

HMRC has revised its policy¹ on the recovery of VAT on pensions investment management costs following a decision² in the Court of Justice of the European Union concerning a Dutch employer and its pension plan. *This is an important development and will have a direct impact on both employers and trustees in the treatment of expenses in occupational defined benefit plans.*

Position Before Now

HMRC has allowed employers to deduct VAT in relation to the general cost of an occupational pension plan on the basis that this is an overhead of the sponsoring employer and has a "direct and immediate link" to the employer's business activities. Employers cannot deduct VAT on investment management costs as these were considered to be an activity of the pension fund (not the employer). Where a combined invoice was issued covering both general costs and investment management and the total cost was passed on to the employer, HMRC allowed employers to reclaim VAT on a notional 30% of the amount, with the remaining 70% deemed to relate to investment management (so not recoverable).

HMRC's New Stance and Its Impact

Following the Dutch VAT case, HMRC is now taking a harder line on the direct link between input tax and output tax. A company must still establish a "direct and immediate link" between the services it has received and the taxable supplies that the business makes. VAT on investment management services alone still cannot be recovered, but where those management services could include services that go further than the management of the plan's investments (and so their costs can be regarded as "general costs"), they could be recoverable by the employer if a series of conditions prescribed by HMRC can be met.

Whilst this could mean that an employer may be able to recover VAT in circumstances where it could not do so previously, in practice, this potential upside is likely to be very limited. HMRC's conditions include a requirement that the employer company must receive the supply for VAT purposes including consideration of whether the employer company has commissioned and paid for the services. The reality of most investment management arrangements, both under legislation and under the contract terms which govern the arrangements, are that the services covered are squarely in the control of the trustees of the pension plan and not the employer. Accordingly, the costs charged cannot easily be seen as having a direct and immediate link to the employer in a manner which would now meet HMRC's criteria for recovery.

As a further consequence, HMRC is also now revoking its previous 70/30 policy. After a transitional period to 3 August 2014, an employer must clearly establish that the costs on which it claims VAT recovery are actually general costs. This is likely to lead to lower recovery overall, unless plan expenses included in combined invoices can be attributable to general costs to meet the HMRC criteria. Any lower recovery by the employer could also impact adversely on the plan, if this impacts the employer's ability or inclination to meet the plan's costs.

Action Needed

- The employer's ability to recover VAT (particularly from 3 August 2014) should be established, and a cost benefit analysis undertaken to assess any potential savings.
- Expense treatment, and accounting and contractual arrangements, for both employers and trustees should be re-examined to see if they can be renegotiated in order to maximise the amount of VAT recovery.
- If any tax efficient transfer of costs is achievable and is to be implemented, the schedule of contributions and funding policy for the plan should be reviewed as it may need to be altered.
- Employers may be able to make a VAT recovery claim in the light of the new policy, subject to a four year retrospective recovery which caps potential claims. This is a complex area on which advice should be sought.

Time is short and we would urge employers to seek expert advice on their position and to involve trustees in discussions at an early stage.

Further Information

For further information please contact any of the partners listed or your usual contact in the Squire Sanders Pensions Team.

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1 Business Brief 06/14. This Brief only relates to occupational defined benefit plans. A separate judgment relating to VAT recovery in relation to defined contribution pension plans is expected soon.
2 Fiscale Eenheid PPG Holdings BV cs te Hoogezand (C26/12)