



# UK Indirect Tax Conference 2015

## VAT on pension costs

Fundamental changes to the VAT recovery rules and how to manage these

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# Introduction

## Where are we now?

- Revenue and Customs Brief 17/15 published on 26 October 2015.
- Current 'transitional period' extended to 31 December 2016.
- HMRC have finally started to address structuring options other than tripartite contracts.
- Still many open issues – although definitely some positive movement...
- Where does that leave pension schemes and employers as things stand now?

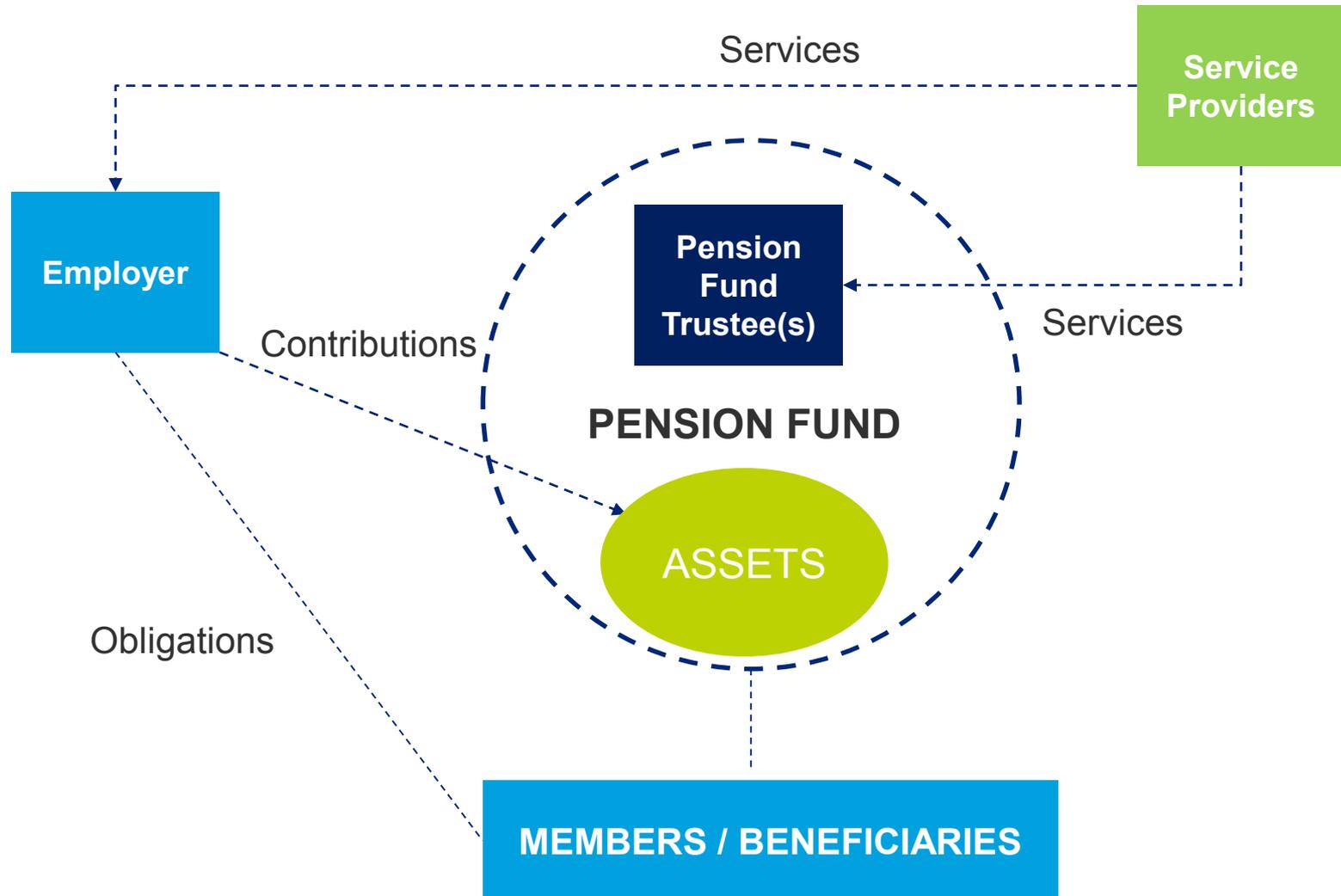
# Agenda

1. Context
2. Impact of *PPG* – HMRC policy old and new
3. Structuring options
4. Other options?
5. Retrospective *PPG* Claims
6. *ATP* – Recovery of overcharged VAT?
7. Final thoughts

# Context

# Context

A typical pension fund?



VAT recovery following *PPG*

# Impact of *PPG*

## Conflict with ‘old’ HMRC policy

- ‘Old’ HMRC practice regarding VAT recovery on scheme costs was set out in HMRC Notice 700/17, and was relatively simple.
- Key feature was a distinction between ‘management’ and ‘investment’ costs.
- Issues around contracting, invoicing and payment were less important.

### ***PPG*** judgment:

- *“an employer who has set up a pension fund... is entitled to deduct the VAT he has paid on services relating to the management and operation of that fund, provided that the existence of a **direct and immediate link**... [to the employer’s activities]... is apparent from all the circumstances of the transactions in question”.*
- A ‘direct and immediate link’ can either be:
  - (a) between the services received and specific output transaction(s); **or**
  - (b) where the cost of the services received are part of the employer’s ‘general costs’.

# Impact of *PPG*

## HMRC's post-*PPG* policy – What is it?

'Post-*PPG*' policy will apply following the end of the transitional period.

