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HM Treasury
1 Horse Guards Road
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Sent via: HMTVATandExcisePolicy@hmtreasury.gov.uk

Dear HM Treasury,

Response to HM Treasury's VAT treatment of fund management services: Consultation

We are grateful for the opportunity to respond to HM Treasury's ("HMT") consultation on the VAT treatment of fund management services published on 9 December 2022 (the "Consultation").

Deloitte LLP has over 20,000 professionals across our Audit & Assurance, Consulting, Financial Advisory, Risk Advisory and Tax & Legal practices, and provides advice to companies in every sector of the economy. We have a core team of specialist experts who advise clients across the investment management industry on indirect tax matters. Our submission to this timely consultation draws on the investment management expertise we have within the Indirect Tax team at Deloitte.

We welcome HMT's commitment to improving the UK VAT legislation in relation to fund management and taking the opportunity to provide a clearer and more certain legislative basis for the UK fund management exemption. Whilst we welcome the focus on clarifying and expanding the current wording of the legislation, we also consider there are additional VAT issues in the fund management sector that, in our view, it will be equally important for HMT to consider as part of the Consultation.

Our responses to the Consultation questions are set out in Appendix 1 and we would welcome the opportunity to discuss these with you further. Please contact me (details above), Hayley Smith (haylsmith@deloitte.co.uk) or Alex Beattie (abeattie@deloitte.co.uk) should you have any questions.

Yours sincerely

David O'Kane
Deloitte LLP

Enclosures.
Appendix 1: Detailed responses to the questions within the Consultation

Appendix 1 - Questions

1 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?

We agree that the current proposal does go some way to achieving greater clarity and that the proposed approach is helpful, on the basis that:

- The introduction of an additional category of Special Investment Funds ("SIFs") for collective investment arrangements meeting a specific set of conditions should future-proof the legislation to some extent, ensuring that new retail-focused collective investment arrangements launched can immediately fall within the scope of the exemption under the UK legislation, providing the relevant conditions are satisfied.

- The conditions proposed are based primarily on the existing conditions currently provided for under various EU case law meaning that there is no significant policy change in this area.

- The omission of the State Supervision condition simplifies the position as this should remove potential distortion. For example, "old-style" charity funds regulated by the Charity Commission were not recognised by HMRC as SIFs, whereas FCA-regulated "Charity Authorised Investment Funds" ("CAIFs") introduced from 1 April 2016 were – even though they essentially served the same purpose. Also this would address the dispute about whether the fund itself had to be state-supervised, or whether it was enough for the manager to be – for example in the case of AIFs, where it is the AIF manager, not the fund, which is subject to regulation.

However, there are a number of areas of uncertainty that we do not consider have been properly addressed. We have outlined these below.

1.1 Proposed wording of new UK legislation

We note that the proposal is to:

- retain the current list of funds contained in Items 9 and 10 of Group 5, Schedule 9 of VATA 1994 but not expand the list in the future; and

- add in an additional category of SIFs to the fund management exemption – i.e. collective investments meeting the specified criteria.

We have some concerns that this may lead to confusion and uncertainty on the basis that this could essentially result in a set list of fund types that will always qualify as SIFs regardless of their investor focus (e.g. ACSs marketed purely to institutional investors) and a newer conditions-based category of SIFs that only includes collective investments intended for retail investors.

We have outlined below the areas that we consider need addressing in HMT's proposals in order to achieve a practical and workable position for businesses in the investment management sector.

1.2 Scope of SIFs

We note that due to the current uncertainty in this sector there are a number of specific retail investment products that are subject to uncertainty, primarily model portfolios and unit-linked life funds.

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It is worth noting that model portfolios and unit-linked life funds do exactly the same "job" as collective funds in allowing retail investors to spread their investment exposure across multiple securities (including fund investments). For instance – if an investor either:

a) invested in a model portfolio the asset allocation for which was a particular ratio of investment funds; or

b) purchased a unit-linked life policy for which the investor's premium was invested in that ratio of investment funds;

they would end up with the same investment exposure to those investment funds as if they had purchased shares in an authorised Open-ended Investment Company ("OEIC"), where the OEIC itself invested in the same ratio of investment funds.

