

EXPLANATORY MEMORANDUM TO

THE VALUE ADDED TAX (FINANCE) (EU EXIT) (REVOCATION) ORDER 2019

2019 No. 1014

1. Introduction

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

2. Purpose of the instrument

- 2.1 This instrument revokes the Value Added Tax (Finance) (EU Exit) Order 2019 (the Finance Order).
- 2.2 The Finance Order would have extended the scope of the United Kingdom's (UK's) VAT exemption for the management of special investment funds to fully reflect the scope of the exemption under European Union (EU) law with effect from the UK's exit from the EU (EU Exit Day). Whilst this would have ensured that UK taxpayers could continue to exempt their supplies under UK law once they were no longer able to rely on the direct effect of EU law, a smaller group of taxpayers would have had to exempt their supplies for the first time.
- 2.3 The Finance Order is being revoked so that new legislation can be laid at a later date that will make the changes that the Finance Order would have made, but with effect from 1 April 2020 rather than EU Exit Day.

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 Jesse Norman MP has made the following statement regarding Human Rights:

“In my view the provisions of the Value Added Tax (Finance) (Revocation) (EU Exit) Order 2019 are compatible with the Convention rights.”

6. Legislative Context

- 6.1 Under EU law, the management of what is termed a special investment fund (SIF) is VAT exempt. The investment funds which are SIFs for UK VAT purposes are listed in items 9 and 10 of Group 5 of Schedule 9 to the Value Added Tax Act 1994 (VATA) and some of the terms used are defined in Note (6) to Group 5 of Schedule 9 VATA (Group 5).
- 6.2 Pension funds are not included in Group 5. In addition, Note (6) to Group 5 requires closed ended collective investment undertakings 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 A number of Court of Justice of the European Union cases have determined that the current UK exemption for the management of SIFs is not as wide as is required under EU law. In the absence of changes to the scope of the UK exemption, HMRC policy has been to allow businesses to choose whether to exempt their fund management services by relying on the direct effect of EU law or to continue to tax them under UK VAT legislation. This includes fund management services provided to certain types of pension funds and state regulated property funds.
- 7.2 HMRC's intention has always been that this would be a temporary solution, subject to a full scale review of the fund management exemption and a subsequent redrafting of the UK VAT provisions.
- 7.3 Informal consultation with trade bodies and their representatives in 2018 showed that the majority of businesses prefer exemption and have been relying on direct effect of EU law to exempt their fund management services. Their preference at the time was not to change legislation if there was an implementation period during which direct effect continued to apply. This was because this would avoid businesses being subject to two changes in legislation: the changes that would be made in the Finance Order 2019 and then later changes as a result of the fundamental review.
- 7.4 To ensure that businesses could continue to exempt these fund management services in the event that the UK exited the EU and could no longer rely on the direct effect of EU law, the Government laid the Finance Order to amend UK legislation.
- 7.5 Since the Finance Order was laid, businesses which currently tax these supplies under UK law have said that they need time to take the necessary legal and commercial steps to implement the mandatory exemption.
- 7.6 Also EU Exit Day has been postponed and affected businesses have raised concerns about the lack of certainty as to when VAT exemption for these services will become mandatory because the commencement date of the Finance Order is linked to EU Exit Day.
- 7.7 Revoking the Finance Order and laying a replacement Order which makes the same changes as the Finance Order but has a specific commencement date will provide businesses with certainty as to when the changes will come into effect and also provides an adjustment period. If the UK leaves the EU before the replacement SI is in force, HMRC will exercise its statutory discretion to enable businesses to continue to exempt their supplies.

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

- 8.1 This instrument relates to the withdrawal of the UK from the EU but is being made under existing powers in VATA. The Finance Order was due to come into force on EU Exit Day to ensure that the correct tax treatment of fund management services could be applied after the UK exited the EU and UK taxpayers could no longer rely on the direct effect of EU law. This instrument revokes the Finance Order to ensure that it does not come into force on EU Exit Day (still an uncertain date) and bring in mandatory exemption without a transitional period for businesses.

9. Consolidation

- 9.1 This instrument revokes the Finance Order which would have made amendments to Group 5 of Schedule 9 to VATA. 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. Feedback from industry members was that they did not want changes to be made to the legislation in the event of an implementation period during which direct effect applies. This was for the reasons set out at paragraph 7.3.
- 10.2 At a recent meeting with industry representatives concerns (not previously mentioned during the 2018 consultation) were also raised that businesses which have chosen to continue to tax such supplies need more time to implement the changes as they will have to review complex contracts to verify whether or not exemption applies and then agree any necessary changes with their customers.

11. Guidance

- 11.1 As the changes which were due to be made to legislation by the Finance Order with effect from EU Exit Day will now be made at a later date, amendments to guidance will not be required at this time.

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 An Impact Assessment for this instrument has not been prepared because this instrument revokes the Finance Order which will not now come into force. For the moment, as now, businesses can continue to exempt their fund management services by relying on EU law or can tax them under UK law.

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 regulatory burdens on small businesses (employing less than 50 people).

13.3 The basis for the final decision on what action to take to assist small businesses is that this Order prevents changes to the current rules coming into effect.

14. Monitoring & review

14.1 In the longer term, the Government will keep the scope of the fund management exemption under review and consult with interested parties on any potential further changes as appropriate.

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 & Customs Telephone: 03000 585738 or email: Kerrie.croke@hmrc.gsi.gov.uk can be contacted with any queries regarding the instrument.

15.2 Eileen Patching, Deputy Director VAT Principles and Risk, Customs & Indirect Tax Directorate, at HMRC can confirm that this Explanatory Memorandum meets the required standard.

15.3 Jesse Norman MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.