VAT focus

Aladdin: a whole new world?

Speed read

The recent Upper Tribunal decision in *BlackRock Investment Management (UK) Ltd v HMRC* about the Aladdin investment management platform raises important issues in two key areas relevant for partly exempt businesses generally and for asset management businesses in particular: when can the provision of a technology platform qualify as a substantive VAT exempt financial service? And in what circumstances could a single supply have more than one VAT liability with elements that remain VAT exempt even where the majority are taxable. Businesses and their advisers should now consider the potential implications for VAT treatments elsewhere and take steps where appropriate to protect their position.

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In the recent case of *BlackRock Investment Management (UK) Ltd v HMRC* [2018] UKUT 415, a US company provided the service of the use and functionality of the Aladdin investment management platform to a group company in the UK. The UK entity used this Aladdin service partly for managing VAT exempt funds (SIFs) and, for the most part, for managing taxable non SIFs. The VAT dispute essentially concerned whether and to what extent the UK company should account for VAT under the reverse charge mechanism on the fees paid for this service.

It was agreed between the parties that there was a single supply of the platform in this case and that the non-SIF usage constituted the predominant element. If it was agreed that the platform could constitute a supply of fund management, the further question then would arise as to whether this single supply could be bifurcated, so that instead of applying taxation by reference to the majority element (per the usual *Card Protection Plan* (Case C-349/96) and *Levob* (Case C-41/04) single supply principles), the services could instead be exempted insofar as they were provided to SIFs.

A diamond in the rough

In a detailed and lengthy decision, the earlier First-tier Tribunal (*BlackRock Investment Management (UK) Ltd v HMRC* [2017] UKFTT 633) had determined that the Aladdin Services supplied qualified as 'management' of funds for VAT purposes. In principle, therefore, they could qualify for exemption depending on the underlying funds involved. However, it found that the consideration could *not* be apportioned to reflect the VAT liability of the underlying supplies. The FTT considered that the case law principles on single supplies did not allow for exceptions in this instance and that therefore the platform supply should be standard rated and the reverse charge would apply in full to it. The taxpayer appealed this decision on the apportionment issue and HMRC cross-appealed on the exemption issue.

A new fantastic point of view

The UT agreed with the FTT on the exemption issue. It referred in particular to the CJEU cases of *Sparekassernes Datacenter (SDC) v Skatteministeriet* (Case C-2/95), *Abbey National* (Case C-169/04) and *GfBk* (Case C-275/11) in determining that the FTT made no error of law in its finding that:

- the Aladdin Services were intrinsically connected to the activities characteristic of an investment fund;
- they formed a distinct whole; and
- they were specific and essential to the management of a SIF (each a key requirement for the fund management exemption).

The UT considered that the Aladdin Services clearly had an inner coherence relative to fund management and that there was no blurring of those services with the activities of BlackRock which could cause those services to lose their distinctive character. Those two facts alone demonstrated that the services formed a distinct whole.

I can open your eyes

The UT, however, diverged from the FTT in finding that the consideration for the Aladdin Services *could* arguably be apportioned for VAT purposes between the taxable non-SIFs and the exempt SIFs. In granting the request for a preliminary reference to the CJEU, the UT relied on uncertainty arising from the CJEU's judgment in *Commission v Luxembourg* (Case C-274/15). That decision had not been considered at the FTT stage in *BlackRock*. *Commission v Luxembourg* concerned the cost sharing exemption. The taxpayer argued that the CJEU's decision in that case showed that it was necessary in certain limited circumstances to apportion a single supply in order to not frustrate the purpose of the exemption by preventing its application in practice. This, the taxpayer argued, was also the case for the Aladdin scenario. The tribunal agreed this point was not clear and should therefore be referred to the CJEU.

You've got some power in your corner now

This is an important case at UK level as it offers further binding precedent that a technology platform fee *can* qualify for the financial services VAT exemption. This is particularly welcome given the harder line HMRC has taken on this issue in the last few years.

What clearly helped was the detailed presentation at the FTT focused on the functionality of the platform and how it was actually used by the recipient in making their onward supplies. Although there were no magic carpets involved, the taxpayer provided the FTT with a comprehensive overview of how the Aladdin platform is involved at various stages in the investment fund management cycle. The court considered that the sophistication and complexity of the Aladdin service was difficult to convey in words. The full capabilities of the platform only became apparent following this practical demonstration.

Based on this, the FTT identified that the service effectively involved monitoring the funds, preparing the daily 'Green Package' of data for portfolio managers, identifying the cause of tracking errors, analysing risk, monitoring cash, regulatory and product rule monitoring, monitoring corporate actions, communicating and tracking trading orders, and post-trade portfolio administration. The conclusion reached was that the services were clearly coherent in that they covered almost all of the aspects in the investment fund management cycle.

It is many years since the CJEU in the *SDC* case tried to distinguish a substantive financial service which could be VAT exempt from a 'mere technical supply'. In the intervening time, technology has evolved and largely replaced human input in the delivery of many services across the industry. In light of the Aladdin platform's services being confirmed as constituting fund management rather than being a taxable IT service, and given the proliferation of platforms of all kinds across financial services in the last few years, businesses and practitioners should consider whether there are more cases where, looking closely at the functionality and role of the platform, VAT exemption is in fact the correct answer.

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As dealt with further below, the UT's decision is also helpful in relation to looking at outsourced supplies of fund management more generally.

