**Association of Consulting Actuaries**

**2016 Annual Conference**

## PENSION SCHEMES AND VAT

### Introduction

HM Revenue & Customs ("HMRC") has been forced by the European Court to rethink its approach to when sponsoring employers can recover VAT on pension scheme costs, including investment management fees. Its proposed approach is rather complex and will still treat investment management fees differently to other administration costs. This talk will review how we have reached the current situation with HMRC and how HMRC expects pension scheme costs to be structured going forwards if sponsoring employers are going to be able to recover VAT on fees incurred by the trustees.

### Background

Historically, HMRC has had a policy of allowing sponsoring employers to treat input VAT on pension scheme "administration" costs as its own input VAT. These administration costs have including the costs of establishing and the "day-to-day management" management of a pension scheme and include, for example, benefit administration costs, audit fees and advisory costs (legal, actuarial etc).

While HMRC's policy stated that sponsoring employers can only treat VAT in this way if the invoice is addressed to the sponsoring employer, a wide variety of practices have been put in place which all appear to have gone unchallenged by HMRC. These practices include allowing the sponsor to recover VAT where the suppler addresses the invoice to the pension scheme's trustees.

However, HMRC has consistently maintained that sponsoring employers may not recover input VAT on pension scheme investment management costs. The rationale for this approach has been that investment management is purely an activity of the pension scheme and so has no connection to the sponsoring employer's business. In a typical balance of cost, defined benefit pension scheme, this has always been a difficult rationale to accept and it has been (and continues to be) challenged in various ways. For example, the *Wheels Common Investment Fund* case argued unsuccessfully that investment management services to defined benefit pension schemes should be exempt from VAT.

The only concession HMRC has been willing to make in relation to investment management costs is to accept that 30% of an invoice from an investment manager can be said to relate to scheme administration – on the basis that the manager will be providing reports and other "administration" services as well as pure investment management services.

**PPG Industries**

A Dutch pension scheme has now forced HMRC into a change of approach. PPG established a pension scheme, which was legally separate from the company, and paid directly for the investment managements costs. The European Court held that PPG could treat the VAT on the investment management costs as its own input VAT because there was a direct link between these costs and the amount PPG would charge its own customers. In other words, the lower the pension scheme's investment returns, the higher the contributions from PPG into the pension scheme and the more PPG would need to charge its customers.

**HMRC's response to PPG**

HMRC has now changed its approach to pension scheme VAT as a result of the PPG Industries case. HMRC now accept that sponsoring employers can recover VAT on investment management costs but only where sponsoring employers can show a direct link between these costs and their own businesses.

In order to be able to demonstrate this link, HMRC requires the sponsoring employer to be a party to the investment management agreement, to receive a supply under that agreement (eg investment performance reports) and to be required to pay directly to the manager the investment management costs. While there are potential corporation tax deduction issues in relation to such direct payments, it should be possible to overcome these issues and discussions with HMRC are continuing in this regard.

These issues regarding VAT on investment management costs have also had a knock-on impact in relation to VAT on scheme administration costs. It appears that HMRC will no longer permit the sorts of practices that have previously been unchallenged. Going forwards, VAT can probably only be recovered by a sponsoring employer in relation to pension scheme administration costs if the VAT is properly accounted for. This might be achieved by the pension scheme trustees registering for VAT, for the supplier to invoice the trustees and for there to be a separate agreement between the trustees and the sponsoring employer under which the trustees will invoice the employer (including VAT) for managing the pension scheme.

## Next steps

Although we now have until the end of 2016 to put new arrangements in place to enable sponsoring employers to recover VAT on pension scheme costs, most employers will need every day of this period to analyse what they are currently doing and to determine what arrangements will work best for them going forwards. There is no "one size fits all" solution to this issue and consideration of this issue should start without delay!

**Fraser Sparks**
**PricewaterhouseCoopers Legal LLP**
**January 2016**

This note has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers Legal LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2016 PricewaterhouseCoopers Legal LLP. All rights reserved. PricewaterhouseCoopers Legal LLP is a member of the PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.