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A legal update from Dechert's Tax Group

Important VAT Change for Investment Managers

In Budget 2008, HM Revenue & Customs announced its intention to extend the scope of the VAT exemption for supplies of fund management services. This followed the ECJ judgment in the *JP Morgan Fleming Claverhouse Investment Trust* case ("the Claverhouse case"), which ruled that investment trusts were "special investment funds" for the purposes of the VAT exemption in the principal EU VAT directive. After some delay, regulations to implement the proposals have finally been released and were laid before Parliament on 17 July 2008. Unfortunately, the legislation confirms that VAT exemption will extend to a wider range of supplies of investment management services. In particular, it will extend to the management of certain overseas funds as well as onshore funds and may result in substantial loss of VAT recovery on associated expenses.

The Current Law

Existing UK VAT legislation exempts the management of authorised unit trusts ("AUTs"), open-ended investment companies ("OEICs") and trust-based schemes from VAT. Funds falling outside the scope of the exemption, and which are therefore subject to VAT on management services provided by UK managers, are at a competitive disadvantage under the current law. The Claverhouse case established that the exemption should be extended to investment trusts. The principles behind this decision were the need to ensure VAT neutrality between the choice of direct investment in securities and investment through collective investment vehicles and the requirement to achieve equality of treatment for those funds which are similar to, and in competition with, funds within the scope of the exemption.

The Regulations

Broadly, the new regulations extend the VAT exemption to cover:

- a new category of closed-ended collective investment undertakings which fulfil certain criteria relating to investment type and object, UK listing status and trading on a regulated market (and which will include investment trust companies, venture capital trusts and similar offshore funds available for investment in the UK under the same conditions); and
- funds established outside the UK which are recognised overseas schemes under the Financial Services and Markets Act 2000 provided that funds are able to be marketed to UK investors. Recognised overseas funds fall into three basic categories:
 - (i) funds established elsewhere in the EEA which are authorised as UCITS compliant in their own Member State and where notification has been given to the FSA of the intention to market the units to UK investors. This category includes funds established in Gibraltar;
 - (ii) funds established in Guernsey, Jersey, the Isle of Man and Bermuda which have similar regulation to the UK and have been recognised by the FSA so that investments can be marketed to UK investors; and

(iii) funds established elsewhere which have similar regulation to the UK and have been given individual recognition awards by the FSA to enable them to market units to UK investors.

It is important to note that, for the purposes of the legislation, each sub-fund in an umbrella fund is treated as a fund in its own right. This means that where it is intended that shares in a number of the sub-funds of an umbrella fund are to be sold to UK investors, notification must be given to the FSA in respect of each sub-fund.

The practical effect of this change will be to apply the VAT exemption to supplies of investment management services to all sufficiently regulated collective investment schemes made available to the UK general public.

It is intended that this legislation will have effect for supplies of management services made on or after 1 October 2008.

The Investment Fund Industry

Investment managers should consider the potential impact of the proposed changes and consider what steps should be taken to minimise potential loss of VAT recovery on associated expenses. For funds which were previously outside the exemption but will soon be included, consideration might be given to the merits of seeking repayment of VAT paid on management services received to date.



This update was authored by Mark Stapleton, David Gubbay and Daniel Hawthorne.

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