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Submitted via email to: HMTVATandExcisePolicy@hmtreasury.gov.uk

RE: VAT treatment of fund management services: Consultation

BlackRock¹ is pleased to have the opportunity to respond to **the consultation on the VAT treatment of fund management services** issued by HM Treasury and HM Revenue & Customs.

BlackRock supports a tax regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to respond to this consultation and will continue to contribute to the thinking of HM Treasury and HM Revenue & Customs on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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¹ BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

Executive summary

BlackRock supports measures that enhance the tax framework for the benefit of end investors.

We note, however, that the scope of the consultation is extremely limited, addressing only the definition of a Special Investment Fund ('SIF'). As a consequence, we are doubtful that the aims set out both in the document and as confirmed by HMT & HMRC in discussions with the industry will be fully achieved by the current proposals.

The proposed approach does little, in our view, to enhance the attractiveness of the UK as a fund management location. Nor do we believe it will reduce the amount of litigation in this area which has been more connected with the definition of 'management' for VAT purposes, a point which is not addressed at all in the consultation.

Importantly, the consultation is not clear on the territorial scope of the proposed measures. HMT/HMRC should make it clear that it is not their intention to extend the current territorial scope of the exemption, as doing so would be detrimental to the UK's position as a competitive location from which to manage funds.

We believe that a much more widely drawn review of the VAT regime applicable to fund management is required in order to achieve the aims outlined above.

As set out in our response to the Review of the UK funds regime published by HMT in 2021, we are of the view that a number of measures need to be implemented to meet the aims set out above. In summary, these include:

- Zero-rating the management of UK funds, putting them on the same footing as offshore funds, and thus enhancing the attractiveness of the UK funds ecosystem while realising the medium to longer term fiscal benefits for Government;
- Updating and broadening the definition of 'management' for VAT purposes to reflect current technologies and service delivery models; and
- Allowing the apportionment of management charges between SIF's and non-SIF's, thus avoiding the situation where the presence of any non-SIFs in a pool of assets leads to the application of VAT to the whole pool, thus defeating the purpose of the exemption.

Answers to 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 consider that the proposed approach of retaining the list of existing SIF's in UK VAT law in combination with a principles-based approach to be applied to other funds creates the potential for confusion and additional litigation and does not achieve its stated aims.

We note that there are funds within the existing list of SIF's which would not fall within the principles set out in the Consultation. We also consider that the principles-based approach has the potential to introduce further complexity and uncertainty and that the better option is to continue with the so-called 'white-list' of SIFs and for this list to be extended as and when new funds are launched. In our view, the number of new funds launched over recent years (only two new fund types

added to Items 9 & 10 of the VAT Act in the last ten years) would suggest that the periodic update of this list would not be problematic.

Whilst clarification around the criteria which will determine if a fund is a SIF for UK VAT purposes might be helpful, recent interactions with HMRC on whether or not a Defined Contribution pension scheme met the conditions for exemption set out by HMRC, leads us to conclude that this approach is by no means a guarantee of certainty and clarity.

Furthermore, we are of the view that there are other, more problematic areas of VAT and fund management that have not been addressed - please also see our response to question 6., below.

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

We note that the consultation makes no reference to the territorial scope of the proposed measures. We assume that any reforms would apply only to UK funds, or non-UK funds only if they are actively marketed to UK retail investors i.e. to mirror the current framework. Under the proposal, as set out in the consultation, it is possible that any fund, irrespective of its location, could be a SIF. As a consequence, management fees charged to such funds would be VAT exempt, rather than outside the scope of UK VAT with the right for the manager to recover related input VAT as is the case now. The consultation states that the proposed reforms ‘...are not intended to result in a significant policy change in VAT treatment for the fund management industry.’ Any widening of the territorial scope of the exemption would, without doubt, represent a very significant and detrimental change. Confirmation that a widening of the territorial scope of the exemption is not the intention, would be welcome.

Under the current proposals, it is possible that funds currently included in items (9) and (10) would not fall within the proposed principles-based approach set out in the consultation. Whilst we understand that existing exemptions will not be disturbed, we feel that this proposal has the potential to cause confusion.

We also note that the proposal refers to ‘funds intended to retail investors’ and indicates that this is intended to mirror the provisions contained within the UCITS Directive. We consider that a very precise definition is required in this area to avoid any doubt around its application. We also question how a reference to the UCITS Directive serves the aim of removing reliance on retained EU law.

