ECJ must still answer VAT exemption question for defined contribution schemes after Wheels ruling

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The European Court of Justice (ECJ) handed down judgment in *Wheels Common Investment Fund Trustees Ltd and Others v Commissioners for HMRC* on March 7 2013.

Robert Waterson, senior associate at Hage Arronson, analyses the ruling and explains why the ECJ still needs to answer the question of whether management services provided to defined contribution schemes could qualify for VAT exemption.

The case concerned the VAT exemption available under Article 135(1)(g) of the Principal VAT Directive for the management of special investment funds and whether it extended to common investment funds into which defined benefit pension schemes are pooled.

The case arose following the ECJ's ruling in *JP Morgan Fleming Claverhouse* in which the court found that the exemption in Article 135(1)(g) extended to cover VAT incurred on the management of authorised unit trusts (AUTs) and open ended investment companies (OEICs).

Article 135(1)(g) is transposed in UK legislation via Schedule 9 Value Added Tax Act 1994, which also covers investment trust companies. The purpose of the exemption is to ensure fiscal neutrality between direct investments in securities – which are exempt from VAT – and investments made through collective investment schemes.

In *Wheels* the crucial issue was whether a defined benefit scheme was comparable with the other types of investments listed above.

If it was comparable, the EU law principle of fiscal neutrality would preclude a difference in the VAT treatment applying to those schemes and the scope of the exemption would be extended accordingly. The estimated potential cost to the Exchequer has been quoted at £2 billion ($2.99 billion), although such estimates should always be viewed with caution since they are notoriously suppositious.

ECJ ruling

The court found that defined benefit schemes were not comparable.

Basing its reasoning on the definition of collective investments found in the UCITS Directive the court distinguished defined benefit in the following three ways:

- Unlike the schemes listed above they are not open to the public, only employees of a particular employer are eligible to join;
- The scheme members do not bear the risk arising from the management of the investment fund because their benefits are guaranteed by the employer; and
- The employer's position could not be said to be comparable with an investor in a collective scheme since, from the employer's perspective, it only enters the scheme to fulfil its legal obligations as an employer.

It was an open question whether the court would side with the pension funds in this matter, however the taxpayer's arguments were hampered by the fact that the EU Commission sided with the member state.

The ruling will come as a disappointment to an industry which has suffered considerably in recent years at the hands of successive governments' reforms of the pension tax system.

Nevertheless, the immediate impact upon the industry is unlikely to be significant since the net effect of the judgment is to maintain the status quo, in the UK at least.

Although *Wheels* is over it is likely that the UK pensions industry – led by the National Association of Pension Funds – will continue its fight over the future of the scope of the exemption by lobbying the EU Commission which is undertaking a review of the Principal VAT Directive.

In the meantime, the immediate question as to the scope of the management services exemption will not go away for the ECJ.

Cases are pending from Denmark and the Netherlands involving the extension of the exemption to other types of schemes.

Of particular interest is *ATP PensionService A/S v Skatteministeriet* concerning a defined contribution scheme.

Unlike *Wheels,* the second differentiation in the court's reasoning does not apply to defined contribution schemes since benefits are not guaranteed. It will be interesting to see if the court takes a similar approach or seeks to distinguish *Wheels*.