VAT RECOVERY AND PENSION SCHEMES

ATP Pension Service A/S

INTRODUCTION

The judgment in *ATP PensionService A/S v Skatteministeriet (Case C-464/12)* was delivered by the European Court of Justice on 13 March 2014. It was the latest in a line of cases concerning the VAT treatment of costs incurred by or, in relation to, pension schemes and represents **good news for defined contribution schemes**. Whereas the case for exemption of management services provided to defined benefit schemes suffered defeat in *Wheels Common Investment Fund* just over a year ago, *ATP* marks a success for defined contribution schemes on the same issue.

FACTS

ATP Pension Service A/S (**"ATP"**) provided services to pension funds in Denmark. Its main customer was PensionDanmark. PensionDanmark administers pension schemes on behalf of trade unions and employers in the public and private sectors. ATP operated a system that opened pension accounts for employees. These accounts were set up by ATP on behalf of the pension scheme members at a financial institution on the basis of information received from employers. ATP would handle payments to and from these accounts, maintain records and provide reports to the employees and employers.

ATP argued that its services should be exempt under either article 13B(d)(3) of the Sixth VAT Directive "*transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection*" (what is now article 135(d) of Directive 2006/112/EC) or article 13B(d)(6) of the Sixth VAT Directive "*the management of special investment funds as defined by Member States*" (what is now article 135(g) of Directive 2006/112/EC). The Østre Landsret referred questions to the ECJ concerning both articles. However, of greatest interest was the question as to whether the expression "*special investment funds*" covered pension funds of the type to which services were provided by ATP.

BACKGROUND CASES

The origins of the argument lie in the cases of *Abbey National (Case C-169/04)* and *JP Morgan Fleming Claverhouse (C-363-05).* The latter case did not concern pension schemes, but it raised the question as to the limits on the discretion of member states to define the scope of "*special investment schemes*". The ECJ held that member states could not exercise their discretion so as to make a distinction between different legal forms or methods of operation. The purposes of the exemption was to permit smaller investors to access the markets through different forms of fund that could engage investment advisers without incurring VAT costs. Accordingly, in the *JP Morgan Fleming* case, it was held that UK law could not grant the exemption to open-ended funds whilst denying it to closed-ended investment trust companies. This prompted the pension fund industry to sponsor its own challenge to the exclusion of pension schemes from the scope of "*special investment fund*".

DEFINED BENEFIT SCHEMES - WHY FAILED TO WIN EXEMPTION ARGUMENT

Wheels Common Investment Fund and Ors v HMRC (Case C-424/11) concerned a common investment fund for defined benefit (**"final salary"**) employer pension schemes. It was argued that such schemes should be treated as special investment funds on the basis that they represented a form of collective investment scheme and the exemption for management services supplied to them should apply to enable them to compete on a level playing field with open-ended investment funds and listed investment companies. The ECJ held that, as well as collective investment schemes within the UCITS Directive (Directive 85/611), those funds (such as investment companies) that "*at least display features that are sufficiently comparable with them to be in competition with such undertakings*" must also be regarded as special investment funds. However, the ECJ found that the fund in the *Wheels* appeal could not be regarded as a special investment fund because it provided employment-related benefits and was not open to the public. This meant that it was not sufficiently comparable with a collective investment scheme to be regarded as being in competition with such schemes. Crucially, it seemed, the members of such a scheme did not bear the risk from the management of the scheme (unlike the investors in a collective investment scheme) because the fund was held to discharge the obligations of the employer to provide the "*final salary*" pension.

DEFINED CONTRIBUTION SCHEMES - CRUCIAL DISTINCTION: INVESTMENT RISK

By contrast with the *Wheels* case, *ATP* concerned defined contribution schemes. With reference to the previous case law, the ECJ considered whether the pension funds served by ATP could be considered to be comparable with collective investment undertakings within the UCITS Directive. It remarked that "*the essential characteristic of a special investment fund is the pooling of assets of several beneficiaries, enabling the risk to be borne by those beneficiaries to be spread over a range of securities*". The pension funds in *ATP* could be distinguished from those in *Wheels*. In *Wheels* the members of the scheme did not bear the risk arising from the management of the investment fund because the amount of the pension was defined in advance based on length of service with the employer and the amount of salary. By contrast *ATP* concerned schemes where the performance of the fund itself determined the level of pension benefits, and it did not matter that the contributions to those schemes were made by the employer (although the employee could, in some cases, also make contributions).