Equally, all three types of investment offering sit alongside each other in the wealth management sector as alternatives offered to a retail investor.

The only real difference is the "wrapper" – which includes the identity of person holding the portfolio of shares/units in the relevant investment funds – i.e. the individual investors in a model portfolio, the life insurer of the unit-linked life fund and the OEIC itself.

In each case, the relevant manager will be managing the shares/units on a collective basis, taking decisions which impact all relevant investors in the same way – i.e. all investors in the same model portfolio; all policyholders whose premiums are pooled in the same unit-linked life fund; and all shareholders in the OEIC.

So it would clearly be distortive if the manager's services were taxable in relation to model portfolios and unit-linked life funds, but exempt in relation to OEICs.

We do not consider the current proposal resolves these issues and we have outlined below in turn why we consider this to be the case.

In relation to model portfolios and life funds, the VAT treatment of their management is currently the subject of uncertainty and/or dispute. Unless there is resolution in favour of exemption, investors in the relevant products face a position where they suffer VAT on the management of the assets, in a way they would not have done had they invested directly in those assets on an advised execution basis (e.g. via an IFA) or if they had invested in an OEIC. This point was also raised by the CJEU in *Claverhouse* (*JP Morgan Fleming Claverhouse Investment Trust* (Case C-363/05)), where it held that the exclusion of certain investment funds from the fund management VAT exemption by the UK government went against the principle of fiscal neutrality.

We consider these issues will continue post the proposed changes by HMT, unless the proposals are updated to include model portfolios, life funds and equivalent collective investment arrangements in the proposed new criteria-based definition of SIFs.

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1.2.1 Model portfolios

Model portfolios are diversified pools of assets, owned by the investors in the portfolio. Each investor holds a beneficial interest in a portion of the overall pool of assets, and the asset allocation of that pool is set by the manager of the model portfolio on a collective basis.

Individual investors cannot vary the composition of the assets comprising their individual beneficial interest. Two investors with the same value of investment in the same model portfolio at any given time will always have the same beneficial interest in the same assets – i.e. the same percentage share in the model portfolio. They will achieve the same investment returns (in line with the performance of the model portfolio assets), and all investment decisions made by the model portfolio manager will impact them in the same way.

Hence, from an economic perspective, the position of each individual investor in the model portfolio is comparable to that of a shareholder or unitholder in a collective investment undertaking which is recognised as a SIF for UK VAT purposes, such as an authorised OEIC, authorised unit trust ("AUT"), investment trust or Recognised Overseas Scheme.

The difference in legal terms is that there is no separate fund entity holding the overall pool of assets, as the individual assets are beneficially owned by the individual investors directly.

Despite this legal distinction, such an arrangement clearly allows for the assets of multiple investors opting for the same model portfolio to be managed on a collective basis, in exactly the same way, leading to an economic outcome for investors which is comparable to owning shares/units in the same SIF (e.g. OEIC or AUT). The risk of each investor is spread across the range of investments in the whole model portfolio in the same way.

The key VAT issue currently faced by model portfolio managers is that HMRC have not accepted in most cases that their supplies of management can be treated as exempt (or indeed, provided a settled alternative view). Many managers have requested non-statutory clearances from HMRC on the issue, and have been told that "VAT is a self-assessing tax and the decision over whether a business' supplies are taxable, or not, is down to them". Other managers have been referred to the published guidance at VATFIN5120, which sets out the conditions for a pension fund to be a "qualifying pension fund" within Item 9(k) of Group 5, Schedule 9 to VATA 1994.

In light of this approach by HMRC, over the past two to three years, a significant number of model portfolio managers have:

- followed HMRC's "self-assess" instruction;
- applied VAT principles following *ATP* and *Fiscale Eenheid X* (as set out in HMRC published guidance); and
- come to their own view that their model portfolio management services do fall within the fund management VAT exemption as management of a SIF,

with the result that exemption for model portfolio management has effectively become market-standard in the UK, and any provider reaching a different decision and treating their model portfolio management services as taxable would in effect be making themselves uncompetitive.

