

# Association of Financial Mutuals

VAT update

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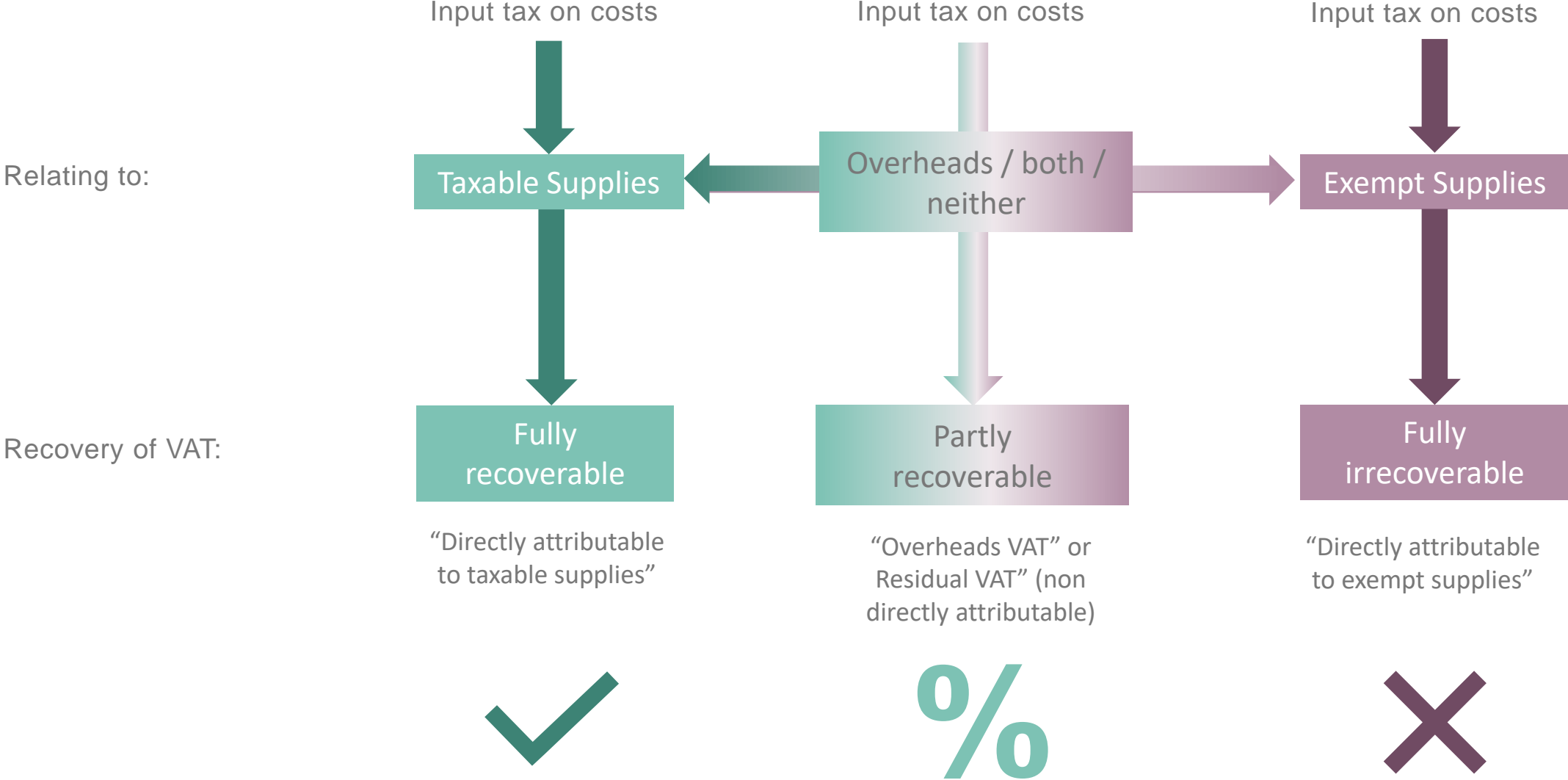
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Partial exemption  
**VAT recovery update**



# VAT recovery and partial exemption



# Partial exemption frameworks

- Standard methods are rarely suitable for complex financial services or insurance businesses
- Extended delays with negotiating and agreeing special methods with HMRC (often several years):
  - Cant agree piecemeal changes – have to review and renegotiate entire method
- HMRC have published frameworks to assist:
  - Intended as a ‘safe harbour’ to promote consistency of PESH approaches – using recommended methodologies likely to be easier to agree
  - Still open (in theory) to taxpayers to agree a different approach to suit their business
- Insurance sector partial exemption framework agreed with ABI and published January 2023
  - ‘fair and reasonable’ means the special method should be:
    - robust,
    - unambiguous,
    - operable by the business without undue difficulty,
    - auditable by HMRC, and fair (reflecting the economic use of costs in making taxable and exempt supplies)
- HMRC now seeking to agree similar framework for life and pension funds