### 1. Were the supplies of services received by the employer?

- RCB 43/2014 – a “*highly fact-sensitive question that will depend on consideration of all the circumstances in which the transaction in question takes place*”.
- In HMRC's view, the employer must (as a minimum) have **contracted** for the services, **paid** for the services and have received a valid **VAT invoice**.
- Have HMRC interpreted *PPG* too narrowly? Unlikely to accept this without UK litigation.

### 2. Did the employer use the services for its business?

- RCB 8/2015 – HMRC accept that, in the case of **defined benefit** pension schemes, all pension fund management services do benefit the employer, given that the employer ultimately bears the burden of ensuring there are sufficient funds in the scheme to pay the promised benefits.

# Impact of *PPG*

## HMRC's post-*PPG* policy – What is it?

### **Extension of the transitional period**

- RCB 17/15 – HMRC have extended the transitional period by 12 months to 31 December 2016.
- However, there is the option of moving to HMRC's revised policy now.

### **Update on tripartite contracts**

- HMRC accept there will be a UK corporation tax issue arising in the case of tripartite contracts for asset management services where the employer is party to the contract and pays for the services. HMRC's view is that the employer will not be entitled to a CT deduction.
- HMRC are considering whether there are alternative tripartite structures which would enable a deduction.

### **Alternative options**

- Onward supplies and VAT grouping are identified as alternative options to tripartite contracts but are not 'signed off' by HMRC.

# Structuring options

# Structuring options

## General considerations for VAT structuring

### 1. Will HMRC accept the VAT treatment without challenge?

- Is it covered by published HMRC guidance?
- If not, has some other form of HMRC clearance/‘buy-in’ been obtained?
- Does it meet HMRC’s basic requirements – i.e. the person claiming VAT recovery has contracted for services, paid for services and received a valid VAT invoice?