We are surprised, due to the extent of this issue across the sector, that model portfolios have not been expressly referenced as part of this Consultation and we consider it is critical that model portfolios are expressly referenced in any accompanying notes or guidance, in order to provide certainty in this sector that has been lacking for a number of years. Based on our review of the proposals, we consider that model portfolios should meet the new criteria-based definition of a SIF. However, we consider it vital, to avoid the ongoing confusion, that HMRC both agree with this point and make it clear that a model portfolio is a 'Collective Investment'. We have provided further comments on the impact of the proposed definition of 'Collective Investment' in FSMA 2000 on model portfolios further at our answers to questions 4 and 5.

Our proposed solution would be for it to be accepted that the management of model portfolios on a collective basis should be treated as VAT exempt in the UK. That approach would achieve neutrality, create a level playing-field, promote investment and support the UK wealth management industry. Also, in light of the fact that a significant proportion of the sector is already applying the exemption, any indication by HMRC that they consider that model portfolios are not SIFs under the new criteria-based definition, would lead to significant upheaval in the wealth management sector.

1.2.2 Unit-linked life funds

In the same way as model portfolios, unit-linked life policies clearly represent a product which allows investors (as policyholders) to achieve investment exposure to securities whilst spreading their risk over a range of securities.

Hence, also in the same way as model portfolios, investing in a unit-linked life policy (i.e. as distinct from a "with-profits" policy) can be regarded as an alternative to purchasing a share or unit in a collective investment undertaking such as an OEIC or AUT. The value of the investor's policy is directly linked to the value of securities in the life fund which supports that policy, in the same way that the value of a purchased share or unit is directly linked to the value of securities held in the relevant fund.

However, at the time of these comments, HMRC have not accepted that the management of the life funds supporting such policies should be treated as exempt from UK VAT.

As we understand it, that position is based on a legal distinction, in that the entity holding the assets being managed is a life insurance company as opposed to a collective investment undertaking itself.

This is also the current situation in cases where all of the relevant policyholder investors in the fund are SIFs themselves (such as qualifying pension funds) – and hence would be entitled to VAT exempt management of any security assets they held directly.

There are some issues in relation to the VAT treatment of unit-linked life funds, when you consider the proposed criteria set out in 2.3 (a) to (d) of the Consultation (and read across to the definition of 'Collective Investment' in FSMA 2000). This is on the basis that it seems very clear that unit-linked life funds would fall within the definition. However, we understand that HMRC are currently litigating on the basis that life funds cannot be SIFs. Therefore, there is a mismatch between HMRC's current thinking and the HMT proposal. However, on the basis we consider the new criteria-based definition of SIFs would clearly include unit-linked life funds, we expect that this will offer a resolution to the current uncertainty that has been subject of litigation and HMRC/taxpayer disputes over many years.

Therefore, our proposed solution, in line with that in relation to model portfolios, would be for it to be accepted that the management of unit-linked life funds should be treated as VAT exempt in the UK and that this is clearly confirmed in any associated notes or HMRC guidance.

1.3 Scope of "management"

We note that the proposals put forward by HMRC only relate to the definition of a SIF and not the definition of management. Whilst the stated intention set out in the Consultation at 1.12 is to codify EU law into UK statute, there is no explicit proposal for codifying all the CJEU case law on what counts as "management". Therefore, we consider this should also be considered by HMT as part of any changes.

There has been significant case law over a number of years that has continued to expand the scope of the definition of 'management' in the context of the exemption. However, there has been a tension between this growing body of case law precedent and HMRC's application to taxpayers. HMT's proposed changes only relate to what constitutes a SIF. However, we consider it is critical that the definition of management is also properly confirmed, particularly in relation to outsourced services, to provide clear guidance to taxpayers.

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

Whilst the legislative reforms do not appear to present any new issues, the current limited scope of the changes does not appear to resolve all current issues in this sector. We have provided further detail on these issues at our responses to Questions 1, 5 and 6.

As a minimum, we request that as part of the legislative changes, there is an accompanying "allow-list" of fund types that would be covered by the new criteria-based SIF definition (that includes, at least, model portfolios, unit-linked life funds and CAIFs), either in a Statutory Instrument or HMRC guidance.

