its latest in a long line of updates regarding the recoverability of VAT on professional fund management costs paid in respect of occupational pension schemes.

Key points

- Significantly, Brief 14 (2016) (deduction of VAT on pension fund management costs following Court of Justice of the European Union decision in *PPG*) announces a further 12-month extension to the current transitional arrangements, so that the VAT treatment outlined in Notice 700/17 can continue to be used until 31 December 2017.
- It also covers the options available to taxpayers who have already made changes to their structure or contractual arrangements to assist in the recovery of VAT.

The pensions & VAT history

Under VAT Notice 700/17: Funded Pension Schemes (2012 version), HMRC allowed employers to recover VAT on invoices relating to general administration fees for work commissioned by and delivered to the trustees of UK occupational pension schemes.

Investment management fees were generally not recoverable, except to the extent that these costs were included in a mixed invoice (containing administration and investment management fees). Where a mixed invoice was delivered, "by way of simplification" HMRC allowed employers to recover 30% of the VAT as administration fees, with the remaining 70% being treated as referable to investment management costs and not recoverable by the employer.

The European cases

In the wake of two European cases, HMRC changed its stance on VAT and pension schemes.

- In the July 2013 decision in PPG Holdings BV, the CJEU ruled that an employer with a DB pension scheme is, as a taxable person, entitled to deduct the VAT paid on services relating to the management and operation of a pension fund set up for employees and former employees (ie both day-to-day

management costs and investment management fees). The court confirmed that input tax recovery is permitted where there is a "direct and immediate link" between the cost of these services and the employer's economic activity as a whole.

- In the March 2014 decision in ATP PensionService, the CJEU concluded that a DC scheme could be a "special investment fund", and therefore VAT exempt, if certain conditions are met. Although it is for Member States to define "special investment funds" (SIFs), the CJEU commented that the "essential characteristic of a special investment fund is the pooling of assets of several beneficiaries, enabling the risk to be borne by those beneficiaries to be spread over a range of securities."

HMRC's post *PPG* approach to VAT recovery

In November 2014, HMRC issued Brief 43 (2014) setting out its view that an employer could recover input tax in relation to the management of its pension scheme ("management" covers investment management and day-to-day administration) only if there is contemporaneous evidence that it:

- is the recipient of the services
- is party to the contract for those services, and
- has paid for those services.

Since then, HMRC has issued various briefs outlining possible (VAT) routes for evidencing an employer's entitlement to deduct VAT, with options currently on the table including the use of tripartite contracts and VAT grouping. Although we were expecting further guidance over the summer, in Brief 14 (2016), HMRC makes it clear that this "has currently been put on hold whilst we fully consider the wider implications of the options being proposed" (see "Transitional period set to continue" below for more details).

HMRC's post *ATP* approach to VAT recovery

In light of the CJEU's judgment in the *ATP* case, HMRC now accepts that UK DC pension funds which have all of the following key characteristics are SIFs for the purposes of the fund management exemption:

- they are solely funded (whether directly or indirectly) by persons to whom the retirement benefit is to be paid (ie the pension customers)
- the pension customers bear the investment risk
- the fund contains the pooled contributions of several pension customers
- the risk borne by the pension customers is spread over a range of securities.

As HMRC acknowledges that "the services of managing and administering those funds should be, and always should have been, exempt from VAT", VAT which has been paid but which should have been exempt may be recovered, subject to specific time limits (Brief 44 (2014)).

Transitional period set to continue

As there are no grounds post-*PPG* to differentiate between the administration of a DB pension scheme and the management of its assets, there is technically no longer a need for the administrative simplification under VAT Notice 700/17 to deal with supplies involving both elements. In each case, the employer will potentially

be able to deduct input tax if it receives the supply of services.

However, a transitional period was put in place until 31 December 2015 by HMRC, to allow trustees and employers to continue to use the VAT treatment outlined in Notice 700/17. Having already been extended once (until December 2016), this transitional period has been extended further by Brief 14 (2016) and is now scheduled to come to an end on 31 December 2017.

HMRC's reason for this further extension is that it is "taking longer than expected to reconcile the [*PPG*] decision with pension and financial service regulations, accounting rules and emerging case law".

Trustee and employer actions

Anyone currently contemplating putting in place one of the alternative options for dealing with VAT recovery now has a choice to make as to whether to press ahead or to wait and see how HMRC's guidance ultimately unfolds. However, HMRC warns that "adopting alternative structures to comply with the VAT requirements could have wider implications, in particular in respect of regulatory requirements and Corporation Tax deductions".

For those employers who have already made changes to their structure and/or contractual arrangements to comply with the judgment in the *PPG* case and HMRC's various updates, Brief 14 (2016) notes that, provided the employer and scheme trustees agree and both apply the same treatment, they may continue with those arrangements. It also confirms that, if employers and trustees wish, they may choose to revert back to the previous treatment during the transitional period.

Next steps

Towards the end of the (newly extended) transitional period, HMRC says that it will review its position and "consider the need for a further extension if necessary". This seems to suggest that there are unlikely to be any further developments in relation to the long running pensions and VAT saga any time soon.

If you would like more information or advice on any of the above, please speak to your usual Sackers' contact.

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