The VAT review for April

Speed read

This month's review covers a number of developments affecting the VAT exemption for the management of SIFs, including long-awaited changes to bring the UK rules into line with EU law, as well as the announcement of a more general review of the application of VAT to financial services after the transition period. The CJEU decision in San Domenico Vettraria SpA is potentially important for the VAT treatment of secondments. Meanwhile, the UK is consulting on bringing in requirements for large businesses to report to HMRC any uncertain tax positions they take, which would cover VAT as well as other taxes, and has announced it will introduce postponed accounting for VAT for all imports of goods following the end of the transition period.

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VAT and fund management changes

Changes to the VAT exemption for the management of special investment funds (SIFs) have finally been made and will take effect from 1 April 2020. The changes, introduced in the VAT (Finance) Order, SI 2020/209, expand the exemption for supplies of fund management provided to SIFs to bring it into line with EU law in two ways. Firstly, the exemption will apply to the management of certain defined benefit pension funds and, secondly, the legislation will no longer limit exemption to only those closed-ended listed SIFs which invest wholly or mainly in securities.

Similar changes were originally legislated in the VAT (Finance) (EU Exit) Order, SI 2019/43, to come into force on exit day. However, the government later agreed that these changes should come into effect on a fixed date in order to provide certainty about the timing of the change. Accordingly, the 2019 Order was revoked by the VAT (Finance) (EU Exit) (Revocation) Order, SI 2019/1014.

The government has now laid before Parliament the revised version of the finance order which will come into effect on 1 April 2020. The new order seeks to achieve the same changes to the scope of exemption as the 2019 Order.

Firstly, the 2020 Order will remove the requirement in note 6 of Group 5 for a closed ended collective investment undertaking (the management of which is exempted under VATA 1994 Sch 9 Group 5 item 10) to invest wholly or mainly in securities. This is intended to align domestic VAT law with the comments of the CJEU in Fiscale Eenheid X (Case C-595/13) that the exemption for the management of a SIF can, in principle, extend to a property fund, which again had already been reflected in HMRC practice on an optional basis.

Secondly, the 2020 Order provides for an extension to the UK domestic exemption for the management of SIFs in VATA 1994 Sch 9 Group 5 item 9 designed to implement the decision of the CJEU in ATP PensionService (Case C-464/12), which had already been reflected in HMRC practice, again on an optional basis. The exemption for the management of SIFs is to be extended to the management of a qualifying pension fund.

The order defines a qualifying pension fund as a pension fund which is solely funded (directly or indirectly) by its members, which pools the investments of more than one pension member, in which the members bear the investment risk and where that risk is spread over a range of investments. It should be noted that the definition requires the pension fund itself to spread the investment risk and the exemption will not apply if the pension fund invests in another fund which itself spreads the risk over a range of investments.

However, unlike the 2019 Order, the definition is now expressed to apply only to pension funds which are established in the UK or a member state. It is understood that this is intended to maintain compliance with EU law during the transition period. For the time being, this means that managers of pension funds established in member states will need to carry out due diligence on their clients to assess whether their management services could be brought within exemption. There may also be some concerns in determining the location where a pension fund is established for these purposes.

Why it matters

Whilst the decision to legislate these changes into domestic law (rather than requiring taxpayers to rely on HMRC practice) is welcome, the need to apply the exemption to non-UK pension funds (at least for the transition period) may be viewed by some managers as burdensome. It will mean that managers of pension funds in member states will be required to check whether the pension fund to which they provide their management services has the characteristics of a qualifying pension fund within the meaning of the rules. Providing management services to EU established pension funds, which would have been exempt if provided to a UK fund, will have an adverse impact on the manager’s input VAT recovery.

VAT on financial services

In his Budget on 11 March 2020, the chancellor announced a review of VAT on fund management fees alongside the establishment of an industry working group to review how financial services are treated for VAT purposes.

The review is an acknowledgement that the UK VAT treatment of financial services, and in particular the scope of relevant exemptions, has developed in piecemeal fashion, largely in response to judgments from the CJEU. It has not kept pace with developments in financial services: for example, is it right that where a retail customer receives portfolio management services direct, this is subject to VAT, whereas if that customer invests via a pooled fund, with fees charged at the fund level, no VAT is due where the fund qualifies as a SIF?

How does the use of technology to deliver financial services affect VAT liability? Does the use of an onshore UK investment vehicle by a fund lead to an unnecessary UK VAT cost that would not exist where an offshore vehicle is used?

Why it matters

Until the end of the transition period, the UK is limited by EU
law in what it can do, and therefore it may well be the case that even if there are changes agreed, these will not come into effect until post-transition. In the meantime, financial services businesses should keep an eye on what emerges from the working group, given the potential impact on their financial position.

