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VAT recovery on pension costs

Overview

- Investment management charges paid by the employer for an employer’s defined benefit pension scheme may be VAT-deductible
- If HMRC accepts this decision, there may be opportunity to reclaim VAT already paid on such costs

The European Court has concluded that because a Dutch employer (PPG) was required to set up its pension fund as a legally separate entity, all of the costs of managing the fund should be regarded as part of its general business costs. This meant that it could deduct the VAT it incurred not just on the management services of the fund, but also on the investment costs which the fund incurs. This is contrary to current HMRC guidance that a business cannot claim back VAT that relates to the investment activities of its pension fund. If HMRC adopts the same view, employers may be able to apply for a repayment of the VAT of which recovery has been restricted in the past.

Background

Earlier this year, the European Court decided in the Wheels case that defined benefit schemes themselves should not be treated as 'special investment funds' which would have exempted them from VAT on investment management services. Therefore, where the pension fund pays the costs of investment management for a defined benefit scheme, it would appear that VAT input tax cannot be recovered.

A key difference between the Wheels case and the PPG case discussed below is that the expenses were paid by the scheme rather than the employer in the Wheels case.

PPG decision

PPG had paid for the provision of various services, including investment management, in relation to its pension fund, which like UK schemes was required to be a legally separate entity. The Dutch tax authority had refused to allow it to deduct the VAT paid on these services but the European Court decided that the services provided to the fund had a direct and immediate link with the employing company’s taxable activities and therefore met the requirements for VAT deductibility.

With the PPG case, the employer may be able to reclaim VAT input tax on the cost of the investment services, if it, rather than the defined benefit pension fund, pays the costs. In these circumstances where the employer pays the costs, it may be difficult for HMRC to maintain its current stance - that only 30% of the invoice is VAT recoverable.

Possible impact

This case suggests that HMRC may in future be unable to prevent UK employers who have a pension scheme set up under trust from reclaiming all the input VAT to which they are entitled. As long as the investment management services provided to the scheme have a direct and immediate link with the employer’s taxable activities, employers should be able to recover all or part of any VAT paid on those costs (to the extent permissible under usual VAT rules).

It is not clear whether HMRC will accept this view or will attempt to limit the impact in some way. The time limit for submitting a claim for deduction of input tax is now limited to four years. We expect that a number of employers will now lodge claims relating to the last four years with HMRC for the recovery of VAT on investment services to UK pension funds which they have established, and where the employer has paid the costs.

HMRC historic view

Many of the expenses incurred by a UK pension scheme are subject to VAT that may be recoverable by the employer if the business is registered for VAT. However...
VAT charged on any supplies which cannot be considered as part of the employer's business, for example, direct investment advice (which is considered to be purely the trustees' responsibility), is not recoverable by the employer.

Where managers include charges for administration (or other management) as well as investment services on the same invoice, HMRC in general accepts a notional split, treating 30% of the invoice as in respect of VAT-recoverable non-investment services.

Many UK schemes are registered for VAT and are within the same VAT group as the employer. This has enabled VAT to be effectively recovered on the 30% of the fees which are deemed to be for administration. Invoices for non-investment management services are rendered to the employer and if the pension fund meets the costs the employer can issue an invoice to the pension fund within the same VAT group without the need to add VAT.

Aon Hewitt does not give tax advice and therefore employers should take advice from their normal tax advisers in relation to the PPG case.