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Sixty second summary

Pensions VAT: guidance revised

Her Majesty's Revenue and Customs (HMRC) has (without fanfare) updated sections of its internal guidance on the ability of employers to reclaim VAT expended on pension scheme costs.[1] Most notably, taxpayers will *not* be required to implement new arrangements in order to facilitate VAT deduction after 31 December 2017: the ability to use historical pensions VAT practices will continue, seemingly indefinitely. However, alternative arrangements may need to be considered in order to maximize the VAT reclaimable. This issue mainly affects defined benefit (DB) schemes.

Background

A decision of the European Court of Justice (ECJ), in 2013, forced HMRC to reconsider its historical stance on employers' ability to recover VAT incurred in the operation of occupational pension schemes.[2] In principle, it should have made it possible to recoup materially higher amounts of VAT.[3] The reality has turned out to be much more complicated, and HMRC has been working ever since to produce suitable guidance on the sorts of structural and contractual arrangements that can be used to optimize VAT efficiency.

To give people time to adapt to the resulting change in policy, HMRC announced a transitional period during which employers could continue to submit VAT claims on the basis of its historical (pre-ECJ-judgment) guidance.[4] The transitional period originally ended six months after the publication of the first Revenue and Customs Brief on the subject, in February 2014. The deadline was repeatedly extended, to 31 December 2015, then to 31 December 2016, and eventually to 31 December 2017.

Revised guidance

HMRC updated one of its VAT guidance manuals on 1 November, with regard to the ability to reclaim VAT paid on costs relating to occupational (mainly DB) pension schemes. The transitional period that was due to expire on 31 December 2017 is being extended, apparently without end. This means that existing rules for VAT deduction, including the assumed 70:30 split for combination investment–administration invoices, will continue to be available for use, alongside the new arrangements that HMRC put forward following the ECJ judgment. It says that '*Which option is applied will depend on whether the employer does or does not directly contract and pay for the services used to run the pension scheme.*'

Notably, the revised guidance says that VAT on investment costs—the perennial sticking point—'*must be treated differently to administration costs*', and that it '*can only be deducted by the employer when it contracts with the supplier directly for the services and pays for them itself*'.[5] There is no additional guidance on how to do that: HMRC continues to mention tripartite

[1] The part of the *Vat Input Tax* manual beginning at VIT44600 (*Specific issues: funded occupational pension schemes*) <www.gov.uk/hmrc-internal-manuals/vat-input-tax/vit44600>.
[2] *Fiscale eenheid PPG Holdings BV cs te Hoogezand v Inspecteur van de Belastingdienst.* (Case C-26/12).
[3] The judgment primarily affected private-sector schemes providing defined benefits. The VAT treatment of defined contribution pension funds was also shaken up around the same time, but by a different ECJ case. Local authorities and other public bodies have their own VAT rules.
[4] The old rules are set out in *VAT Notice 700/17: Funded Pension Schemes* <www.gov.uk/government/publications/vat-notice-70017-funded-pension-schemes>.
[5] VIT44700 (*Specific issues: employers with funded pension schemes—arrangements where the employer does not directly contract and pay for the services*) <www.gov.uk/hmrc-internal-manuals/vat-input-tax/vit44700>.

contracts, onward supply arrangements and VAT grouping, but without offering solutions to the problems that come with each of those solutions.

Historical arrangements

Prior to the ECJ judgment, HMRC refused to allow employers to reclaim VAT attributable to investment activity; only administration costs could be recouped. In principle, therefore, a supplier that provided a mix of 'investment' and 'administration' services would have to issue a separate invoice for each type of service, or at the very least clearly apportion its VAT between the two categories. As a concession, however, when a supplier issued a single invoice covering both administration and investment services, HMRC has allowed employers to simply assume that thirty per cent of the VAT relates to administration, and is therefore recoverable.

The revised guidance allows for this practice to continue.

Alternative arrangements & their disadvantages

Following the ECJ judgment, HMRC announced that employers would only be able to reclaim pensions VAT if they directly contracted and paid for the services. The industry quickly objected that the legal and regulatory context within which some pension scheme services are provided can make this difficult, or indeed impossible. Discussions soon focused on three solutions to this problem.

Tripartite contracts

It was suggested that services could be provided under a tripartite contract between a supplier, the pension scheme trustees and the sponsoring employer. However, that would be inappropriate in the case of the scheme actuary, auditor and legal adviser appointments that trustees must make under statute. In addition, HMRC confirmed that an employer that pays for asset-management costs under a tripartite contract will not be entitled to a corporation tax deduction in respect of the outlay.

Onward supply & VAT grouping

One alternative is for the employer to enter into a contract with the pension scheme trustees, in accordance with which they undertake to operate the pension scheme on the employer's behalf. The trustees contract with service providers, which issue VAT invoices to the trustees, who then present their own VAT invoices to the employer (the trustees have to be VAT-registered in their own right for this to work).

The other suggestion is to arrange for a corporate trustee to become part of the same VAT group as the employer. The group registers for VAT in the name of a representative member (the employer, for example), and is thereafter treated as a single entity for VAT purposes. The VAT incurred by the trustee can be deducted by the representative member to the extent that it is attributable to VAT-able supplies made outside the group: for example, the goods or services provided by the group businesses to their customers.

The onward supply and VAT grouping options suffer from similar drawbacks. Any investment costs incurred are considered by HMRC to be used both for the trustees' investment activities and for the supplies made by the trustees to the employer (where the onward supply approach is taken) or the supplies made by the employer itself (as part of a VAT group). Where that sort of '*dual use*' applies, it appears that the full amount of the VAT cannot be recouped.

It seems that employers and trustees will need to separately consider each of the services required to operate the pension scheme, and how VAT recoverability can be maximized for each. Expert advice may be required. The ability to continue with longstanding VAT-reclamation practices should remove the pressure to shoe-horn statutory appointments into 'tripartite' contracts. Trustees and employers may, however, have to accept that VAT on 'investment services' can never be fully recouped. Having said that, court rulings on challenges to HMRC's pensions VAT stance could still change the position; and goodness knows how VAT policy will develop after the UK leaves the European Union…