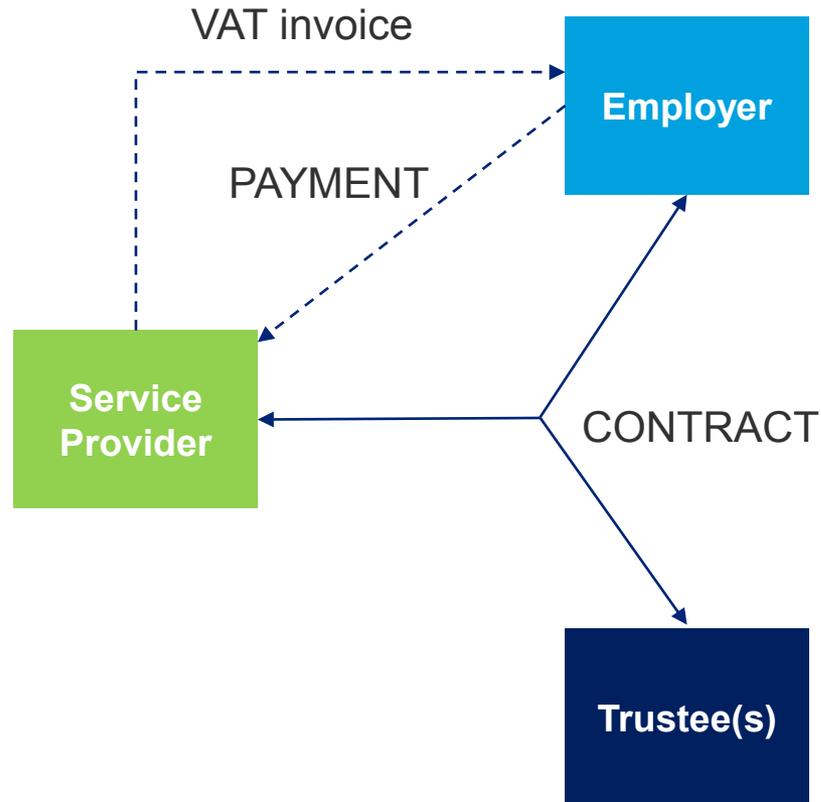
### 2. How onerous and time-consuming will it be to implement?

- Are new contracts required?
- Do third party suppliers have to agree to them?
- What levels of time, costs and management resource are involved?

### 3. What are the non-VAT implications?

- Accounting and corporation tax treatment of costs?

# Tripartite contracts



# VAT recovery of pension scheme costs

## Tripartite contracts

### Implementation:

- Need to persuade suppliers to agree to tripartite contracts.
- ‘Consultancy-type’ service providers (e.g. lawyers, accountants, actuaries) may be reluctant to enter into them due to actual or potential conflicts of interest.
- Models **may** be available – e.g. Investment Association developing Investment Management Agreement and looking to agree with HMRC that it meets all conditions for VAT recovery by the employer.

### Non-VAT implications:

- Costs sit with employer.
- Accounting and corporation tax treatment of employer payments.

