VAT on services supplied to pension schemes: revised HMRC guidance

On 25 November 2014, HM Revenue & Customs (**"HMRC"**) published two pieces of new guidance on the charging and recovery of VAT on 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 (**"CJEU"**) decision in the *PPG* case and this year's CJEU decision in the *ATP* case.

Recovery by the employer of VAT charged on administration and investment management services

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).

In the UK, prior to February 2014, under VAT Notice 700/17 HMRC allowed employers to recover VAT paid on administration services provided to their pension schemes, but not VAT paid on investment management services. The employer was generally entitled to recover VAT on 30% of the investment management services (unless it could provide evidence to HMRC that it should be entitled to recover a higher proportion). The pension scheme was generally entitled to recover VAT on 70% of the investment management services, but its rate of recovery was usually much lower than the employer's.

In 2013, the CJEU decided in the *PPG* case that an employer was entitled to recover the VAT charged on both the administration services 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 CJEU decided that it was for the national court to decide whether there was a direct and immediate link.

In February 2014, HMRC issued guidance setting out its policy on the recovery by employers of VAT on services provided for the benefit of the employers' pension schemes in the light of PPG. Unfortunately, the position that it set out was by no means clear – for more details, please see our February 2014 legal update. The policy applied with effect from 3 February 2014, but there was a six month transitional period where, if the pension scheme was invoiced for the services, the 70/30 split would continue to apply. The transitional period was extended indefinitely in August 2014 pending revised guidance from HMRC.

HMRC'S REVISED GUIDANCE

HMRC's revised guidance reiterates HMRC's view from its February 2014 guidance that VAT is only recoverable if the services in question have been supplied to the employer. However, the revised guidance gives more detail on when services will be considered to have been supplied to the employer. HMRC notes the question will be very fact-specific, but it will not allow VAT recovery by the employer unless as a minimum "there is contemporaneous evidence that the services are provided to the employer and, in particular, the employer is a party to the contract for those services and has paid for them". The employer will also need a valid VAT invoice addressed to it.

The main change from the February 2014 guidance is that HMRC has now abandoned its distinction between administration and investment management services. VAT on both types of service will in theory be recoverable by the employer, provided that the services have been supplied to the employer.

In addition, the revised policy restates that where services have been supplied to the employer, but the employer recharges the costs of those services to the pension scheme, the employer must charge the pension scheme an equivalent amount of VAT in respect of the recharged costs. This VAT is potentially recoverable 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.

The revised guidance applies with immediate effect, but HMRC has extended the transitional period where, if the pension scheme is invoiced for the services, the 70/30 split continues to apply, until 31 December 2015. Claims for a refund of VAT are limited to periods ending four years or less before the date of the claim.

VAT status of administration and investment management services

BACKGROUND

Under the terms of the EU VAT Directive, the "management of special investment funds as defined by member states" is a VAT-exempt supply of services. Until now, HMRC has taken the position that pension schemes were not special investment funds. This position was upheld by the CJEU in 2013 in the *Wheels* case in relation to defined benefit (**"DB"**) schemes.

In March 2014, the CJEU decided in the *ATP* case that management services supplied to defined contribution (**"DC"**) schemes that satisfy the following criteria are exempt from VAT:

- the scheme is funded by the members (in this context, it does not matter if the contributions are paid by the employer);
- the scheme's funds are invested using a risk-spreading principle; and
- the members bear the investment risk.

HMRC'S NEW GUIDANCE

In light of the *ATP* decision, HMRC's new guidance states that HMRC will consider a pension scheme to be a special investment fund if:

- it is solely funded (whether directly or indirectly) by the members;
- the members bear the investment risk;
- it contains the pooled funds of several members; and
- the risk borne by the members is spread over a range of securities.

In practice, only DC schemes will be able to satisfy the above criteria as, among other things, members of DB schemes do not bear the investment risk.

HMRC plans to amend UK legislation to reflect its new guidance, but schemes can rely on the policy as set out in the guidance with immediate effect. Claims for refunds of VAT are again limited to periods ending four years or less before the date of the claim.

Comment

Where DB schemes are concerned, it seems clear that it will be necessary for there to be a tripartite services agreement between the employer, the trustees and the service provider. It will need to be clear from the agreement that the employer benefits from the services, and the employer must pay for the services and receive the VAT invoice (addressed to the employer). New agreements will need to be drafted in this way, while it will be necessary to make a variation to existing agreements to address these issues. Where the employer is able to recover the VAT, and the scheme is currently VAT-registered but does not invest in commercial property, the scheme may consider de-registering in due course.

DC schemes will need to decide whether, and to what extent, they satisfy the criteria to benefit from the "special investment fund" exemption from VAT. The wording in HMRC's guidance on the requirement for the scheme to be solely funded by the member "whether directly or indirectly" creates some ambiguity as to whether a DC occupational pension scheme which accepts both member and employer

contributions would fall outside the scope of the exemption. As this interpretation seems incompatible with the CJEU judgment, our view is that DC occupational pension schemes should work on the basis that they do fall within the exemption.

All types of scheme will need to consider whether to lodge a claim for a refund of overpaid VAT.

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

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