

EXPLANATORY MEMORANDUM TO
THE VALUE ADDED TAX (FINANCE) ORDER 2020
2020 No. 209

1. Introduction

- 1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs (HMRC) on behalf of Her Majesty's Treasury and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

- 2.1 This instrument amends legislation to (1) extend the existing Value Added Tax (VAT) exemption for the management of investment funds to the management of pension funds that satisfy certain conditions and (2) remove the current restriction on the type of assets that a close-ended collective investment undertaking can invest in for its management to qualify for exemption.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

- 3.2 As the instrument is subject to the negative resolution procedure, there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the whole of the United Kingdom.
4.2 The territorial application of this instrument is the whole of the United Kingdom.

5. European Convention on Human Rights

- 5.1 The Financial Secretary to the Treasury, the Rt Hon Jesse Norman MP, has made the following statement regarding Human Rights:

“In my view the provisions of the Value Added Tax (Finance) Order 2020 are compatible with the Convention rights.”

6. Legislative Context

- 6.1 Under European Union (EU) law, the management of what is termed a special investment fund (SIF) is VAT exempt. The investment funds which are SIFs for United Kingdom (UK) VAT purposes are listed in items 9 and 10 of Group 5 of Schedule 9 to the Value Added Tax Act 1994 (Group 5) and some of the terms used are defined in Note (6) to that Group. Pension funds are not currently included in Group 5.

- 6.2 This instrument inserts a new paragraph (k) into item 9 of Group 5 to provide for exemption for the management of what is termed a ‘qualifying pension fund’ and further inserts a definition of this term and some of its constituent parts into the Notes to Group 5 (Note (6) and new Note (6B)).
- 6.3 This instrument also amends Note (6) to Group 5 to remove the requirement for certain funds to invest wholly or mainly in securities for the fund management exemption to apply.

7. Policy background

What is being done and why?

- 7.1 The government has decided to amend UK law with effect from 1 April 2020 to widen the exemption for the management of investment funds to provide for exemption for the management of certain pension funds (as defined) and to remove the current restriction on the type of assets that a close-ended collective investment undertaking can invest in for its management to qualify for exemption.
- 7.2 Currently the majority of businesses exempt their supplies of fund management services in reliance on the direct effect of EU law. Such supplies fall to be taxed at the standard rate under UK law. This instrument legislates for a wider exemption and will provide certainty for businesses and be aligned with the majority of current practice in the sector.
- 7.3 This instrument replaces the Value Added Tax (Finance) (EU Exit) Order 2019 (S.I. 2019/43) (the Finance Order 2019) which was revoked on 8 July 2019. It makes the same changes that the Finance Order 2019 would have made except that (1) new paragraph (k) inserted into Item 9 now refers to a ‘qualifying’ pension fund as opposed to a ‘recognised’ pension fund and (2) the changes will not apply in the case of pension funds that are established overseas (i.e. outside the UK and the EU).

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

- 8.1 This instrument does not relate to the withdrawal from the EU. It provides for an extended exemption in UK law which will allow UK businesses to exempt their supplies under UK law (as opposed to having to rely on the direct effect of EU law). The amendments are not linked to the withdrawal of the UK from the EU other than that this has crystallised the need for legislation and legal certainty.

9. Consolidation

- 9.1 This instrument makes amendments to Group 5 and there are no plans to consolidate the legislation at this time.

10. Consultation outcome

- 10.1 The changes effected by this instrument were subject to an informal consultation with trade bodies and their representatives in summer 2018. Further stakeholder meetings continued with industry representatives till the end of 2019.
- 10.2 The consultation confirmed that the majority of businesses that provide fund management services prefer exemption to taxation. They relied on the direct effect of

EU law to exempt their fund management services as opposed to taxing them in accordance with the UK provisions.

- 10.3 To ensure that businesses could continue to exempt these fund management services when they could no longer rely on the direct effect of EU law, the Treasury made and laid the Finance Order 2019.
- 10.4 The Finance Order 2019 was laid in January 2019 with a coming into force date of EU Exit Day which at that time was set to be 31 March 2019. Once EU Exit Day had been postponed, there were further discussions with industry stakeholders. Concern was expressed about the ongoing uncertainty created and affected businesses requested a definite implementation date and a fixed period before implementation to allow them time to take the necessary legal and commercial steps to implement the mandatory exemption.
- 10.5 Following these representations, the Finance Order 2019 was revoked by the Value Added Tax (Finance) (EU Exit) (Revocation) Order 2019 (S.I. 2019/1014). At the same time, a formal announcement was made in the explanatory memorandum to that Order of the Government's intention to bring forward legislation that would make the same changes that the Finance Order 2019 would have made with effect from 1 April 2020.
- 10.6 Since the Finance Order 2019 was revoked, affected businesses have made further representations to the effect that they were having significant practical difficulties in establishing whether the pension funds that they manage would fall within the mandatory exemption changes or not. To address this issue, a further limited change has been made to exclude pension funds established overseas from the scope of the wider exemption.

11. Guidance

- 11.1 The changes made by the instrument will be reflected in published HMRC guidance on the VAT liability of financial services at <https://www.gov.uk/hmrc-internal-manuals/vat-finance-manual>. This guidance will be updated before 1 April 2020.

12. Impact

- 12.1 There is no, or no significant, impact on business, charities or voluntary bodies.
- 12.2 There is no, or no significant, impact on the public sector.
- 12.3 A Tax Information and Impact Note covering this instrument will be published on the website at <https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins>.

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 No specific action is proposed to minimise the impact of the requirements on small businesses (employing up to 50 people) as the rules are by necessity of general application within the sector.
- 13.3 The basis for the final decision on what action to take to assist small businesses is that it is not anticipated that many small businesses within the definition engage in the type of activity covered by this instrument.

14. Monitoring & review

- 14.1 This instrument will be kept under review through communications with key stakeholder groups, including the Joint VAT Consultative Committee (made up of a wide range of representatives), to ensure that it meets the policy objectives set out in section 7 above.
- 14.2 The instrument does not include a statutory review clause because it relates to tax and therefore meets the requirements of the exemption set out in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015.

15. Contact

- 15.1 Kerrie Croke at HM Revenue and Customs Telephone: 03000 585738 or email: kerrie.croke@hmrc.gov.uk can be contacted with any queries regarding the instrument.
- 15.2 Ian Broadhurst, Deputy Director, Indirect Tax Directorate at HM Revenue and Customs can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 The Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.