

VAT treatment of fund management services: Consultation

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Sent to: HMTVATandExcisePolicy@hmtreasury.gov.uk

UK Finance is the collective voice for the banking and finance industry.

Representing more than 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

Executive Summary

We welcome the opportunity to respond to the HM Treasury ('HMT') and HM Revenue & Customs ('HMRC') 'VAT treatment of fund management services: Consultation' ('the ConDoc'). Please see, in the section 'Specific Questions' below, UK Finance's direct responses to the six questions asked in the ConDoc.

In summary, UK Finance does not believe that the changes set out in the ConDoc will have the desired effect of either:

- providing greater certainty over the definition of a "*Special Investment Fund*" for UK VAT purposes following the UK's exit from the European Union ('EU'); or
- supporting the UK as a location in which to establish investment managers and/or funds.

Indeed, UK Finance believes that the changes set out in the ConDoc will have a negative impact on both points.

In terms of specific points of concern, the ConDoc makes no reference to the definition of "*management*" for UK VAT purposes. In UK Finance's opinion, this is problematic, as the current UK VAT exemption for fund management relies on EU case law (*Abbey National, GfBk, DBKAG & K* etc) to define "*management*". UK Finance believes that this point needs to be addressed.

In addition, UK Finance is concerned with the changes set out in 2.3d) of the ConDoc. The proposed wording is problematic for the following reasons:

1. Explicit reference is made to the UCITS Directive – this appears to undermine the stated aim of the ConDoc, which is to remove references to EU law;
2. "*same conditions of competition ... as*" – This is a wholly subjective test and one that is arguably met by every single fund, given all operate under the same economic competition of trying to attract and retain investors; and
3. "*funds intended for retail investors*" – This is unclear, as it can be interpreted in two different ways, namely **either** 'funds that are sold to retail investors' **or** 'funds of a type that might be sold to retail investors', and also makes no distinction between UK retail investors and non-UK retail investors.

UK Finance believes this third point is critically important. Many UK funds that currently are treated as "*Special Investment Funds*" will have 'Institutional-Only' share class / units or similar

arrangements. Ultimately, the assets invested via these 'Institutional-Only' arrangements are themselves sourced from retail investors, but any narrowing of the scope of the UK VAT exemption for fund management under this principle would have significant and negative implications for the UK investment management and/or funds industry.

As such, UK Finance would urge HMT / HMRC to clarify that the UK VAT exemption for fund management will continue to apply to "*Special Investment Funds*" as a whole and that the purpose of the UK VAT exemption for fund management remains, relieving those funds of a type that might be sold to retail investors from the burden of tax.

Specific Questions

Q1. Do you agree that the proposed approach to refine the UK law covering the VAT treatment of fund management, set out above, achieves its stated aims?

A1. UK Finance does not believe that the changes set out in the ConDoc achieves the stated aims. In fact, we believe that any move from an explicit list of funds considered to be "*Special Investment Funds*" to a principles-based approach will actually *increase* uncertainty for taxpayers/HMRC and the likelihood of litigation.

Specifically, the principles set out in the ConDoc to define a "*Special Investment Fund*" either are unclear (e.g. "intended for retail investors" – see Executive Summary above) or cross-refer to other statute rather than separately defining a "*Special Investment Fund*" for UK VAT (e.g. "must be a Collective Investment" – see A4. below).

As detailed in the Executive Summary above, the ConDoc also makes no reference to the definition of "*management*" for UK VAT purposes and, in UK Finance's opinion, this is problematic.

Q2. Do the proposed legislative reforms present any issues for your business?

A2. UK Finance represents many businesses for which the proposed legislative reforms would present material issues, as noted in the Executive Summary above. Furthermore, UK Finance notes that there is no explicit reference in the ConDoc to the UK VAT treatment of non-UK funds. Under the Specified Supplies Order, non-UK funds are, in effect, only subject to the UK VAT exemption for fund management if they are '*actively marketed*' to UK retail investors. There is no definition of what constitutes '*actively marketed*'. This brings in a new and unwelcome element of subjectiveness which creates additionally uncertainty. Arguably the expectation is that amendments should seek to make the VAT rules affecting financial services clearer and not add to the opaqueness of the existing regime.

HMT's / HMRC's stated position is that there is no intention to change the scope of the UK VAT exemption for fund management under the changes set out in the ConDoc. In this regard, the absence of any specific reference to the management of non-UK funds retaining their "outside the scope with recovery" treatment, is concerning to UK Finance. We would urge HMT / HMRC to clarify the matter, especially given HMT's stated agenda to support the UK as a location to establish investment managers and/or funds.

Q3. Do you currently rely on Items 9 and 10 of Group 5, Schedule 9 VATA 1994 or exempt any transactions using that law?

