

## HMRC issues updated VAT guidance

Alert | 13 November 2017



### Introduction

After a long wait, HMRC has revised its [internal VAT manual](#) to make clear that the VAT treatment for professional fund management costs outlined in [Notice 700/17](#) (the so-called 70/30 recovery method) will no longer be withdrawn from 31 December 2017. Therefore, this treatment will continue to be available to employers indefinitely, alongside other (newer) methods for recovering VAT, such as the use of tripartite contracts.

### Key points

- The VAT treatment outlined in Notice 700/17 will no longer be withdrawn, as had been expected, from 31 December 2017.
- HMRC's guidance confirms that this method, alongside those alternatives set out following the CJEU decision in *PPG*, may all continue to be used going forward.
- By way of reminder, following the CJEU's judgment in the *ATP* case, HMRC accepted that UK DC pension funds which have certain key characteristics are "special investment funds" (SIFs), and therefore exempt from VAT.
- However, with effect from 1 January 2018, insurers will no longer be permitted to treat their supplies of non-SIF pension fund management services as VAT exempt insurance.

### Pensions and VAT: background

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 a 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 therefore not recoverable.

In the wake of European cases, HMRC changed its approach to VAT recovery. In the July 2013 decision in [PPG Holdings BV](#), the CJEU held that an employer that had established a DB pension scheme was entitled to deduct VAT on both day-to-day management costs and investment management services, provided that there was a “direct and immediate link” between those services and its own taxable supplies.

Following this, HMRC issued various briefs outlining [possible routes](#) for evidencing an employer’s entitlement to deduct VAT, with options including the use of tripartite contracts and VAT grouping.

## Allowing recovery to continue under VAT Notice 700/17

Whilst it reviewed different options, HMRC put a transitional period in place, running from 3 February 2014 (when HMRC first announced its change in policy) until initially 31 December 2015, during which the VAT treatment outlined in Notice 700/17 could continue to be used. This period was extended twice and was finally due to come to an end on 31 December 2017.

After much to-ing and fro-ing, HMRC has finally announced that the VAT treatment outlined in Notice 700/17 is here to stay.

HMRC’s internal VAT manual, as amended at the start of November, states that “following the review and in consideration of the difficulties encountered by some taxpayers with implementing options that would allow appropriate deduction of VAT as per *PPG*, HMRC has come to the view that the existing rules for input tax deduction will continue to be available to taxpayers going forward, together with the newer options following *PPG*.”

This gives permanence to the transitional arrangements and allows employers to adopt any of the approaches contained in the previous briefs for recovery of VAT on administrative and investment costs.

## Other options for recovering VAT

### Tripartite contracts

Subject to certain conditions being met, a tripartite contract between a supplier, pension scheme trustee and the employer may be used to recover VAT on pension scheme costs, including costs for investment services.

HMRC notes some important considerations for schemes contemplating this option:

- changes in the recipient of an investment manager’s services may have regulatory implications
- a tripartite arrangement may also have implications for an employer’s Corporation Tax deduction
- finally, a tripartite contract will not be appropriate for some supplies, in particular, where there would be a conflict of interest if the employer contracted for the services. Examples include audit, actuarial and some legal costs of the trustees.

### Trustees supplying scheme administration services to an employer

Where trustees pay third party pension service providers, they could potentially contract with an employer to supply the service of running the pension scheme on that employer’s behalf. This means that any VAT charged by the trustees to the employer would then be deductible (to the extent it relates to the taxable supplies of the employer). VAT incurred by the trustees on “administration and other general pension scheme related services (including legal, audit or actuarial services) used by it in order to make the onward

taxable supply to the employer” will then be deductible by the employer in full.

As regards VAT paid in respect of asset management services, such services must be included in the contract between the trustees and employer in order to have a “direct and immediate link” to the trustees’ supply of scheme services to the employer, and thereby be deductible. If, however, the asset management services are put to dual use, and are used for any purpose beyond that of the scheme, a full deduction in respect of the VAT will not be possible and instead would have to be apportioned between the two activities on a “fair and reasonable basis”.

### **VAT grouping**

Another option is for a corporate trustee to be included in the employer’s VAT group, provided that certain eligibility criteria are met. Once included in the VAT group, any supplies in relation to the scheme made by the trustee would be treated as being made by the representative member of the group.

Costs of administration and other general scheme related services will then be deductible in accordance with the activities of the group as a whole. However, if asset management services are put to dual use, any deduction in respect of the VAT incurred on these services would need to be apportioned (see above).

As members of a VAT group are jointly and severally liable for the tax due from the representative member, trustees would want to consider the potential liabilities this option might involve carefully. However, HMRC makes clear that it is unable to recover VAT from scheme assets, except to the extent that a VAT debt is attributable to the administration and operations of that pension scheme.

## **Insurers providing pension fund management services**

In the past, HMRC did not consider pension funds of any kind to be SIFs and therefore treated services provided in connection with all types of pension fund as falling outside the VAT exemption for fund management services. However, in the March 2014 *ATP* case (see our [Alert](#)), the CJEU found that a pension fund which pooled investments from a number of DC occupational pension schemes could be a SIF and therefore VAT exempt. Following this decision, HMRC accepted that UK DC pension funds which have certain key characteristics are SIFs and therefore exempt from VAT.

As HMRC understands that there will now be no further review of EU rules in this area before Brexit, it has [announced](#) that it intends to update its policy to reflect the settled case law. Consequently, insurers will no longer be permitted to treat their supplies of non-SIF pension fund management services as VAT exempt insurance.

In announcing this change, HMRC said that it understands that the “great majority of pension fund management services provided by insurers are supplied for [DC] pension funds and therefore qualify (and have always qualified) for exemption as SIFs”. However, we understand that some DB schemes do use fund management services provided by insurers.

The change was intended to take effect from 1 January 2018, but HMRC has apparently agreed to postpone in order to provide insurers with more time to take action. HMRC will announce the revised implementation date shortly.

## Actions

For those schemes that have continued to use the 70/30 VAT recovery method, the good news is that they can continue to do so. For trustees and employers who wish to take advantage of any of the other options for recovering VAT on pension costs, they should speak to their advisers.

DB schemes using fund management services provided by insurers may wish to seek advice on the implications of HMRC's change in policy outlined above.

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