So, in contrast to defined benefit schemes, defined contribution schemes can be regarded as "*special investment funds*" so that the provision of management services to them can be exempt. It will be interesting to see how the tax authorities in the member states respond to the decision.

IMPACT OF PPG CASE

In the UK, HMRC had already announced a policy change in response to the decision in *PPG Holdings BV (Case C-26/12).* That case concerned the ability of the employing company, as opposed to the pension fund trustees, to recover VAT on the management costs of occupational pension schemes. The ECJ held that an employer that has set up a pension fund that is legally and financially separate from the pension fund could recover the VAT incurred on administration and pension fund management services if there is a "*direct and immediate*" link between the cost of the services as a general overhead and the employer's own taxable supplies. HMRC had previously only permitted employers to recover the VAT on the administration costs borne by the employer. In Revenue and Customs Brief 6/2014 of 5 February 2014, HMRC acknowledged that the *PPG* decision meant that its policy to treat VAT on investment management costs in all cases as recoverable only by the pension fund itself was wrong. However, HMRC suggested that if there is a separate charge for investment management it would be hard to treat that as having a "*direct and immediate link*" to the supplies of the employer (so such VAT would remain irrecoverable). Therefore, the Brief indicates that VAT on such costs would only be recoverable if subsumed within a combined supply of administration and investment management. In taking this approach HMRC seem to be interpreting the *PPG* decision too narrowly. HMRC went on to reiterate that where the costs of such administration or investment management services were recharged to the pension fund by the employer, then the employer would have to charge VAT to the pension fund anyway. That would leave the pension fund to recover the VAT if it could. So HMRC are seeking to narrow the benefit of the *PPG* decision, so it appears that the decision in *ATP* is likely to be of more practical benefit to funded occupational pension schemes that are defined contribution schemes because it provides authority for the proposition that the services of management, including investment management, should be exempt as provided to a "*special investment fund*".

CONCLUSION

The decision in *ATP* is also useful to defined contribution pension schemes in what it says about what "*management*" of a special investment fund can include. The services provided by *ATP* did not amount to investment management in the normal sense, but concerned the setting up of pension accounts, crediting and debiting payments and dealing with records and reports. However, the ECJ held that these services did constitute "*management*" of the fund noting that "*crediting contributions to such accounts are essential to the management of the special investment fund*" and that "*if such services were to be made subject to VAT when provided by a third party, that would give pension funds which have decided to record themselves the contributions made by pension customers an advantage over those which have decided to make use of a third party for that purpose*".

In relation to the application of article 13B(d)(3), the ECJ also held that the exemption for transactions concerning payments also applied to the services provided by ATP in creating accounts within the pension scheme, crediting those pension accounts "*and any transactions which are ancillary to those services or which combine with those services to form a single economic supply*".

In conclusion the decision in *ATP* represents good news for funded defined contribution pension schemes. Trustees and employers should (to the extent they have not already done so) seek advice on the recovery of overpaid VAT on services provided in the past and should ensure that the relevant services are treated as exempt going forward. In the light of the recent decision in *Littlewoods Retail Limited*, compound interest may be available in addition to the wrongly paid VAT.

DLA Piper UK LLP
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David Thompson
Partner
T +44 (0)161 235 4182
david.thompson@dlapiper.com

Richard Woolich
UK Head of Tax
T +44 207 153 7336
richard.woolich@dlapiper.com

Charlotte Jones
Associate
T +44 20 7796 6338
charlotte.jones@dlapiper.com

www.dlapiper.com

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UK switchboard**:** +44 (0) 8700 111 111