3 Do you currently rely on Items 9 and 10 of Group 5, schedule 9 of VATA or exempt any transactions using that law?

A large number of our clients rely on Items on Items 9 and 10 of Group 5, Schedule 9 of VATA and exempt transactions using that law.

4 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?

The legal definition for '*Collective Investment*' in FSMA 2000 does provide some additional clarity over the application of the qualifying criteria. However, there is still scope for interpretation and uncertainty. Therefore, we consider that in order for this legal definition to be sufficient, it is vital that it is accompanied by clear HMRC guidance and worked examples regarding how the various concepts and defined terms used in the definition should be applied in practice.

For example, regarding unit-linked life funds:

- Investors selecting the same unit-linked life product each pay a premium to the life insurer and enter into a life policy (contract of insurance).

- All those investors' premiums are pooled together in the same life fund and applied by the life insurer (in accordance with the decisions of the appointed manager of the fund) to purchase a portfolio of securities or other investments.

- The redemption value of each investor's policy is directly determined by the investment performance of that portfolio of assets.

Hence – in this way, the requirements of s.235 FSMA are clearly met.

- 235(1) - the investors taking part in the arrangements (by becoming policyholders) participate in the profits/income of the relevant property – i.e. the investment performance of the assets held in the life fund.

- 235(2) – the participants (policyholders) do not have day-to-day control over the management of the property (i.e. the life fund assets).

- 235(3)(a) - the contributions of all policyholders (i.e. their premiums) are pooled together into a single life fund – which also contains any profits/income arising from the assets purchased with those contributions and held in the life fund.

- 253(3)(b) – the property (assets held in the life fund) is managed as a whole, by the manager appointed by the life insurer.

- 253(4) – N/A, as a single fund.

Hence, in our view, unit-linked life funds would clearly represent "collective investment schemes" for the purposes of s.235 FSMA – and therefore would satisfy condition (a) of the new criteria-based SIF definition. However, given HMRC's previous approach of arguing that the management of unit-linked life-funds is not covered by the fund-management exemption (see above), taxpayers will require (at least) published guidance confirming HMRC's position before applying the exemption.

In relation to model portfolios:

- When an investor selects and invests in a model portfolio, their investment capital is used to purchase securities in accordance with the relevant model portfolio's asset allocation, in the same way as all other investors selecting the same model portfolio.

- The securities purchased for each investor are held for their benefit, either by a custodian or on an investment platform.

- A manager is appointed to monitor the asset allocation of the model portfolio and to make decisions about that asset allocation, updating it (from time to time), with a view to achieving investment returns for the investors in the model portfolio (whilst remaining compliant with the specific investment and risk profile attached to the model portfolio).

In our view, there's a strong argument that the requirements of s.235 FSMA are met.

- 235(1) - the investors all participate in the investment performance of exactly the same portfolio of assets, by themselves becoming owners of the assets.

- 235(2) – the investors do not have day-to-day control over the management of the property – i.e. the asset allocation of the model portfolio, and therefore the identity of the assets held by them.

- 235(3)(a) – technically each of the investors is the beneficial owner of their portfolio – i.e. the assets purchased for them in accordance with the asset allocation of the selected model portfolio. But from a commercial/economic perspective the result (in terms of the investment exposure of each investor) is the same as if the investors' assets had been pooled together in a single fund.

- 253(3)(b) – when the model portfolio manager makes decisions about the asset allocation of a model portfolio, these decisions are applied to the assets of every investor in the same model portfolio, in the same way. Hence the effect is that all investor's assets are managed "as a whole".

- 253(4) – N/A, as it is a single model portfolio, where all investors selecting the same model portfolio get exactly the same asset allocation, with no option to "bespoke".

Therefore, we consider that model portfolios should also be regarded as "collective investment schemes" for the purposes of s.235 FSMA – and hence considered as satisfying condition (a) of the new criteria-based SIF definition. However, it is vital for HMRC to confirm their agreement with this, given the existing market-standard practice of exempting model portfolio management – and the huge uncertainty which would arise if not confirmed.

