



professional direction paper

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VAT & Adviser Charging

This paper is one of a series of papers the PFS is producing under the **Professional Direction** title. It follows extensive liaison with, and input from, HMRC and is intended solely to assist members in understanding the rules in relation VAT and adviser charging.

Disclaimer

Every attempt has been made to ensure the accuracy of this text at the time of going to print (February 2013). This supersedes the earlier iteration published in September 2012. However no liability can be accepted for any loss incurred in any way whatsoever by any person acting or refraining from action as a result of the information contained in this document.



introduction

The Retail Distribution Review requires that from 31st December 2012 all advisers must have adopted 'Adviser Charging' for advising and arranging retail investment products. Advisers are no longer able to be paid by commission, through a product charge, by a product provider. Advisers implementing adviser charging need to understand the VAT implications and to assist advisers, HMRC published their final guidance in relation to VAT and adviser charging in March 2012.

<http://www.hmrc.gov.uk/manuals/vatfinmanual/VATFIN7650.htm>

This paper is aimed at those providing financial advice on retail investment products. It sets out some of the different scenarios that may occur within the financial advice process and looks to provide clarity on the associated VAT position in relation to the adviser charge.

With over 34,000 members, the Personal Finance Society is the leading professional body for the financial planning profession in the UK. The PFS takes an active role in setting standards of professionalism and our members commit to the highest standards of professionalism by keeping their technical knowledge up to date and by adhering to a respected code of ethics.

The PFS is part of the Chartered Insurance Institute, which is the world's largest professional body for insurance and financial services in the world, with over 100,000 members in 150 countries. Established in 1873 and a Chartered body since 1912, the CII's mission statement is 'Protecting the public by guiding the profession'.



the rules

What are the VAT rules?

When considering the VAT treatment of services, in the context of the RDR, it is important to understand the meaning of 'advice' for regulatory purposes.

'Advice' is a personal recommendation to a retail client in relation to a retail investment product. Retail Investment Products, as defined by the FSA are:

- a life policy; or
- a unit; or
- a stakeholder pension scheme; or
- a personal pension scheme; or
- an interest in an investment trust savings scheme; or
- a security in an investment trust; or
- any other designated investment which offers exposure to underlying financial assets, in a packaged form which modifies that exposure when compared with a direct holding in the financial asset; or
- a structured capital-at-risk product;

whether or not any of these products are held within an ISA or CTF.

From a VAT perspective, general financial advice is **not** synonymous with the term 'advice' for regulatory purposes and it is important to remember that although VAT rules have not changed as a result of RDR, application of the rules may vary. Under VAT general principles, fees or commission for advice only services are **always taxable** and remuneration for an intermediary service may benefit from the **VAT exemption** if the adviser acts as an intermediary by bringing together parties to an exempt financial service.

Intermediation, for the purposes of VAT exemption, consists of bringing together, with a view to the provision of financial services, persons who are or may be seeking to receive financial services and persons who provide financial services. In order to qualify for exempt intermediation, an adviser would need to clearly evidence to HMRC that there has been customer specific interaction between the adviser and the product provider in relation to the sale of exempt products. Providing a customer with product provider material or information on products is not sufficient to demonstrate intermediation has taken place.

HMRC have stated that a firm would need to evidence that the customer entered the relationship with the intention of purchasing a retail investment product, following on from personal recommendations made by the adviser. If the customer subsequently decides not to progress, the service would still qualify for VAT exemption as it would fall into the category of an aborted transaction. Remuneration for introducing a customer to an exempt financial service will be in the form of fees paid by the client to the adviser and no VAT is chargeable on such fees. Put simply, **general financial** advice is taxable and **intermediation** is VAT exempt.



process & exemption

The advice process

HMRC have detailed a 6 stage process that an adviser would normally follow when entering into arrangements with customers.¹

1. gather information about the customer (fact-find)
2. carry out research to find suitable investment options
3. provide the customer with reports, financial health-checks, forecasts
4. recommend specific investment products to the customer, including the prices at which these can be arranged
5. act between the product provider(s) and the customer with a view to arranging the sale of the Retail Investment Products agreed with the customer
6. and, where applicable, i.e. where the customer agrees to an ongoing review service, monitor the customer's ongoing position to ensure that the products continue to meet the requirements of the customer.

Where the customer is seeking the arrangement of a Retail Investment Product and the adviser performs the arrangements as outlined at stage 5 above, (regardless of whether the sale of the product is finally concluded): and is able to evidence that they have done so; the services in stage 1–6, which fall within the agreement concluded with the customer, will be VAT exempt.

