Pension schemes and VAT – further guidance from HMRC

April 2015

HIGHLIGHTS

HMRC has published eagerly awaited guidance (Revenue and Customs Brief 8 (2015)) on the deduction of VAT on pension fund management costs. The brief is limited to administration and investment services provided to DB schemes but does provide clarification in certain areas:

• tripartite contracts between the sponsoring employer, trustees and service provider may be used in relation to administration and investment services to demonstrate that the services are supplied to the employer (meaning that the employer may potentially reclaim the VAT on fees for those services);

• the employer must pay for the services directly – the employer will not be able to reclaim VAT where it has reimbursed the trustees for fees they have paid.

The guidance sets out HMRC’s requirements for tripartite contracts. However, it does not fully address the trust and pensions law and other constraints facing trustees when deciding whether to enter into a tripartite agreement with their service provider and sponsoring employer.

Further guidance is expected in the summer on areas not covered by Brief 8/2015, including recovery of VAT on fees in respect of other services to pension schemes; VAT treatment of services to defined contribution (DC) schemes; and the use of VAT grouping when reclaiming VAT on pension scheme services.

BACKGROUND

Historically, HMRC has divided the services received by occupational pension schemes into:

• administration (or management) services; and

• investment services.

HMRC allowed sponsoring employers of pension schemes to recover VAT on administration services but not on investment services. Where services straddled both, they allowed a split of 70/30 (where 30% of the invoice was attributed to "administration" and VAT could, therefore, be recovered on that part by the employer). Recent decisions of the Court of Justice of the European Union (namely the cases of PPG Holdings (C-26/12) and ATP PensionService (C-464/12)) prompted HMRC to rethink its position. HMRC issued two previous Revenue and Customs Briefs in February (Brief 06/14) and May (Brief 22/14), followed by further Revenue and Customs Briefs (43/2014 and 44/2014), issued on 25 November 2014. These Briefs left some issues unclear.

SCOPE OF LATEST BRIEF 8/2015

Brief 8/2015 is limited in scope, as it only addresses VAT recovery in respect of pension fund management services (ie administration and investment services) provided to defined benefit (DB) schemes. It focusses on use of tripartite contracts between the sponsoring employer, trustees and service provider as a means of achieving VAT recoverability.

Brief 8/2015 does not cover VAT recoverability in relation to:

• Other services used by pension schemes (for example: legal, actuarial and accounting services)

• Other types of pension scheme, such as defined contribution (DC) or hybrid schemes

• Use of VAT groups including a corporate pension trustee and a sponsoring employer.

HMRC intends to provide further guidance on these areas in summer 2015.

TRIPARTITE CONTRACTS

HMRC has made clear that, for an employer to deduct VAT paid in respect of particular services, the service must be supplied to the employer. However, it accepts that for DB pension schemes there are usually two potential recipients of the supplies: the employer and the pension scheme through its trustees. Trust law and regulatory constraints mean that in many cases the employer cannot simply contract with the service provider alone.

HMRC has accepted that tripartite contracts between the employer, trustees and service provider can be used to demonstrate that the employer is the recipient of a supply of DB pension fund management services (and may therefore be entitled to recover VAT on those services).

However, balancing HMRC requirements for VAT recoverability with constraints of pension legislation and trustees’ general duties is not simple.

At a minimum, HMRC expects a tripartite contract to evidence that:

• The service provider makes its supplies to the employer (even though the provider may be appointed by or on behalf of the trustees).

• The employer pays the provider directly for the services supplied.
• If the provider is not paid the fees it is owed, it will pursue the employer for payment (and only pursue the trustees if, for example, the employer has entered administration).

• If there is a breach of contract by the provider, the provider will be liable to both the employer and the trustees, although:
  - the compensation due may be capped at the level which would have been due to the trustees if the contract had been with the trustees alone; and
  - any compensation may be payable to the trustees rather than the employer (for example, in circumstances where the scheme is not fully funded).

• The service provider must supply fund performance reports to the employer on request, although the trustees may require the reports to be withheld, for example where there could be a conflict of interest.

• The employer must have a right to terminate the contract, although this may be subject to the trustees’ consent. In addition, the trustees may have a right to terminate the contract unilaterally.

Actions to avoid
If the employer pays the service provider’s fees but then recharges the trustees for the fees it has paid, VAT will be chargeable on the recharge.

If the trustees pay a service provider’s fees on behalf of the employer, or the employer reimburses the fees paid by the trustees, this will not be treated as direct payment by the employer, and so it will not be able to reclaim the VAT on the fees.

If the employer’s contributions to the scheme are reduced by specific amounts to take account of specific fees paid by the employer to service providers in a particular period, HMRC will treat this offsetting in the same way as a recharge by the employer to the trustees on which VAT will be due.

However, a general review and reduction of employer contributions to recognise that the employer is now paying service providers’ fees, will not be treated as a recharge. Careful drafting will be needed when revising a scheme’s schedule of contributions.

TRANSITIONAL PERIOD
HMRC has confirmed that, if they wish, employers may continue to apply the previous HMRC policy (allowing VAT recovery by the employer on administration services and 30% of combined services) up to 31 December 2015. Employers and trustees should agree which VAT treatment they will choose, but may not "mix and match" elements of both the previous treatment and the new treatment in respect of the same period.

NEXT STEPS
Trustees and employers should consider the impact of a reduction in VAT recoverability and whether they wish to take steps to minimise this. Your usual Hogan Lovells contact should be able to assist you with this.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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