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

We consider that introducing this additional definition could be improved by providing an accompanying "allow-list" of the different types of retail investments the definition encompasses. This allow-list of retail investment types would not itself need to be in statute. For example, it could be included in a Statutory Instrument – or even in published HMRC guidance. However, we strongly consider this needs to be accessible to taxpayers, otherwise HMT's aim of providing clarity and certainty simply will not be met.

It is worth noting that one VAT reason why Luxembourg and Ireland are attractive jurisdictions for establishing funds is that it is (generally) straightforward to establish whether a particular fund is or is not a SIF for Luxembourg/Irish VAT purposes.

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

There are a number of additional issues that would benefit from modification and clarification as part of these or future reforms to improve the fund management regime for taxpayers. We have outlined each below in more detail. In the course of our points below, we have looked to identify issues where the current position (taking account of both UK VAT law and published HMRC guidance):

a) is unclear, resulting in uncertainty and differences in treatment among service providers (i.e. legal certainty issues);

b) requires the application of complex or time-consuming analyses to determine the applicable VAT treatment (i.e. tax simplification issues);

c) results in UK funds or fund managers incurring irrecoverable VAT – thereby creating a VAT cost, and potentially undermining tax neutrality between direct investments (in which investors do not incur VAT on the acquisition, holding and disposal of securities) and indirect or collective investments; or

d) creates actual or potential distortions – e.g. between UK-established funds or managers and those established offshore.

6.1 Depositary services

As we understand, it has been HMRC policy since the 2006 judgment of the CJEU in *Abbey National* (*Abbey National plc, Inscape Investment Fund v Commissioners of Customs & Excise* (Case C-169/04)) that depositary services represent the "control and supervision" of fund activities – as opposed to fund management – and therefore are always taxable, even when supplied in relation to a SIF.

However, in our view, that policy now looks anomalous, especially from a 2021 perspective when, following *GfBk* (*GfBk Gesellschaft für Börsenkommunikation mbH v Finanzamt Bayreuth* (Case C-275/11)), it has been established for a number of years that all other fund specific administration functions do constitute "management", including (as per *GfBk* and the UCITS Directive) "regulatory compliance monitoring".

In addition, we note that a significant proportion (if not most) of the actual functions carried out under many depositary service contracts could be viewed as global custody functions, which would typically be treated as exempt in the UK if provided as a separate supply. As a practical matter, the current HMRC policy is creating real blocked input tax for UK managers and funds.

6.2 Single/Multiple supplies of management services

6.2.1 BlackRock and supplies of management

The clear implication of the CJEU judgment in *BlackRock* (*BlackRock Investment Management (UK) Ltd v Commissioners for Her Majesty's Revenue & Customs* (Case C-231/19)) is that, for a supply of management to be exempt as SIF management, the relevant services must be supplied in relation to SIFs only. If even one non-SIF is also covered by the single supply, then the relevant VAT exemption will not apply.

We understand this is also current HMRC policy. However, we note that it can produce results in a number of real-life scenarios which are distortive.

- For instance, if a UK manager is appointed under a single contract to manage a single UK pension fund, 10% of which comprises the assets of a defined benefit pension scheme and 90% the assets of a defined contribution scheme (which will be entitled to exempt management), application of that policy will result in a wholly taxable supply from the manager to the fund, even though the majority of the fund is defined contribution.

Following the end of the post-Brexit transitional period, it would be helpful for the UK fund management industry if HMRC were able to take a more pragmatic approach going forwards and support the ability of managers in the above situation to apply the exemption to 90% of the value of the management services. (We agree that the onus in such situations should be on the manager to establish that such application can be done in a fair and reasonable way.)

If this type of flexibility is not supported, we anticipate that many managers will look to manage the distortion – e.g. by "splitting" existing management contracts or fees and thereby making separate supplies of services in relation to SIFs and non-SIFs.

Given this anticipated outcome, one other thing which would be of practical help to UK managers and funds would be published HMRC guidance, setting out their view on the situations where such an approach would or would not be appropriate, or how the split should or should not be done.

- For instance, in a situation where an outsourced service provider contracted with a fund manager to carry out fund administration functions (e.g. valuation and pricing functions) in relation to a number of funds, including both SIFs and non-SIFs, and invoiced the fund manager separately for the services provided in relation to each fund, we would expect the service provider to be treated as making a number of individual "per-fund" supplies of fund administration (and hence fund management) services, where each such supply can be treated as exempt or taxable for UK VAT purposes, depending on whether the fund being administered is a SIF or a non-SIF.