# VAT recovery of pension scheme costs

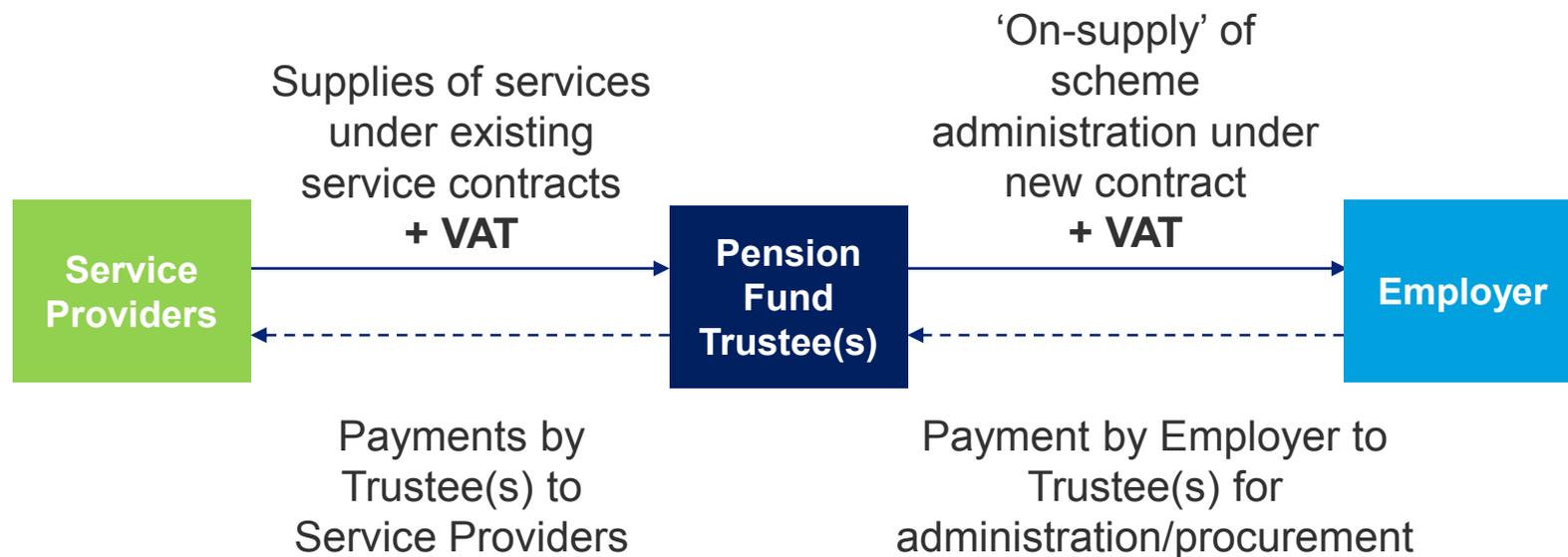
## Tripartite contracts

### VAT and HMRC position:

- Approved by HMRC in published guidance RCB 8/2015.
- But only for:
  - pension fund management services (including IM and administration);
  - provided in respect of Defined Benefit Schemes;
  - where the requirements in the ‘6 bullets’ are evidenced in the contract; and
  - where the employer pays the service provider directly and receives a VAT invoice.
- No need to obtain further HMRC clearance, provided the employer is confident that all relevant criteria are met.
- HMRC don’t agree that tripartite contracts ‘work’ for investment management in situations where the employer is already VAT grouped with a corporate trustee.
- **But** – in RCB 17/15 HMRC considered that the employer would not be entitled to a corporation tax deduction when it pays directly for ‘asset management’ (including IM) services. HMRC to do more thinking on this point.

# VAT recovery of pension scheme costs

## On-supply arrangements



## Rationale?

- Employer has an obligation to maintain suitable pension provision for its current/former employees.
- Needs the scheme to operate properly, in order to allow it to discharge that obligation.
- Therefore has an interest in ensuring that the pension fund trustee(s) procure and purchase necessary functions.