No one to tell us no?

Despite confirmation that the fund management exemption could apply, the taxpayer still faced the problem that the underlying funds being serviced were predominantly taxable so that apportionment was the only route to exemption. The somewhat daunting obstacle standing in the way was VAT orthodoxy itself in the form of the composite supply rule. A fundamental principle of VAT law is that ordinarily a single supply has a single VAT liability determined by the predominant nature of the core or principal supply.

The CJEU recently came out with a strong endorsement in favour of this principle in *Stadion Amsterdam CV v Staatssecretaris van Financiën* (Case C-463/16), where the court refused apportionment of the consideration to reflect the underlying VAT liabilities of each part of the supply, relying on the fact that such treatment would undermine the effective functioning of the VAT system. In that case, there was a single supply including the principal element of a stadium tour (standard rated) and an ancillary element of a museum visit (reduced rate). The CJEU reasoned that applying various rates of VAT to elements of a single supply would involve artificially splitting that supply.

Historically there *have* been limited exceptions to this rule. In the case of *Talacre Beach Caravan Sales Ltd v Customs & Excise Commrs* (Case C-251/05), the contents of a caravan (taxable) were supplied with a caravan (zero rated) in a single supply. It was considered that it would undermine the relevant VAT Directive if the ancillary element (the contents) were allowed to take on the VAT liability of the principal element (zero rating); therefore, the ancillary element retained its standard rated liability. However, this case can clearly be distinguished on its specific facts and the reliance on the scope of the UK's derogation to apply zero-rating by exception. In any event, strictly the liability of the whole supply still remained taxable, just at a number of different rates.

The UT in *BlackRock* carefully considered the arguments on both sides. In considering *Stadion Amsterdam*, the court stated that the single supply 'principle' is an important one but that it cannot itself be determinative, particularly as regards the proper scope of an exemption. The UT agreed with counsel for BlackRock that the appeal was not so much concerned with the question as to whether different rates of VAT can be applied to separate elements of a single supply but rather with the question of the proper construction of article 135(1)(g). The point was made that if that article required apportionment of the consideration based on use then it was arguable that it would not be artificial to split the supply. Persuaded there were indications in the recent CJEU decision on the cost-sharing exemption that apportionment may be required in some cases, the UT decided to refer the point.

Crystal clear?

In the authors' view, the proper approach to the application of the exemption needs to take into account the teleological nature of the VAT system. If VAT exemption for the services in respect of the underlying SIFs were denied, that could run contrary to the intention behind article 135(1)(g) of the Principal VAT Directive. The purpose of the exemption for SIFs is firstly to ensure that small investors are not placed at a disadvantage vis-à-vis institutional investors by suffering VAT on the cost of accessing professional investment advice. Secondly, it is to ensure fiscal neutrality between funds which are self-managed and those required to outsource their management. If VAT exempt funds are serviced or managed together with a majority of taxable funds, they have no way of accessing the VAT exemption, which would frustrate the intention of the legislation. The answer will perhaps ultimately depend on how easy or difficult it would be to make alternative arrangements, such as contracting for multiple supplies, in respect of each fund or fund type. If there are other commercially viable options available to access the exemption, the court may shrink from sanctioning apportionment.

New horizons to pursue

What are the practical implications of the *BlackRock* case?

In the case, it was agreed before the hearing that there was a single supply so this point was not examined further. This will not necessarily be the case in every supply of investment management services (whether or not involving a technology platform). Businesses may therefore wish to consider whether they can contract and charge relevant fees on the basis that there are separate supplies *per fund*, thus avoiding the issue of needing apportionment.

This is made more important by the nature of HMRC's approach when there are a majority of VAT exempt SIFs involved in a single supply. Referencing the specific and essential and distinct whole requirements from the case law, HMRC has been denying the VAT exemption on the basis that the non-SIFs 'taint' the supply. This is a case of 'heads they win' (where the majority of funds are taxable and the single supply principles apply VAT to everything) and 'tails the taxpayer loses' (as even £1 of non-SIF money in a defined contribution pension fund will deny VAT exemption).

> The CJEU's decision may offer support to combat HMRC's tainting approach, which has in the past been used to deny refunds for pension fund management and has blocked more recent efforts to access VAT exemption for substantive investment research provided in respect of SIFs following the MIFID II changes

It is possible that the CJEU's decision may offer support to combat HMRC's tainting approach, which has in the past been used to deny refunds for pension fund management and has blocked more recent efforts to access VAT exemption for substantive investment research provided in respect of SIFs following the MIFID II changes last year. Taxpayers should consider the scope for revisiting previously denied claims and the potential need to protect their commercial and contractual position against future changes in the VAT liability of supplies received and made.

One of the complicating factors in looking at fund management from this purposive aspect is, of course, the question of which underlying investors actually benefit from exemption in practice. UCITS funds have very significant levels of institutional investment. Should the management fees in respect of those investments be VATable, given they are not 'small investors'? The single supply rule is long established and a final result which disapplies it extensively could have serious practical and cost implications for all stakeholders.

It is perhaps to be hoped that particular genie will be kept in its bottle. ■

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- ▶ VAT and SIFs: what does 'management' mean? (Etienne Wong, Alex Tostevin, 24.1.19)
- ▶ Cases: *BlackRock Investment Management v HMRC* (8.1.19)