- In our view, this VAT treatment as separate per-fund supplies reflects commercial and operational reality – in that the service provider's performance of administration functions for one fund cannot reasonably be regarded as a component part of (or ancillary to) the service provider's carrying out of those functions for another fund. However, we have encountered a number of situations where an HMRC officer has taken a "single contract, single supply" approach – which has resulted in protracted disputes.

6.2.2 Land-related services

Land related services are subject to UK VAT when the land in question is situated in the UK, irrespective of where the supplier or the recipient of the supply belongs. However, UK VAT is not due on management services that are not land-related and are either outside the territorial scope of UK VAT or fall within the SIF management exemption.

Therefore, whether or not UK VAT is due on a supply (or a particular fee or charge) may depend on whether there is a UK land-related service. In turn, this may depend on whether or not a particular fee or charge, under an agreement that provides for the provision of a range of management services for various fees/charges, is consideration for a distinct supply with its own VAT treatment.

Typically, in the case of funds that invest in property, management agreements set out an extensive range of services to be provided, with fees that could be recurring and/or triggered by particular events (e.g. a sale of a property or a new lease being agreed with an occupier). Viewed in isolation, certain services and/or fees may appear to be land-related. However, it will not always be appropriate to view such a service or fee in isolation.

Applying single/multiple supply analyses in these situations can be a time-consuming exercise. Also, the approach of managers, funds and HMRC to these analyses can be inconsistent, given the lack of sufficiently detailed guidance in this area. We also note that, in many cases, the outcome of such an analysis may not have any impact on the overall VAT revenues, on the basis that, where the fund is investing in opted UK commercial property and receiving taxable rental income, any UK VAT properly due on the property management services would be recoverable.

As a specific example of where further and more detailed guidance would be of great practical assistance:

- VAT Notice 741A (place of supply of services) at paragraph 7.4 provides the following as an example of a service that is land related: “property management services carried out on behalf of the owner (but not the management of a property investment portfolio)”.

- The subsequent paragraph then includes “management of a property investment portfolio” as an example of a service not directly related to land.

- This guidance does not provide any further detail on what the management of a property investment portfolio is, how this can be differentiated from property management, or whether a property investment portfolio could comprise a single property or asset.

  Hence any additional guidance would be of great assistance to managers and funds that enter into complex investment management agreements (and need to identify specific land related services that would be subject to UK VAT).

6.3 VAT recovery for fund managers

6.3.1 Manager “look through” to fund recovery rate

On the basis we understand that HMT and HMRC do not consider that allowing UK managers to zero rate their management of UK funds is appropriate, an alternative option which might be considered is an arrangement similar to that accepted in Ireland.

Under that arrangement, UK managers supplying exempt management services to UK funds would be entitled to recover some or all of the input tax attributable to their supplies, by reference to the UK VAT recovery position of the fund itself.

This is often referred to in Ireland as a “look-through”, where the fund calculates its Irish VAT recovery rate (e.g. by calculating the “non-EU” percentage of its asset holdings or asset sales), and the same recovery rate is applied by the manager to the input tax it incurs on its costs of managing the fund.

In our view, such an approach could be workable in the UK in the same way as in Ireland – although UK funds would be calculating a “non-UK” rather than “non-EU” percentage.

6.3.2 Application of the Specified Supplies Order (“SSO”) to fund management

In addition, we note that, in situations where UK managers manage non-UK funds which are SIFs for UK VAT purposes (e.g. non-UK open-ended funds “actively marketed” to UK retail investors, or non-UK closed-ended funds listed and traded on a UK regulated market), the manager’s supplies of services will not carry the right to recovery of attributable input tax, even when the recipient of those services is established outside the UK.

This is because the current scope of the SSO does not extend to supplies of management falling within Items 9 or 10 of Group 5, Schedule 9 to VATA 1994.

