

Recovering VAT on pension scheme investment management services: new HMRC guidance

On 3 February 2014, HM Revenue & Customs (“HMRC”) published new [guidance](#) on the recovery of VAT paid on pensions administration and investment management services provided to pension schemes. The guidance was required as a result of last year’s Court of Justice of the European Union (“ECJ”) decision in the *PPG* case.

Background

EU legislation essentially provides that a business should be able to recover VAT paid on services if those services are used for the purposes of the company’s economic activities (assuming that the business itself makes supplies which are subject to VAT). If the services are used only partly for the company’s economic activities, the company is entitled to recover a proportion of the VAT.

In the UK, prior to publication of the new guidance, under VAT Notice 700/17 HMRC allowed employers to recover VAT paid on pensions administration services provided to their pension schemes, but not VAT paid on investment management services. Pensions administration services include collecting contributions and paying pensions, actuarial and legal advice, and accountancy and audit services. Investment management services include investment advice, professional trustee services, and custodian and brokerage charges. The employer was generally entitled to recover 30% of the VAT on investment management services unless it could provide evidence to HMRC that it should be entitled to recover a higher proportion.

In July 2013, the ECJ held in the *PPG* case that an employer was entitled to deduct the VAT charged on both the pensions administration and the investment management services provided for the benefit of its pension scheme if there was a direct and immediate link between the services and the employer’s economic

activities as a whole. The ECJ held that it was for the national court to decide whether there was a direct and immediate link.

Shortly after the judgment, HMRC announced that it would issue guidance setting out its policy on the recovery of VAT paid on fees for services provided for the benefit of pension schemes in the light of *PPG*.

HMRC guidance

HMRC’s guidance has been long-awaited. Unfortunately, the position that it sets out on VAT recovery is by no means clear.

In principle, HMRC accepts (as it has to do) that VAT on costs relating to pensions administration and investment management services can be recoverable by the employer if there is a direct and immediate link between the services received and the employer’s economic activities. The historic 70%/30% split between pensions administration and investment management expenses for invoices covering both service types has been scrapped meaning there is, in theory, no upper limit on the level of VAT that employers can recover, but also no 30% lower limit.

However, HMRC will not allow VAT to be recovered by the employer if:

- the services are not deemed to have been supplied to the employer (HMRC does not specify when it will deem services to have been supplied to the employer, but states that the question includes, but is not limited to, consideration of whether the employer has commissioned and paid for the services); or
- investment management costs alone are incurred. (HMRC does not believe that investment management services have a direct and immediate link to the employer’s economic activities.)

In addition, where the services are deemed to have been supplied to the employer and VAT is recoverable by the employer, but the pension scheme bears the cost of the services (whether by way of reimbursement or a set-off against pension contributions), HMRC will require the employer to charge the pension scheme an equivalent amount of VAT in respect of the amounts reimbursed. This VAT is potentially deductible by the pension scheme to the extent that the scheme itself is engaged in taxable business activities. Some pension schemes do engage in taxable business activities (e.g. those owning commercial property), but many of those activities are exempt from VAT, limiting the level of recovery that schemes can expect to make. Schemes would also need to be VAT-registered in order to recover VAT (a corporate trustee can be included as part of an employer's group VAT registration).

The net effect of the guidance is that it is unfortunately now harder to say with any certainty in which circumstances an employer will be able to recover VAT charged on pensions administration and investment management services. VAT Notice 700/17 will be updated to reflect the revised policy and it is to be hoped that this provides some much-needed clarity.

HMRC's revised policy applies with effect from 3 February 2014, but there will be a six month transitional period where, if the pension scheme is invoiced for the services, the 70/30 split will continue to apply.

Comment

The ECJ's decision in PPG offered the hope of improved VAT recovery on investment management services, albeit by the employer rather than the pension scheme. It is difficult to predict how HMRC will seek to apply its revised policy to any particular pension scheme and its associated employer without a detailed assessment of the particular circumstances of both scheme and employer, but HMRC seems to be using PPG to make VAT recovery in this area harder, not easier, than before. Following PPG it is for the UK courts, not HMRC, to decide whether there is a "direct and immediate link" between a supply and an employer's economic activities as a whole, and it is likely that HMRC's interpretation will in due course be challenged, so there may be further developments in this area in future.

If you have any questions about this update, please get in touch with your usual Mayer Brown contact.

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