# VAT recovery of pension scheme costs

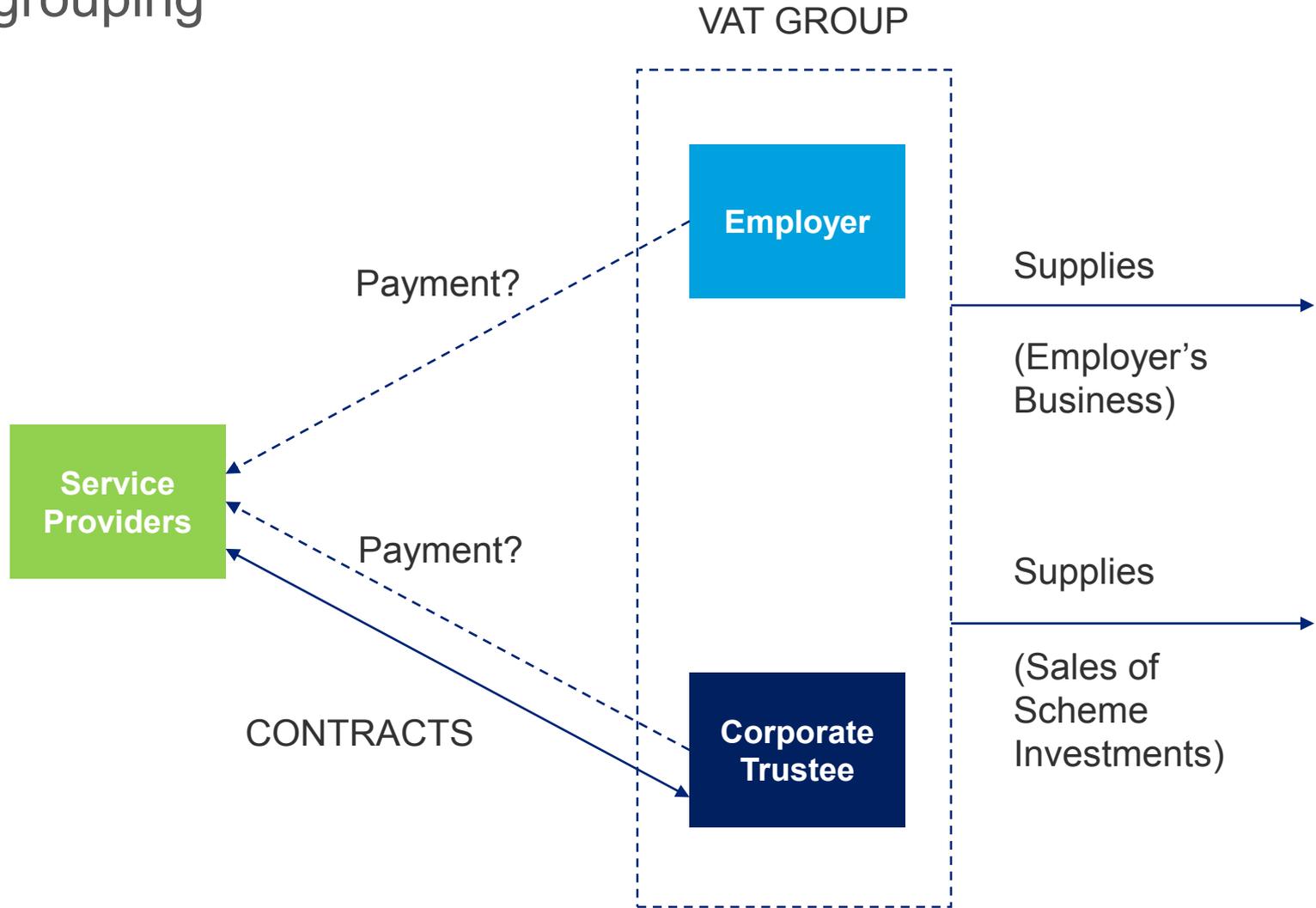
## On-supply arrangements

### VAT and HMRC position:

- Recognised as an option by HMRC in RCB 17/15.
- For administration and ‘general pension scheme related services’ (e.g. legal/audit), the trustee should recover this VAT if making an onward taxable supply to the employer.
- However, outstanding issues remain.
  - Supply by trustee(s) to employer needs to be a VAT-able supply – may be an issue for DC or mixed DC/DB schemes.
  - HMRC consider that any VAT incurred by trustee(s) on asset management services will have a link to the trustee(s)’ investment activities, likely to be VAT exempt. (However – HMRC seem to accept that the VAT may **also** have a link to the on-supply to the employer, allowing some recovery?)
  - To recover the VAT charged by the trustee(s), employer will still need to demonstrate a link between the onward supply and its own taxable supplies.

