SLAUGHTER AND MAY

BRIEFING
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VAT treatment of pension fund management services: HMRC brief 8 (2015)

A. OVERVIEW

1. Since the decision of the CJEU in *PPG* (Case C-26/12), HMRC have issued a succession of Briefs (namely Briefs 6, 22, 43 and 44 of 2014) setting out their evolving views on the implications of that judgment for recovery of VAT borne on pension fund management and administration services.

2. On 26 March 2015, HMRC published another Brief (Brief 8 (2015)), in which HMRC developed some aspects of their thinking regarding DB schemes. The new Brief says nothing further about DC schemes.

B. POSITION AS AT PUBLICATION OF LAST HMRC BRIEF

1. A high level summary of where HMRC had got to in their thinking as at the date of publication of their last two Briefs on this subject (25 November 2014) is as follows:

   1.1 A sponsoring employer of a DB scheme can now potentially treat the whole of the VAT borne on a supply of pension fund administration, investment management or combined administration and management as part of the employer's own input tax, provided that:

   - the employer is a party to the contract for the supply;
   - the employer pays for the supply;
   - the employer receives a VAT invoice for the supply; and, in particular
   - there is "contemporaneous evidence" that the relevant service is *provided* to the employer.

   1.2 If the employer charges to the pension scheme any costs incurred by the employer in relation to the administration or investment management of the scheme, that on-charge will represent the consideration for a taxable supply by the employer to the pension scheme trustee on which the employer will have to account for VAT output tax (unless both employer and pension scheme trustee are members of the same VAT group).

   1.3 Until 31 December 2015, the employer and pension scheme trustee can, if they wish, disregard **1.1** and **1.2** above and, instead, continue to adopt the VAT treatment of pension scheme expenditure set out in HMRC VAT Notice 700/17. Under the practice described in that Notice, the employer can:

   - recover no VAT borne on a supply of pension fund investment management alone;
   - treat 30% of the VAT borne on a combined supply of pension fund administration and investment management as part of its input tax;
   - treat 100% of the VAT borne on any supply of pension fund administration alone as part of its input tax (even if that supply would normally be treated as received by the pension fund trustee instead); and

– on-charge to the pension fund trustee any administration (but not investment) costs without accounting for VAT (regardless of whether any VAT group registration is in place).

2. As explained below, HMRC Brief 8 (2015) sets out HMRC's further thinking on points **1.1** and **1.2** above. Brief 8 (2015) also reconfirms (without change) the transitional relief outlined in **1.3** above.

C. EMPLOYER INPUT TAX RECOVERY AND TRIPARTITE CONTRACTS

1. HMRC Brief 43 went further than the two previous Briefs in describing how a sponsoring employer could, potentially, recover the VAT borne on supplies of pension fund investment management services as well as pension fund administration services. But it stopped short of explaining how this would be possible in a case where pensions law constraints prevent the contract for the relevant supply being made between the service provider and the employer alone.

2. In Brief 8 (2015), HMRC now state that, in the particular context of DB schemes, a **tripartite contract** between service provider, employer and trustee "…can be used to demonstrate that the *employer* is the recipient of a supply of DB pension fund management services…" (emphasis added).

3. That is subject, however, to the tripartite contract satisfying various criteria identified by HMRC in a succession of bullet points contained in this part of Brief 8 (2015). In outline, the tripartite contract must demonstrate that:

   – the third party service provider "makes its supplies to the employer", even though regulatory considerations may mean that the service provider was *appointed* by (or on behalf of) the pension scheme trustee;

   – the employer makes direct payment for the services supplied under the contract;

   – the service provider will normally be permitted to pursue the employer alone for payment of its charges, so that only in the event of the employer defaulting on its payment obligation (e.g. where the employer goes into administration) will it recover its charges from the pension fund trustee instead;

   – the employer, as well as the pension scheme trustee, is entitled to bring legal action against the service provider in the case of a breach of contract, but without that employer right of legal redress giving the service provider any greater liability than it would have incurred if it had contracted with the pension scheme trustee alone (and HMRC add that they do not mind if any compensatory payments falling due from the service provider go direct to the pension scheme, even if the employer brought the action giving rise to that compensation);

   – the third party service provider agrees, except in some special circumstances, to provide fund performance reports direct to the employer on request; and

   – the employer, as well as the pension scheme trustee, has a unilateral right to terminate the contract (although HMRC can tolerate the employer's termination right being subject to the pension scheme trustee giving its prior written consent).