A3. Businesses represented by UK Finance rely very extensively on Items 9 and 10 of Group 5, Schedule 9 VATA 1994 to exempt transactions.

As per comments in A2. above, businesses represented by UK Finance also manage a number of non-UK funds that would fall within the scope of the UK VAT exemption for fund management if there was no '*actively marketed*' test set out in the Specified Supplies Order.

Furthermore, various businesses represented by UK Finance will manage specific UK funds other than those listed in Items 9 and 10 of Group 5, Schedule 9 VATA 1994. In some cases, those businesses will have come to an explicit agreement with HMRC that the specific UK funds properly benefit from the UK VAT exemption for fund management as "*Special Investment Funds*".

Q4. Would the legal definition for 'Collective Investment' in FSMA 2000 meet the intended aim of providing much greater certainty over correct application of the associated qualifying criteria?

A4. UK Finance does not believe that using any definition of '*Collective Investment*' imported from FSMA 2000 would provide much greater certainty over correct application of the UK VAT exemption for fund management. This is because a number of funds – including DC pension funds and Investment Trust Companies – currently properly benefit from the UK VAT exemption for fund management without falling into the legal definition of '*Collective Investment*', as the assets of individual investors are legally held on a segregated basis.

Fundamentally the problem is that the UK VAT exemption for fund management, as currently set out in Items 9 and 10 of Group 5, Schedule 9 VATA 1994, does not directly correlate with any principles-based approach. The legislative changes set out in the ConDoc appear to be a direct copy of the logic used by the European Court when it decided cases such as *JP Morgan Claverhouse*, *Wheels*, *Fiscale Eenheid X* and *ATP PensionService*.

Whilst the logic helped the European Court decide what is a "*Special Investment Fund*" under the Principal VAT Directive, we do not believe that simply transposing the same wording into UK VAT legislation will be an effective way to manage UK VAT following the UK's exit from the EU. UK Finance also notes that application of the principles-based approach, as currently drafted, would materially change the scope of the UK VAT exemption for fund management, which is contrary to HMT's / HMRC's stated aims.

Q5. If the answer to 4 is no, how might the government improve the definition to attain that aim?

A5. UK Finance believes that the only way to provide certainty to taxpayers on the definition of a "*Special Investment Fund*" is to retain Items 9 and 10 of Group 5, Schedule 9 VATA 1994 as an explicit list, to be updated both to reflect current policy and as the fund management sector develops. This explicit list should be retained in UK VAT law instead of a principles-based approach.

In the absence of an explicit list of funds, UK Finance believes that extensive litigation will arise as taxpayers and HMRC seek to apply a principles-based approach to specific funds. Furthermore, as

detailed in A3. above, businesses represented by UK Finance will have previously agreed with HMRC that certain funds are properly treated as “*Special Investment Funds*”. Under a principles-based approach, these businesses will have to reassess the position of those funds, creating unnecessary extra work for both business and HMRC.

UK Finance was heavily involved in the process under which Items 9 and 10 of Group 5, Schedule 9 VATA 1994 were redrafted in 2008. UK Finance is only aware of two material changes that have been made to the scope of the UK VAT exemption for fund management since 2008, namely the addition of Authorised Contractual Schemes and Qualifying Pension Funds. As such, UK Finance does not believe that the process of updating Items 9 and 10 of Group 5, Schedule 9 VATA 1994 would be onerous for HMT / HMRC as new funds are created, especially in light of wider statutory changes that are often required for such new funds.

Q6. Are there any further VAT related modifications the government might introduce under these or future reforms to improve the fund management regime for taxpayers?

A6. As detailed in the Executive Summary above, UK Finance believes that any proposed statutory changes that exclude a definition of “*management*” for UK VAT purposes are flawed. UK Finance believes that this point needs to be addressed in order to provide certainty over the UK VAT treatment of fund management following the UK’s exit from the EU.

Furthermore, we note the previous work undertaken by various businesses represented by UK Finance with HMRC’s Policy Lab. This work concluded that the best way to advance HMT’s stated agenda to support the UK as a location to establish investment managers and/or funds would be to treat the management of UK funds as *subject to UK VAT at the zero rate*.

Application of zero-rating for fund management would ensure that UK funds are taxed on the same basis as non-UK funds when managed by a UK investment manager, such as those represented by UK Finance. Whilst we understand HMT has had to disregard the proposal at this time due to the potential upfront cost to the Exchequer, we note that there can be no better way, from a VAT perspective, to support the UK as a location to establish investment managers and/or funds.

If you have any questions relating to this response, please contact Sarah Wulff-Cochrane at sarah.wulff-cochrane@ukfinance.org.uk.

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