Investment management  
**VAT update**



# Fund management current exemption: a choice for taxpayers

## EU legislation / retained law: art 135(1)(g) PVD

The management of special investment funds as defined by Member States

plus

Lots of case-law to explain what this means

## UK legislation: Items 9 and 10 of Group 5, Schedule 9

The management of–

- an authorised open-ended investment company,
- an authorised contractual scheme,
- an authorised unit trust scheme,
- a Gibraltar collective investment scheme that is not an umbrella scheme,
- a sub-fund of any other Gibraltar collective investment scheme,
- an individually recognised overseas scheme that is not an umbrella scheme,
- a sub-fund of any other individually recognised overseas scheme,
- a qualifying pension fund, or
- a closed-ended collective investment undertaking

# HMRC Consultation (February 2023)

## Proposals aim:

- to improve clarity and certainty of UK VAT exemption
- remove reliance on retained EU law
- Seek to create more attractive tax environment for fund management in UK
- But intend no significant change for fund managers:
  - retain the current list of exempt funds, and
  - provide additional criteria for exemption for other funds (largely based on principles of case-law)

## Proposed criteria for funds not in the list:

- collective investment;
- operating on the principle of risk-spreading,
- return on investment must depend on the performance of the investments, and holders must bear the risk, and
- must be:
  - subject to the same conditions of competition, and
  - appeal to the same circle of investors, as a UCITS, i.e. funds intended for retail investors
  - but no requirement for state supervision (as in case-law).

# Current problems with fund management exemption

- Lack of clarity re which funds fulfil case-law criteria for exemption, e.g.:
  - unit-linked funds (functionally and economically equivalent to UCITS),
  - model portfolios
- Lack of clarity re meaning of 'management':
  - Outsourcing and the use of software
  - The Blackrock effect: why should apportionment be restricted?





# Current problems with fund management exemption (2)

- Distortions of competition re input tax recovery:
  - Services to overseas funds are (generally) outside the scope with recovery of input tax
  - Services to UK funds are (generally) exempt, i.e. no VAT recovery
  - Overseas fund managers managing UK funds in many locations may not have a similar VAT recovery restriction
  - Zero-rating would fix this but has been ruled out
  - Extensive lobbying on this point but so far unsuccessful



# Will the consultation proposals extend the current in-built distortions?

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- an authorised unit trust scheme;
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- a sub-fund of any other Gibraltar collective investment scheme;
- an individually recognised overseas scheme that is not an umbrella scheme;
- a sub-fund of any other individually recognised overseas scheme;
- a qualifying pension fund; or
- a closed-ended collective investment undertaking

- NB Fund management is not a specified supply (unlike other financial services).
- Effect on VAT recovery for UK fund managers:
  - Supplies to UK funds: exempt (no VAT charged but no VAT recovery on costs)
  - Supplies to most overseas funds: taxable but outside the scope of VAT (no VAT charged but VAT recovery allowed on related costs);
  - Supplies to exempt overseas funds (i.e. blue ones on list): exempt (no VAT charged but no VAT recovery on costs)
- By adding the new criteria to the UK rules, there is a hidden change: instead of being able to choose UK or EU rules, the EU criteria will always apply:
  - potential is to unexpectedly increase the number of overseas funds with restricted VAT recovery (may now include overseas UCITs, except those not marketed or sold to UK investors)
  - Extra admin burden to identify additional exempt funds?
  - For affected situations, will this push fund managers offshore?

# Possible solutions?

- Add fund management to the list of specified supplies?
  - would bring fund management into line with other financial services
  - dispense with the need to differentiate between overseas exempt and taxable funds.
  - But might this encourage UK-based funds to move elsewhere?
- Restrict the exemption to purely UK-based funds?
  - same potential unintended consequence of incentivising managers to move offshore.
- Widen the rules to allow (say) 30% UK investors before exemption applies to overseas funds, rather than the current 5%.
  - still likely administrative problems in identifying and monitoring affected funds, but the net would be narrower than otherwise.
- Zero-rate all fund management services, wherever the location of the funds.
  - by far the best option for industry
  - simple to administer, promotes UK fund management industry competitiveness / growth, removes incentives to move elsewhere.
  - current economic and political constraints may make this difficult



# Prudential case - Services invoiced and paid after leaving a VAT group

- Prudential received investment management services from a separate company called Silverfleet Capital Ltd (SCL) whilst both companies were member of the same VAT group.
- SCL subsequently left the VAT group and ceased providing these services. However, SCL did not issue an invoice and receive payment until after it left the group due to the long-term nature of the payments due under the IM agreements.
- HMRC considered that a continuous supply of services was being made and the tax point was created when the invoice was issued which was after SCL left the VAT group, i.e., the supply was liable to VAT.
- Prudential argued that the transaction should be treated as outside the scope of VAT since both parties were members of the same VAT group when the supplies were actually made.
- The FTT had ruled in favour of Prudential. It held that services provided whilst the supplier and recipient were members of the same VAT group were disregarded for VAT purposes, and this did not change even where the invoices were issued after the supplier had left the VAT group.
- The UT determined that:
  - the time of supply deeming provision had to take priority over the VAT grouping deeming provisions. Accordingly, a continuous supply tax point arose when the parties were no longer members of the same VAT group.
  - the supply could therefore not be disregarded under the VAT grouping provisions and was within the scope of VAT.



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