# VAT recovery of pension scheme costs

## VAT grouping



# VAT recovery of pension scheme costs

## VAT grouping

### VAT and HMRC position:

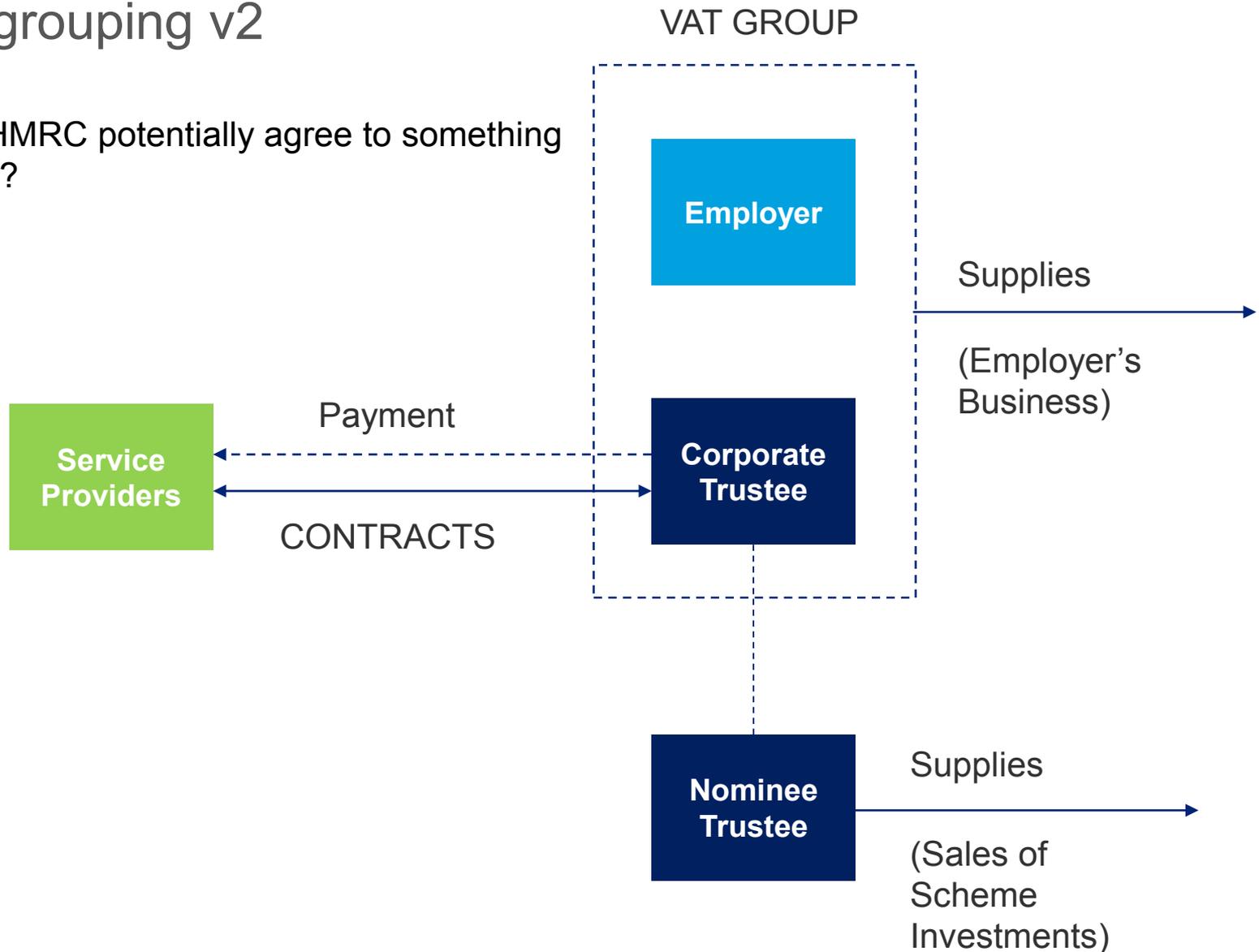
- RCB 17/15 – HMRC accept a corporate trustee can be included in a VAT group with the employer, subject to eligibility criteria.
- Following VAT grouping, any supplies by the trustee will be supplies made by the VAT group. This may impact the group's VAT recovery.
- HMRC still see a distinction between (a) 'administration and other general scheme-related services' and (b) 'asset management services':
  - VAT on administration/general services can be treated as residual.
  - VAT incurred on asset management services will link to the trustee's investment activities.
- HMRC now accept that the employer may also use the asset management services, which could allow increased recovery of the VAT incurred on them?
- HMRC confirm that where an employer and trustee are VAT grouped, the cannot enforce a VAT debt arising from the employer's business against pension scheme assets.

