VAT recovery and pension schemes: A problem for employers, trustees or HMRC?

Matthew Swynnerton discusses the confusion surrounding HMRC's shifting guidance towards pension schemes recovering VAT costs

HMRC's apparent revised approach to VAT recovery in respect of pension scheme costs has caused considerable confusion across the industry and prompted talk of new structures. HMRC may not have intended everything the industry has read into its recent publications. Still, trustees and employers need to take note.

A HMRC VAT Notice in July confirmed that employers could recover VAT on scheme investment costs in full, but also appeared to refocus attention on the formalities of who contracts, receives the service, pays, and holds the VAT invoice.

An unannounced June update to the VAT Input Tax Manual was also unsettling as it seemed to go further and potentially restrict the employer's ability to recover VAT on administration costs (including actuarial, legal and covenant advice), where the principles were thought to be settled. In particular, the changes have called into question whether the current practice of employers recovering VAT where the invoice is addressed to (or states that it is payable by) it remains possible.

The theoretical solutions that remain available sit awkwardly with existing practice and trustee decision-making, adviser appointment, privilege, conflicts and funding documentation:

- Advisers contracting directly with the sponsor could raise questions about conflicts, independence and the trustees' ability to rely on their advice.
- Onward charging by trustees would require trustees to be VAT registered and have a service agreement in place with the sponsor.
- VAT grouping may be possible for some schemes but is unlikely to be suitable for all trustee structures, especially where the trustees are individuals or if a corporate trustee is not a subsidiary of the employer.

Ultimately trustees should remember that VAT recovery is fundamentally an employer tax issue.

Where the employer normally meets scheme expenses, trustees may not be aware of how it approaches VAT recovery. It seems helpful for them to check it is aware that there could be an issue and encourage it to take tax advice if appropriate. The employer's investigation should ask how much VAT is at stake, which costs are affected, what would need to change, and whether the saving would survive the legal and administrative costs, as well as how trustees are likely to respond.

If the employer identifies an opportunity to improve recovery, trustees can consider any proposal through the usual trustee governance lens. Will they still receive independent advice? How will conflicts be managed? Is the arrangement consistent with scheme rules and funding documents? Could reporting lines become blurred? Is the added complexity going to be a drain on already stretched resources?

Trustees should not advise on VAT or presume to know the best structure. To the extent that any changes are agreed, trustees should ensure the process is clear, documented and consistent with the scheme rules and funding documents.

There is also a point to be made on timing. Industry bodies and advisers are raising practical issues and inconsistencies with HMRC and further clarification may follow. This is another reason not to rush into elaborate structures that may prove unnecessary.

For now, sponsors should decide whether there is something real to investigate before proposing change, and any proposal should be anchored in scheme-specific facts rather than generic VAT structuring. Trustees should engage with sensible proposals but keep governance principles intact: the VAT tail should not wag the fiduciary dog.

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