

The NAPF/Wheels VAT Case – where is it now and what action should be taken?

Summary

This update looks at the long-running case brought by the National Association of Pension Funds (the “**NAPF**”) and Wheels Common Investment Fund Trustees (“**Wheels**”) (and others) against HMRC and the decision of the First-Tier Tax Tribunal (the “**Tribunal**”) to make a reference of certain issues central to that case to the European Court of Justice (the “**ECJ**”). Although the decision to make a reference was made in February 2011, the exact scope and terms of the reference were not known until August 2011.

Here, we explain the key implications of the NAPF/Wheels case for occupational defined benefit (including ‘final salary’) pension funds (“**DB Schemes**”), common investment funds and pension fund managers, as well as other types of pension fund. Key points to take away are as follows:

- Trustees of DB Schemes and affected common investment funds should ensure that their fund managers have filed protective claims with HMRC for the recovery of potentially overpaid VAT on fund management services.
- DB Schemes and affected common investment funds may wish to file protective claims in their own right, although HMRC has suggested that if the ECJ decides against HMRC, HMRC will only repay overpaid VAT to fund managers and it will then be up to the fund managers to repay VAT to their managed funds.
- There is a rolling VAT recovery period of four years so it may be necessary to update protective claims to cover later periods.
- Although the reference to the ECJ relates specifically to DB Schemes, other types of pension fund – in particular, defined contribution pension funds – may wish to consider asking their fund managers to make protective claims.

Background

The NAPF/Wheels VAT case concerns the VAT treatment of fund management services supplied to Wheels (a common investment fund) and three DB Schemes of the Ford Motor Company group (the “**Ford Pension Funds**”). In September 2007, after the judgement of the ECJ in *JP Morgan Fleming Claverhouse Investment Trust plc and another v Commissioners for HM Revenue and Customs [2007] (Case C-363/05)*¹, the supplier of the fund management services submitted a claim to HMRC for the repayment of VAT accounted for in respect of the supplies of fund management services to Wheels and the Ford Pension Funds, suggesting that those services should be treated as exempt from VAT under the UK VAT rules. HMRC rejected the claim, which triggered an appeal to the Tribunal by the NAPF, Wheels and the Ford Pension Funds (together, the “**Appellants**”).

HMRC’s position is based on the interpretation of a provision of the EU VAT Directive which make the “*management of special investment funds as defined by member states*” a VAT exempt supply. HMRC considers that DB Schemes are not “special investment funds” principally because they are not open to the public and because the amounts invested in a DB Scheme are ‘disconnected’ from the amount of the contribution to the fund, the investment performance of the underlying assets and the management fees paid by the fund.

¹ Here, the ECJ held that fund management services supplied to investment trusts are exempt from VAT. The UK VAT rules were amended to extend VAT exempt status to fund management services supplied to closed-ended collective investment undertakings as well as authorised unit trust schemes and open-ended investment companies. However, fund management services supplied to DB Schemes and common investment funds into which their assets are pooled are not currently recognised by HMRC as VAT exempt supplies.

The Appellants argue that DB Schemes do fall within the definition of “special investment funds” because they share the key characteristics of a collective investment fund in which a number of persons pool their investments to generate a single return from a spread of investments made by that fund. Accordingly, it would be in breach of the principle of ‘fiscal neutrality’ for DB Schemes to be treated differently to other types of collective investment funds.

The Tribunal considered it was unable to decide the appeal without guidance from the ECJ and therefore has made a reference of certain key issues to the ECJ, essentially to determine whether the term “special investment funds” is capable of extending to DB Schemes and common investment funds in which their assets are pooled. It is estimated that it will take one to two years before the reference is considered by the ECJ.

Implications

If the ECJ’s decision goes in the Appellants’ favour, it is estimated that DB Schemes receiving supplies of fund management services in the United Kingdom will save around £100 million per year in VAT costs. In addition, some pension fund managers (and pension funds themselves) may be in a position to make backdated claims against HMRC for substantial

amounts of overpaid VAT. Furthermore, although the reference to the ECJ relates specifically to DB Schemes, other types of pension fund – in particular, defined contribution pension funds – may also benefit from a decision in the Appellants’ favour and may wish to ask their fund managers to file protective claims with HMRC and/or to make protective claims themselves.

The flipside of a decision in the Appellants’ favour is that fund managers will see a very significant change in their VAT recovery position. Presently, these services are taxable supplies for VAT purposes, meaning that fund managers may recover VAT they pay on related supplies. If fund management services supplied to DB Schemes are VAT exempt, fund managers will no longer be able to recover the VAT they pay on related supplies. This may trigger an increase in fund management fees.

If you have any questions about this update, please contact Peter Steiner or your usual Mayer Brown contact.

Peter Steiner

Partner, London

+44 20 3130 3811

psteiner@mayerbrown.com

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