We are also not clear around how these principles would apply in practice to Life Funds, for example, which in our view meet the conditions for exemption under the principles-based approach set out in the consultation, but which previously HMRC have not seen as being SIF’s.

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

Yes.

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?

We believe that this could be a useful step towards providing more clarity in this area and that including this wording in the VAT legislation is preferable to cross-referencing to other non-VAT specific law. However, we note that s. 235 (5) of FSMA 2000 grants Treasury the power to determine a scheme as not being a ‘Collective Investment’. The exercise of this power could create issues around consistency and certainty for taxpayers and we would suggest the removal of this provision if the definition were to be included in primary VAT legislation.

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

We have no comment on this point.

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?

As we noted in our response to the Review of the UK funds regime in April, it is important to recognise that a competitive VAT regime for existing and new UK funds is required in order to ensure their competitiveness and suitability as an alternative to offshore funds. VAT can be a significant cost to UK-based fund managers when managing UK funds, disproportionately impacting business decisions. On the other hand, countries like Hong Kong and the US do not apply a VAT or GST regime; whilst others such as Japan, Singapore and Switzerland have VAT/GST regimes that work in a way that results in zero or minimal VAT costs for the investment management businesses. In order to remain and grow as an asset management hub, the UK should seek a competitive VAT regime. VAT should not be a cost borne by the end investor, whether implicitly or explicitly, and we suggest that the following points be addressed:

- a) Under the current VAT regime, a UK investment manager managing an offshore fund can benefit from full VAT recovery while no VAT is charged on the fund itself. In contrast, the management of UK funds is either exempt from VAT (if they are qualifying funds) or is subject to VAT (otherwise). This is an important drawback of managing UK funds from the UK, and the regime should be augmented to extend the current VAT treatment available on UK management of offshore funds to the management of comparable UK vehicles. This can be done, for example, by applying a zero rate of UK VAT to the management of such funds.
- b) The application of VAT within the investment management supply chain also needs to be reviewed. We believe any service related to the provision of investment management or similar services should receive an exemption or zero-rating for VAT purposes. The exemption for fund management services provided to special investment funds (referred to as the SIF VAT exemption) under Article 135(1)(g) of the Principal VAT Directive aims to ensure tax neutrality between direct investments (whereby investors do not incur VAT) and indirect or collective investments. A clearly defined interpretation of special investment funds in the UK allows the UK to be a good place for international

- provision of investment management and investment management adjacent services, whilst providing scope for a UK fund range which does not suffer VAT drag.
- c) In order for the purpose of the exemption to be respected, it is essential that UK VAT law properly reflects the principle that everything that is specific and essential to the management of a fund should also be VAT exempt, irrespective of how and by whom those essential elements are delivered. The current regime can often lead to situations where services that are clearly fundamental to the supply of management are subjected to VAT because they are delivered via a technology and/or are outsourced to third party providers. This VAT is often irrecoverable.
- d) Another issue we suggest addressing is the so called 'tainting' principle regularly applied by HMRC in the context of pension fund management. For example, an investment manager may manage a pool of assets for a client and charges a single fee for doing so. 99% of those assets relate to defined contribution ('DC') pension schemes which are 'qualifying funds' for UK VAT purposes. The remaining 1% relates to a defined benefit ('DB') pension scheme which is not a 'qualifying fund' for UK VAT purposes. In this case, HMRC's interpretation is that because the fee does not relate entirely to a qualifying fund, the whole charge must be subject to VAT. In this example, the 1% of DB assets 'taints' the whole pool resulting in VAT being applied to the entire fee, which defeats the purpose of the exemption. In this example, DC investors are suffering a 20% VAT cost because a tiny fraction of the asset pool relates to non-qualifying funds. There has been a huge amount of consolidation and aggregation of legacy pension schemes over recent years that has been driven by a number of factors, none of them VAT related, such that this issue is a very real and prevalent one faced by managers and investors alike. We strongly believe the UK should allow charges to be apportioned between qualifying and non-qualifying funds, adhering to the principle of the exemption.

Conclusion

In our view, the proposals contained in the consultation are too limited in scope and consequently fail to address some of the significant difficulties that fund managers and their clients face in determining the VAT treatment of services. They also do not help to promote the UK as a competitive location from which to launch and manage funds.

There are also areas, such as territorial scope, which the proposals in the consultation do not address, and we would urge HMT and HMRC to ensure that any changes to the UK VAT regime for fund management do not make the position worse for UK based fund managers and their clients.