Other options?

# Other options?

## VAT grouping v2

Could HMRC potentially agree to something like this?



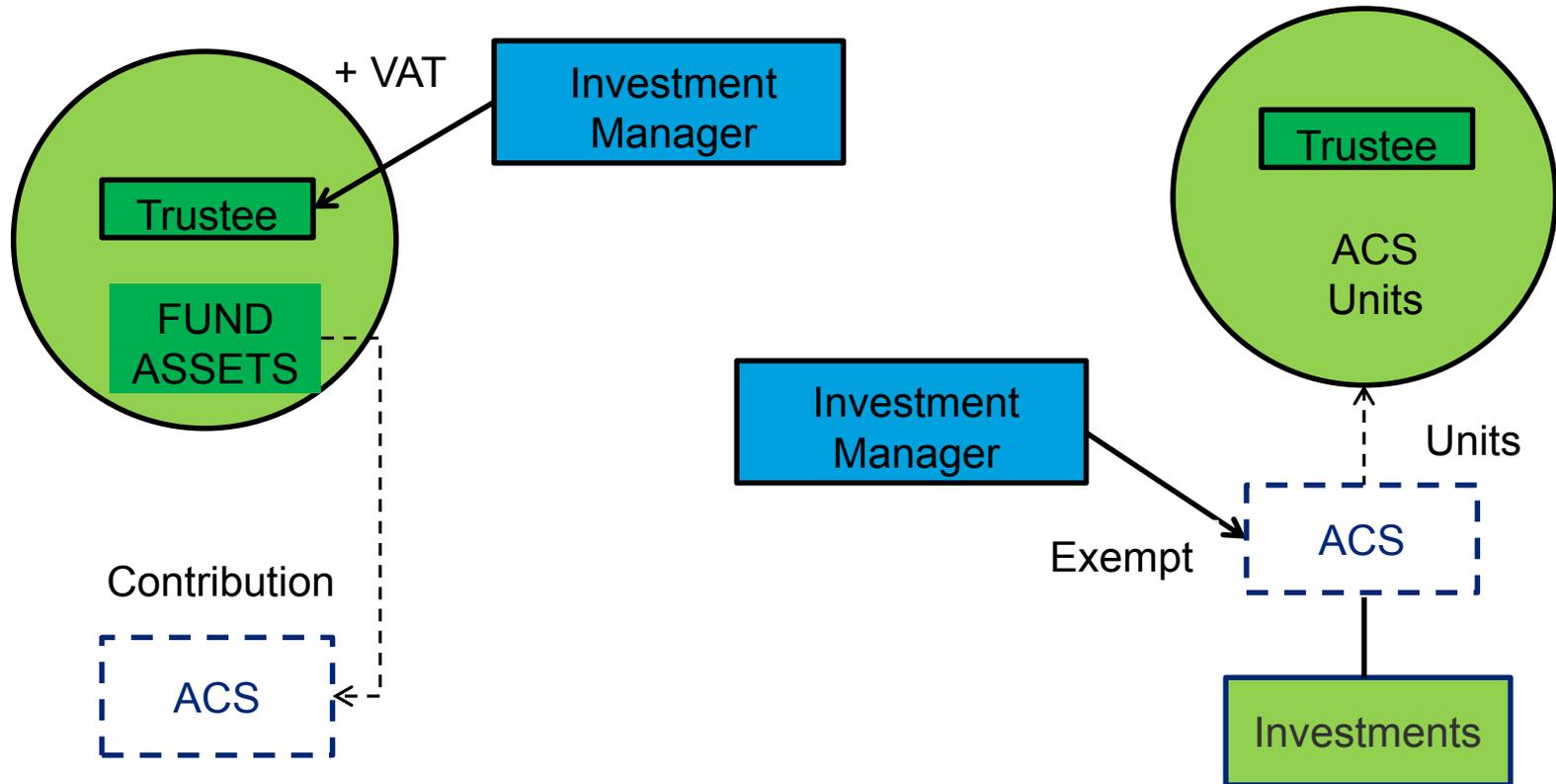
# Other options?

