Analysis

Taxation of investment income of non-UK pension schemes

Speed read

In *BAV-TMW-Globaler-Immobilien Spezialfonds v HMRC* [2019] UKFTT 129, the First-tier Tribunal (FTT) considered an appeal on whether income tax paid on property investments in the UK attributable to a German pension scheme was repayable. BAV-TMW-Globaler-Immobilien Spezialfonds (BTI) sought equivalence with predominantly UK pension schemes registered in the UK under the provisions of FA 2004, which were exempt from tax. The FTT found that BTI could not have registered as a pension scheme in the UK to benefit from exemption, which was overtly discriminatory and a breach of EU law.

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During the tax years under appeal, BAV-TMW-Globaler-Immobilien Spezialfonds (BTI), a German real estate investment fund, received income from UK property investments. The ultimate beneficial owner of BTI was a German pension scheme, Bayerische Ärtzeversorgung (BÄV). As a matter of German law, BTI was tax transparent and so BÄV was entitled to the income from BTI's UK property investments as it arose.

BÄV was established by the Bavarian Parliament in 1923 as a pension scheme for doctors, dentists and vets. It is administered by Bayerische Versorgungskammer (BVK), an administrative body for Bavarian pension schemes, which forms part of a ministerial department.

Under German law, BÄV qualified for exemption from German corporate income tax by virtue of its status as a 'professional pension scheme' and by satisfying certain other relevant requirements.

Unlike the investments of similar pension schemes registered in the UK, BÄV's UK investment income was subject to income tax. BTI accounted for tax on income from its UK property investments by filing annual SA700 self-assessment tax returns pursuant to the non-resident landlord scheme, although the economic burden and liability for tax fell to BÄV because of the tax transparent structure.

Taxation in the UK

Pension schemes registered in the UK are exempt from income tax on their investment income (pursuant to FA 2004 s 186). FA 2004 s 154 provides for certain categories of pension scheme to be eligible for registration; specifically:

- an occupational pension scheme;
- a pension scheme established by a person with permission under the Financial Services and Markets Act (FSMA) 2000 to establish a pension scheme in the UK; or
- a public service pension scheme.

As an industry wide pension scheme, BÄV was not established by an employer and, therefore, was not an occupational pension scheme as defined. The parties agreed that BÄV was not established by a person with permission under FSMA 2000. This meant that if BÄV was not considered to be a 'public service pension scheme', it would not be eligible to register as a pension scheme under FA 2004. If so, it was prevented from claiming exemption from tax on its investment income by registration. Relevantly in this appeal, a public service pension scheme included one 'established by or under any enactment' pursuant to FA 2004 s 150(3)(a).

It is possible for pension schemes to be deemed registered and therefore automatically exempt from income tax on their investment income. Under transitional provisions for the FA 2004, a pension scheme which was a relevant statutory scheme immediately before 6 April 2006 was treated as becoming a registered pension scheme on that date (FA 2004 Sch 36 and s 153(9) and ICTA 1988 s 611A). A 'relevant statutory scheme' is one established before 14 March 1989; and a 'statutory scheme' is a 'retirement benefits scheme established by or under any enactment' (ICTA 1988 s 612). The relevance of this was that BÄV, if it met the relevant criteria, could have been deemed registered and its investment income exempt from tax.

BTI's arguments

There were three main arguments made by BTI before the FTT:

1. BTI was not eligible to apply to be a registered pension scheme under FA 2004 s 153 as it was not a public service pension scheme for the purposes of FA 2004 s 154(2), resulting in direct discrimination (the 'enactment argument').
2. If BTI was considered to be a pension scheme established by or under any enactment, it was deemed to be a registered pension scheme from 6 April 2006 with the tax exemption treatment that would follow (the 'deemed registration argument').
3. A UK registered pension scheme is exempt from income tax on its investment income, whereas BÄV, as an objectively comparable non-resident pension scheme, is subject to income tax on its UK investment income amounting to a restriction on the free movement of capital which cannot be justified (the 'restriction argument').

HMRC submitted that the issues in dispute in the appeal were hypothetical and unarguable as BÄV had not actually applied to register as a pension scheme in the UK. The FTT rejected this outright, noting there was nothing hypothetical about claims made for repayment of income tax or the closure notices refusing them.

The enactment argument

BTI contended that 'any enactment' in FA 2004 s 150(3)(a) meant only an act of the UK Parliament, excluding a pension scheme established by the Bavarian Parliament.

HMRC disagreed, arguing that 'any enactment' could mean any enactment by any body or person authorised to legislate anywhere in the world. The consequence of such an argument would mean that a large number of overseas pension schemes could, theoretically, be eligible to register.

The FTT's view was that 'enactment' refers to an Act of the UK Parliament and therefore, by applying the ordinary rules of construction, 'any enactment' did not include legislation passed by the Bavarian Parliament. As such, BÄV was not considered to be a 'public service pension scheme' for the purposes of FA 2004 s 154(2) and was not eligible to register as a pension scheme under FA 2004 s 153.