4. In terms of the above six bullet points:

   – the second is merely a restatement of what was already in Brief 43 (2014);

   – the third to sixth are new but seem, in the main, to be unproblematic; and

   – the first is slightly more opaque, in that for the service provider properly to be regarded as making its supplies to the employer would seem to be a legal consequence of a correctly drafted tripartite contract, rather than a provision to be incorporated in the contract itself: further clarification may therefore need

to be sought from HMRC on this particular point.

5. Subject to that, Brief 8 (2015) effectively confirms that, in cases where commercial, professional and regulatory constraints allow a tripartite contract to be entered into, the use of such a contract will provide a mechanism for reconciling the pensions law requirement that the pension scheme trustee must contract directly with any provider of certain categories of service with the VAT law requirement that the employer must normally contract and pay for a service on which it wishes to recover any applicable VAT. To that extent, the new Brief is a useful development in HMRC's thinking on the implications of the *PPG* decision.

D. PASSING ON BY EMPLOYER OF COSTS TO PENSION FUND TRUSTEE

1. Brief 8 (2015) reconfirms that, upon expiry of the above-mentioned transitional period on 31 December 2015, the on-charging by an employer to a pension fund trustee of any category of pension fund expenditure will (except where a group registration is in place) crystallise a taxable supply on which the employer will be liable to account for output tax.

2. In Brief 8 (2015), however, HMRC, for the first time, effectively qualify that statement by acknowledging that not every type of arrangement for putting the employer back in funds for costs incurred by it in relation to pension fund management and administration will constitute a payment of "consideration" for VAT purposes.

3. HMRC state that if, in the course of a periodic review of the necessary level of contributions to be made by the employer to the pension fund in order to keep its assets at a sufficient level to meet pension benefit commitments, an adjustment is made to take account of the fact that it is the employer, rather than the fund, that is paying for certain types of expenditure, the recognition, in the overall course of the process of computation of future employer contributions, of that employer outgoing does not constitute consideration for a taxable supply by the employer. That is subject, however, to there being "no specific reduction equal to the actual costs that were incurred in any given period".

   Comment: In other words, in order for this mechanism to be VAT-effective, HMRC expect to see a certain degree of subtlety in the drafting of the adjustments to the Schedule of Contributions, rather than merely a simple direct set-off of a specific cost incurred by the employer against the contributions otherwise payable by it. Conceivably further dialogue with HMRC may be needed to determine what types of language will pass muster for this purpose and what types will not.

E. MATTERS NOT COVERED IN BRIEF 8 (2015)

1. In the opening part of the new Brief, HMRC acknowledge that the *PPG* judgment has given rise to certain other, as yet unresolved, issues regarding the VAT treatment of pension fund management services. Those other issues include:

   – certain specialist types of pension fund related service, such as legal, actuarial and accounting services

     Comment: the issue here is that the provider of such a service may frequently be unable, for professional or other reasons, to enter into the type of tripartite contract discussed in **C** above.

   – the admission of the corporate trustee of a pension fund to the same VAT group as the sponsoring employer

     Comment: it appears that HMRC are still considering the wider VAT implications of such grouping.

2. HMRC offer no further observations on those subjects in Brief 8 (2015), noting merely that HMRC "intends to provide further guidance in the summer".

F. CONCLUSION

1. In Brief 8 (2015), HMRC have gone further than before in identifying how it may be possible, in light of the *PPG* judgment:

   – to restructure a pension fund investment management contract in order to allow the employer to treat 100%, rather than just 30%, of the VAT borne on the supply as part of the employer's "overheads" input tax; and

   – for the employer (if it wishes) to pass on the cost of those (or other pension fund) services to the pension fund trustee without thereby creating an output tax exposure which cancels out that input tax credit.

2. However, on both of those matters, HMRC have still left some points of slight uncertainty which may require further dialogue with HMRC to achieve a robust conclusion.

3. Moreover, HMRC have acknowledged that there are other issues in this area which require further consideration on their part before any public guidance can be given.

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