## Amending Trust Deed

- Proposal by Association of Pension Lawyers.
- Relevant to trust-based schemes.
- Proposal to include additional provision into Trust Deed or Scheme Rules, providing that services required to operate the scheme are procured by the trustee(s) to provide benefits to the scheme members on behalf of the employer.
- Aim is to establish direct and immediate link between services contracted for by trustee(s) and the business of employer.
- May require employer to pay for services and/or for service providers to issue VAT invoices to employer only.
- HMRC very unlikely to be able to agree to this, given position taken to date that employer must have contracted for services (in addition to paying for them and receiving a VAT invoice).

# Other options?

Use of pooling vehicles – ‘Authorised Contractual Scheme’



- Two different types of ACS – Co-ownership fund and limited partnership.
- Management of UK ACSs is **VAT exempt**. (Item 9(aa) in Schedule 9 Group 5, just before Unit Trusts and OEICs – ‘*authorised contractual scheme*’.)

# Retrospective *PPG* claims

# Retrospective input tax claims

## Claims and HMRC responses to them

- HMRC appear determined to protect historical VAT revenues.
- Claims submitted following *PPG* judgment were initially held on file pending internal discussions at HMRC.
- Started to be actively managed in May 2015.
- All claimants received a questionnaire asking for confirmation that the employer had contracted for and paid for the services, and held a VAT invoice from the supplier(s).
- Expected that very few taxpayers will be able to confirm this – resulting in the claim being rejected.
- Rejections are starting to be received.
- Taxpayers should continue to protect their position historically.
- Appeals are being lodged and it is likely that a lead case will emerge in time.

# *ATP* – implications

# VAT on pension costs

## Cases on liability

Fund management exemption (Art.135(1)(g)) – “*The management of special investment funds as defined by Member States*”.

### 1. *Wheels*

- The funds of DB schemes are not special investment funds.
- “*The members of DB schemes did not bear the risk arising from the management of the fund*”.

### 2. *ATP*

- ATP provided administrative and payment-related services to a pension fund which pooled investments from a number of DC schemes.
- ‘Management’ services **do** fall within the fund management exemption provided a number of conditions are met, including:
  - the pension schemes are funded by the members who receive the benefits;
  - the funds are invested using a risk-spreading principle; and
  - the members bear the investment risk.
- HMRC also demand (see Brief 44/2014) that “*the risk borne by the pension customers is spread over a range of **securities***”.

# Impact of *ATP*

Has too much VAT been charged?

- Funds of DC schemes can be SIFs for purposes of fund management exemption.
- Scope of ‘management’ is very wide (following *GfBk* etc.) – likely to cover a range of IM and admin functions.

## ‘Go forwards’ position?

- Work out if *ATP* applies and ask suppliers to ‘switch off’ VAT?
- Contractual implications.

## Retrospective position?

- Consider the impact of the litigation in the *Investment Trust Companies* case.
- There may be scope for a claim in restitution against HMRC.
- Need to consider claims against service providers.

# Final thoughts

# VAT on pension costs

## Final thoughts

- Transitional period end date is good news, but it is clear HMRC have lots more thinking to do.
- Tripartite option originally 'blessed' by HMRC for management services and DB schemes, but there are problems with it. Can HMRC solve them?
- There are other options – some of which may be easier to implement.
- More HMRC guidance inevitable.
- Retrospective *PPG* claims are very likely to be resisted by HMRC – but may be possible, depending on the facts.
- *ATP* may mean that employers and fund trustee(s) have been charged too much VAT by service providers in the case of DC and mixed DB/DC schemes.

# VAT on pension costs

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