Where there is no evidence of such product arrangement services or where one or more of the stages are contracted for under a separate agreement, so that the service provided to the customer is that of general advice or recommendation only, any charges to the customer will carry VAT at the standard rate. The VAT liability depends on what is done by the adviser and it makes no difference whether a fee is levied up front or over the life of a product, for example with regular contribution products.

How do I determine if my services are VAT exempt?

It is clear from HMRC guidance that it is 'what is done by the adviser' in any particular case that will determine whether the charge made by the adviser is exempt or chargeable. The critical factor in determining exemption (for intermediation) is that the adviser should 'act between the product provider(s) and the customer with a view to arranging the sale of the Retail Investment Products agreed with the customer (stage 5 above). Where this 'act' takes place (and there is sufficient evidence that it took place) then any charge to the customer will be VAT exempt – regardless of whether any product sale is finally concluded. Intermediation, if transacted through a platform, would qualify for VAT exemption.

¹ HMRC VATFIN7665 – The Retail Distribution Review – services of a adviser



exemption & examples

Examples in practice

EXAMPLE 1

An individual has approached a financial adviser to discuss his retirement planning needs.

Subject to the findings in relation to any potential shortfall, the individual agrees that the adviser should make a recommendation on how any funding shortfall should be met. A fixed fee is specified for the work.

Outcome (a)

The adviser gathers client information (stages 1–3), identifies a shortfall but makes no product specific recommendation on how this should be met. At this stage, the adviser has not made contact with any product providers. The client receives the report, pays the fee but takes no action.

Likely position – VAT charged

The fee for the advice is not exempt from VAT as no intermediation took place.

Outcome (b)

The adviser gathers client information, agrees retirement objectives and carries out research to identify the most suitable financial products to meet the client's objectives. As part of the recommendation, the adviser contacts the product providers chosen by email or telephone to obtain personal illustrations, which are then supplied by the providers. The adviser recommends a retail investment product(s) in a personal report or suitability letter that meets regulatory requirements. The client receives the recommendation, pays the fee but decides to take no further action.

Likely VAT position – VAT exempt

As the adviser has undertaken stages 1–5 of the advice process with a view to arranging the sale of a RIP, it is likely that the fee charge would be VAT exempt.

Outcome (c)

The client receives the recommendation in the personal client report or suitability letter and agrees to act upon the advice given. The adviser assists the customer with the completion and submission of the application forms. The client pays a fee for the service provided.

Likely VAT position – VAT exempt

Intermediation has taken place.

Outcome (d)

The adviser acts as in outcome (c) and the sale is transacted via a platform.

Likely VAT position – VAT exempt

Intermediation has taken place.

N.B. If in **Outcome (c)** or **(d)** the customer subsequently changes their mind and does not proceed with the products, VAT exemption would still apply as this would fall into the category of an aborted transaction.

In the above example, the VAT position is the same whether or not the client holds existing financial products.



examples

EXAMPLE 2

An individual asks an adviser to carry out an analysis of their estate to determine the inheritance tax liability and to recommend ways it could be mitigated or provided for financially.

Outcome (a)

The analysis is carried out by the adviser and an inheritance tax liability is identified. A client report is produced and refers to generic solutions that are based on the use of financial products (life assurance investment bonds) and trusts. The client receives the report and pays the fee. No specific recommendation for a RIP is given and none are purchased.

Likely VAT position – VAT charged

No intermediation has taken place.

Outcome (b)

The analysis is carried out and the adviser designs a solution based on the use of life assurance bonds that will be written under trust. The adviser selects the product and asks the product provider to send him the written investment bond key features and personal illustrations. He presents his suitability report to the client with the illustrations. The client receives the report and personal recommendations and agrees to proceed. The adviser arranges the product for the client.

Likely VAT position – VAT exempt

Intermediation has taken place.

Ongoing Services

In relation to ongoing services, the VAT rules for charges made for these services will depend on the services the customer has agreed the adviser should perform, as described in the initial agreement. The adviser should be able to determine and evidence where they are in the process with a particular customer, and apply the VAT treatment accordingly.

EXAMPLE 3

An individual asks an adviser to review their existing investment portfolio comprising mostly of RIPs with a view to recommending any necessary adjustments to meet the client's stated financial planning objectives. There is no contractual obligation or agreement for the adviser to undertake regular reviews.