As a result, UK managers of many non-UK funds (especially retail-sector UCITS funds) are incurring irrecoverable input tax on their management of such funds. Commercially, the cost of this irrecoverable input tax needs to be passed onto fund clients, thereby making the UK manager's services less competitive in comparison to non-UK managers.

Extending the SSO to include fund management would eliminate that distortion, hence supporting UK managers and the UK fund management industry as a whole.

6.4 UK VAT establishment issues for funds

6.4.1 HMRC guidance on UK establishment

The capacity of the UK fund management industry to establish and manage offshore funds is clearly of great benefit to the sector.

However, one complex issue is establishing to what extent non-UK funds can have functions carried out for them in the UK without it constituting a UK business or fixed establishment (e.g. through an agency of the fund).

One useful piece of HMRC Policy guidance would be an "allow-list" of delegated functions which could be carried out in the UK without creating a UK establishment risk – thereby supporting the UK as a preferred location for providers of high value ad fund management and other fund support/administration services.

6.5 VAT registration and VAT grouping for UK funds

6.5.1 VAT registration and reverse charge obligations of UK funds

Following both:

a) the amendments to the definition of "relevant business person" in section 7A VATA (with effect from 1 January 2021); and

b) the *Wellcome Trust* (*The Commissioners for Her Majesty's Revenue & Customs v Wellcome Trust Ltd* (Case C-459/19)) CJEU judgment released on 17 March 2021, confirming that the purchase and sale of securities, even when non-economic activities, may still represent "business activities" (as they did in Wellcome Trust's own case),

there are concerns that many UK funds which receive taxable services from non-UK providers (e.g. depositary services, some management services) will have obligations to register for UK VAT and account for reverse charge UK VAT which they did not have before.

The position is made more difficult for funds, given the lack of clarity around the new definition of "relevant business person" in section 7A, VATA 1994 – i.e. the only requirements are that the person receiving the services "carries on a business", and does not receive the services "wholly for private purposes". ("Business" is simply specified in section 94, VATA 1994as including "any trade, profession or vocation".)

We appreciate that HMRC may be concerned that UK funds carrying out non-economic activities only should not avoid incurring UK VAT on taxable services by purchasing them from non-UK service providers.

However, from a practical perspective, HMRC Policy guidance on the application of both "economic activities" and "business activities" in a funds context would be greatly appreciated by the funds industry.

6.5.2 VAT registration and Option to Tax mechanics

In our view, taxpayers would also welcome additional clarity on HMRC's position regarding how certain funds should register for VAT and, more specifically, regarding which entity should opt to tax any real estate interests which are held as fund assets. For instance, in the case of a unit trust, both the VAT registration and any option to tax are generally effected by the unit trustee in the name of the trust.

For example, such additional clarity would be very welcome in situations where there is a change in the legal person(s) representing the fund (e.g. a change of trustee(s)) may or may not appear to give rise to a transaction for VAT purposes, and may or may not necessitate a new VAT registration and option to tax.

6.5.3 VAT grouping for UK funds

In the case of some funds, there is potential for the entity representing the fund for VAT purposes (e.g. the unit trustee in the case of a unit trust, or the Operator in the case of an ACS) to be under common control with the manager for Companies Act purposes, despite the fact that beneficial ownership of the overall portfolio of fund assets is held by third-party investors.

In such scenarios, it would be administratively beneficial in many cases to include the fund entity in the same VAT group as the manager (or other providers of outsourced services).

However, one factor mitigating against this is the joint and several liability that would arise, with the fund entity becoming jointly and severally liable for VAT debts of the representative member of the group. That clearly has the potential to impact on the bankruptcy-remoteness of the fund, thereby making VAT grouping unfeasible.

However, in the case of pension funds, we note there is specific published guidance (in VIT454409) confirming HMRC's position that, when the VAT-grouped entity is the corporate trustee of a pension fund, its joint and several liability "does not extend to the assets of any fund(s) that they are responsible for managing as these are not the trustee's assets and cannot be used to pay debts that are not the result of the trustees fulfilling their duties as trustees".

We believe that equivalent confirmation in the case of funds (i.e. that the joint and several liability of the entity representing the fund for VAT purposes does not extend to the assets of the fund itself) would be welcomed by the UK funds industry.