HMRC accepted that if BÄV was ineligible to register, there was a discriminatory breach of EU law restricting the free movement of capital. However, in such a scenario, HMRC considered that EU law would require a conforming interpretation be given to the meaning of 'any enactment'. The principle of consistent interpretation is summarised in *Vodafone 2 v HMRC* [2009] STC 1480, and any conforming interpretation must go with the grain of the legislation (per *Ghaidan v Godin-Mendoza* [2004] UKHL 30).

The FTT considered that FA 2004 s 150(3)(a) could not be given a conforming construction and could not widen the meaning of 'any enactment' as asserted by HMRC. This was on the basis that the interpretation would dramatically increase the category of public service pension schemes and reduce the UK government's ability to restrict the availability of relief from tax. The FTT considered that such an amendment would go too far and cross the boundary between interpretation and amendment.

BTI's appeal was allowed on the basis that:

- BÄV was not a public service pension scheme under FA 2004 s 154(2); and
- a conforming construction could not operate to widen the meaning of 'any enactment' under FA 2004 s 150(3)(a).

The deemed registration argument

An alternative argument was advanced by the taxpayer in case HMRC was correct on the meaning of 'any enactment', such that it included enactments of overseas jurisdictions (albeit the FTT had found that BTI's interpretation of 'any enactment' was preferred). In this case, the deeming provisions in FA 2004 s 153(9) and Sch 36, with ICTA 1988 s 616, would operate to make BÄV a registered pension scheme.

As BÄV was established in 1923 by an act of the Bavarian Parliament, BTI argued that BÄV was (on this argument) a relevant statutory scheme in existence immediately before 6 April 2006 and a deemed registered pension scheme from that date.

HMRC argued that, in the context of the deemed registration provisions, 'any enactment' would *not* extend to cover enactments anywhere in the world, as it had a different meaning to FA 2004 s 154(2). The FTT considered that the impact of HMRC's argument was that until the relevant provisions of FA 2004 came into force on 5 April 2006, the UK was in effect in breach of its obligations under the Maastricht Treaty.

The FTT decided that the meaning of 'any enactment' in the context of ICTA 1988 s 612 and FA 2004 s 150(3)(a) was the same; and, on the basis of its reasoning on the enactment argument, 'any enactment' was confined to Acts of Parliament or similar UK legislation. Therefore, the deeming provision did not apply. If the FTT was wrong on the enactment argument such that 'any enactment' should include legislation of the Bavarian Parliament, then BÄV would be deemed to be a registered pension scheme with tax exemption for its investment income.

The restriction argument

It was not necessary for the FTT to consider the EU law arguments concerning the additional administrative burdens and potential tax charges applicable to BÄV should it have been a pension scheme entitled to be registered under the UK domestic rules, as it had already found in favour of BTI on points of construction. However, this was considered for completeness.

It was agreed that the acquisition of investment property in the UK by BÄV, and the right of income deriving from it, was a movement of capital under article 63 of the Treaty on the Functioning of the European Union. If BÄV was eligible to register as a pension scheme in the UK, the discrimination would be covert if, as alleged, the initial registration and ongoing requirements were more onerous and difficult to comply with for non-resident versus resident pension schemes.

The FTT considered that BÄV was not comparable to a pension scheme registered in the UK, as it had not actually registered. On this basis, the FTT formed the view that it was comparable to an unregistered pension scheme. As such, the UK domestic rules were not discriminatory.

> The outcome of this appeal is likely to be relevant to non-resident pension schemes which have UK investments but have not registered under the domestic rules and so have not obtained exemption

Implications of the FTT's decision

This decision, which has not been appealed by HMRC, provides some clarity as to the FTT's understanding of the use of 'any enactment' in domestic legislation and its scope. If the purpose of the relevant provisions contained in FA 2004 is to restrict those that can establish registered pension schemes (and therefore exemption from tax on any investment income), it perhaps seemed illogical for HMRC to argue before the FTT that the definition of a public service pension scheme should extend to those created by any enactment of any legislative body around the world.

The outcome of this appeal is likely to be relevant to non-resident pension schemes which have UK investments but have not registered under the domestic rules and so have not obtained exemption. Whether or not a pension scheme is eligible for registration will be fact-specific. However, there may be non-resident pension schemes with similar fact patterns to that of BÄV that are established by an act of overseas legislature and, in accordance with the FTT's findings, are not eligible to register in the UK. The specific provisions of UK domestic legislation relating to the eligibility to register, including FA 2004 ss 153–154, may require amendment in order to make them EU law compliant. ■

The authors' firm acted for the taxpayer in this case.

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- Repayment claims: practicalities and procedure (Richard Doran & Nicola Hine, 14.2.19)