**VAT and secondments**

In *San Domenico Vetraria SpA* (Case C-94/19), the CJEU has held that VAT is chargeable on payments from a subsidiary to its parent company in the context of a secondment of an employee, even where the amount consists of a simple reimbursement of the parent's costs. The amount of the consideration was irrelevant in determining whether there was a supply of services. In 2004, Avir seconded one of its directors to its subsidiary, San Domenico Vetraria (SDV). Avir issued invoices to SDV in amounts equal to its costs incurred in relation to the seconded director. SDV claimed input VAT recovery in relation to the amounts shown on those invoices. The Italian tax authorities rejected SDV’s claim, taking the view that there was no supply of services between a subsidiary and its parent company for a consideration in this situation.

In its decision, the CJEU emphasised the wide scope of the meaning of a supply of services, being ‘any transaction which does not constitute a supply of goods’. It was clear in this case that there was a legal relationship between Avir and SDV in relation to the secondment of the director and so the only question was whether there was a supply for a consideration. Did a mere reimbursement of costs amount to consideration?

The Commission contended that there was no direct link between the payment and the secondment in the absence of remuneration higher than the costs borne by Avir. In that situation, the secondment would not take place with the aim of receiving consideration, according to the Commission.

The CJEU rejected this argument. If it were to be established, which was a matter for the referring court to ascertain, that the payment by SDV of the amounts invoiced to it by Avir was a condition for Avir to second the director and that the subsidiary paid those amounts only in return for the secondment, there would be a direct link between the two. The amount of the consideration, and in particular the fact that it was merely equal to the costs which the taxable person incurred in providing the service, was irrelevant. As a result, in that situation the transaction should be regarded as having been carried out for consideration and subject to VAT.

### Why it matters

In the UK, HMRC has a specific policy in relation to secondments. Notice 700/34 provides that where an employer seconds a member of its staff to another business under arrangements where (very broadly) that business is responsible for paying the employee's remuneration directly to the employee and discharges the employer's obligations to pay to any third party PAYE, NICs, and similar payments relating to the employee, then such payments are disregarded in determining the value of the supply of seconding the employee. However, this treatment will not be available where the secondment of the employee is done with a view to the employer deriving financial gains from the arrangements.

It is not clear at this stage whether this practice will be affected by the decision in *San Domenico Vetraria SpA*. However, in most cases, it will be possible to avoid any tax leakage in this scenario by ensuring that the parent and subsidiary are part of the same VAT group.

### Notification of uncertain tax treatment by large taxpayers

The government has released a consultation document on the introduction of a requirement for large businesses to notify HMRC of uncertainties in the tax treatment of their filing position for tax purposes. The consultation follows on from the Budget 2020 announcement by the chancellor.

The proposal is for all large businesses to be required to notify HMRC of any tax position that they take which HMRC is likely to challenge, subject to a £1m de minimis. The administrative features of the regime will be similar in some ways to that of the senior accounting office regime. Indeed, there will be personal responsibility placed on an individual within affected organisation to ensure compliance with the potential for personal penalties to be imposed for failures to comply.

The proposed range of tax covered by the new requirement include VAT. Generally, it is proposed that the notification should be a single, annual process which encompasses all of the relevant taxes. However, since VAT returns will not necessarily align with the business’s accounting period, transactions with uncertain tax treatments which occurred within the VAT tax year preceding the date the certification is due would be notifiable as part of that certification.

### Why it matters

The consultation, and the administrative requirement it proposes, will raise many questions for businesses and their tax compliance functions. The scope of the requirement is clearly subject to a great deal of uncertainty and, in principle, requires a judgement as to what action HMRC might seek to take in relation to any tax position. It will be important for businesses to actively engage with the consultation to ensure that the obligation is ultimately workable. The consultation will run until 27 May 2020. Responses should be sent to uncertainvatnotification@hmrc.gov.uk.

### VAT postponed accounting following Brexit

From 1 January 2021, postponed accounting for VAT will apply to all imports of goods, including those from the EU. The aim of this measure is for businesses to manage administrative costs and VAT cash flow when the UK exits the EU.

In the run up to the end of 2019 and with the prospect of a no-deal Brexit and no transition period, the government published a number of amending statutory instruments to make changes to UK VAT law post-Brexit to ensure that it would continue to operate effectively in the event of a hard Brexit. In particular, since ‘acquisition VAT’ on the acquisition of goods from other member states will be replaced by ‘import VAT’, provision was made for traders to account for import VAT on a deferred basis on their VAT returns rather than at the point of customs clearance.

Following the entry into force of the withdrawal agreement with the EU, the government announced that this easement had been withdrawn, as it considered that businesses now had sufficient time to prepare for the changes. However, it now seems that these proposals have been replaced by deferred VAT accounting.

More broadly, the government has announced that it will also be reviewing its longer-term cross-border goods policy and will launch an informal consultation in spring 2020 to review the VAT and excise treatment of goods crossing the border once the UK leaves the EU.

### Why it matters

Affected businesses should review the proposals when more details are published to ensure that they meet the conditions required to benefit from the easement.