Outcome (a)

The review is carried out, valuations secured and a new RIP investment is recommended and detailed in a suitability letter. The client accepts the recommendation and the adviser arranges the investment.

Likely VAT position – VAT exempt

In arranging the investment, a transaction has taken place and the adviser has acted between the product provider and the client.

Outcome (b)

The adviser contacts the relevant providers to secure valuations and although no new investment is recommended, the adviser recommends that some RIPs are realised/encashed with the resulting funds held in cash. A suitability letter containing the recommendation is provided to the client but the client decides not to proceed with the recommendation.

Likely VAT position – VAT exempt

The adviser has liaised with the product providers and provided a personal recommendation to encash an exempt RIP. Intermediation has taken place.



examples

EXAMPLE 4

An adviser has arranged a number of RIPs for a client. In some cases these may be administered on an investment platform. The adviser has a responsibility (recognised by the client agreement) to review the portfolio of RIPs and, as appropriate, to:

- rebalance the investments to remain aligned to an agreed asset allocation model
- recommend new investments
- top up existing investments

Outcome (a)

A review takes place and the adviser contacts the appropriate product providers to obtain relevant information on a client's existing investments, with a view to rebalancing the client's portfolio. As a result of the information received and an analysis of the client's overall investment portfolio, the adviser makes a recommendation to the client that no action is required.

Likely VAT position – VAT exempt

As the client has signed up to a periodic review service, the review is therefore an ancillary part of the exempt supply of intermediation.

Outcome (b)

The review takes place and the adviser executes the rebalancing in line with the original asset allocation.

Likely VAT position – VAT exempt.

The adviser is carrying out a transactional service under the terms of his ongoing advisory service.

Outcome (c)

The review takes place and the adviser makes a recommendation for a top-up to an existing product.

Likely VAT position – VAT exempt

The VAT exemption would apply as the initial agreement made express provision for the adviser to make recommendations to top up existing investments. The VAT position would remain the same, irrespective of whether the client agreed to the top-up or not, and whether or not any rebalancing was also executed.

The periodic review is part of the exempt supply of intermediation on the basis that the review service is a relatively minor element of the overall supply in terms of both what is provided and what is charged for. HMRC have stated that in any other circumstances, i.e. where the review services are not transacted as part of the original intermediation supply and form a supply in their own right, the VAT treatment will be determined from the nature of the services being supplied. If a charge is made for a one-off review then the VAT treatment will be determined on exactly the same basis as the original advised sale as per the steps laid out in this guidance.

N.B. If it is a discretionary investment service that is being provided, then the adviser charge would not be VAT exempt – see below re Discretionary Investment Management

In all examples, a provider can be a life office, a fund manager or a platform.



VAT & adviser charging

Evidence and record keeping

We would expect that in most cases the application of VAT will be straightforward, especially where an adviser charge is contingent on a product sale. Evidence and record keeping are crucial and advisers will need to keep sufficient records to evidence the tax treatment applied to services supplied, whether or not the firm is registered for VAT.

For VAT exempt services, the evidence will need to demonstrate that intermediation has taken place, or was fully intended to take place following recommendations from the adviser, and that the adviser has acted between the customer and the product provider, with a view to arranging the sale of a retail investment product. If an adviser is unable to provide sufficient evidence that an exempt supply has taken place, VAT will be due on that supply.

VAT registration

Any business that makes taxable supplies which exceed the current registration threshold, must register for VAT. It is important that firms monitor their taxable turnover and are careful to include all taxable fees and commissions (such as those for introductions to discretionary investment management services), even if these are currently under the VAT threshold.

The current VAT registration threshold is £77,000 but is subject to change at budget time, so it is important that advisers check the threshold regularly.

Discretionary Investment Management

Regardless of how it is remunerated, there is **no exemption** for the introduction of the client to a discretionary investment management service because discretionary investment management is a taxable service that does not fall within the financial services exemptions.

The service provided by the adviser is a taxable introduction to a taxable management service. It is not correct for IFAs to look through to the selection and purchase of VAT exempt assets by the discretionary investment manager and treat their services as being exempt introductions to a series of VAT exempt transactions. For further information on discretionary investment management see VATFIN5800.²

In light of recent European Court of Justice rulings in this area, HMRC are planning to issue further guidance on the VAT treatment of Discretionary Investment Management in the coming months.

² VATFIN7600 –
Intermediaries: independent
financial advisors (IFAs)

