

VAT and Adviser Charging

The Retail Distribution Review requires that from 31st December 2012 all advisers* must adopt 'Adviser Charging'. This means that advisers can no longer be paid by commission, through a product charge, by a product provider. Whilst most advisers are well on the way to implementing adviser charging, there are some VAT implications to be aware of and HMRC published their final guidance in relation to VAT and adviser charging in March 2012.

In this document we have tried to provide a practical summary of the rules as well as giving you some real life examples to provide further clarity to the VAT rule for Adviser Charging.

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 (RIP), 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 (a) to (h) are held within an ISA or CTF.

From a VAT perspective, general financial advice where no specific product recommendation is made is not synonymous with the term 'advice' for the purposes of RDR and it is important to remember that although VAT rules have not changed as a result of RDR the application of the rules may vary.

Under the general principles for VAT any fees or commission for advice only (where there is no product recommendation) are always taxable however remuneration for an intermediary service may benefit from the VAT exemption if the adviser is directly involved in assisting the client with the intermediation of a product.

Intermediation, for the purposes of VAT exemption, consists of bringing together, with a view to the provision of Retail Investment Products, someone looking to buy a product with a Product Provider.

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.

*Adviser charging only applies to Investments. Mortgage and Insurance firms are exempt from this requirement.



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 intended to purchase a retail investment product, following on from recommendations made by the adviser. If the customer, subsequent to committing to effecting a policy, decides not to progress, the service would still qualify for VAT exemption, as it would fall into the category of an aborted transaction.

The advice process

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

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.



EXAMPLE 1

An individual has approached a financial adviser to review 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, using appropriate financial products. A fixed fee has been agreed for the work.

The adviser undertakes his standard advice process and discovers a retirement funding shortfall. He provides the client with a report detailing this shortfall but does not make a personal recommendation to resolve the shortfall by making further contributions.

In this instance the payment would be a taxable payment for VAT purposes as no attempt at intermediation took place.

EXAMPLE 2

An individual has approached a financial adviser to review 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, using appropriate financial products. A fixed fee has been agreed for the work.

The adviser undertakes his standard advice process and discovers a retirement funding shortfall. He makes a specific recommendation about how the client should solve this shortfall and provides the client with illustrations and an application form to be submitted to the provider.

In this instance the payment would be exempt from VAT as there is clear intention for intermediation to take place.

NB: there does appear to be some mixed messages that suggest that the client in Example 2 then chooses not to go ahead with the purchase of the Product recommendation then this would render the payment taxable for VAT purposes. It is however our opinion that as long as you can clearly demonstrate that there was a clear intention for intermediation to take place throughout the process, then any payment will remain VAT exempt. The intention to provide intermediation at all times should be made very clear in your Client Agreements.

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 HMRC has recently issued a further statement on ongoing services which states clearly that any ongoing services agreed at the point of intermediation is seen as incidental to the overall service of intermediation and will also be exempt from VAT.

The key to this will be in ensuring that any client agreement and subsequent service proposition make it very clear that any ongoing services are directly linked to ensuring the initial intermediation of the product remains effective.



EXAMPLE 1

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 undertaken a responsibility (recognised by the client agreement) to review the portfolio of RIPs and, as appropriate, rebalance the investments to remain aligned to an agreed asset allocation model, recommend new investments and to top up existing investments

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.

In this instance any ongoing payments will remain VAT exempt as although no intermediation took place as long as it is clearly evident that the ongoing payment is part of an overall 'package' of services encompassing advice, intermediation and ongoing review – with the ongoing review part being ancillary to the main exempt intermediation service.

EXAMPLE 2

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 undertaken a responsibility (recognised by the client agreement) to review the portfolio of RIPs and, as appropriate, rebalance the investments to remain aligned to an agreed asset allocation model, recommend new investments and to top up existing investments

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 top up his existing ISA account and to rebalance his overall portfolio in line with the clients agreed risk profile.

In this instance any ongoing payments will be VAT exempt as intermediation has clearly taken place.

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.

For VAT exempt services, evidence will need to be demonstrated through the Client Agreement and Ongoing Service Agreement that it in all instances it is the clear intention of the firm to undertake intermediation on behalf of its clients.

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 (on a rolling retrospective 12-month basis) 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.

It should be noted however that in some instance a firm might make a personal recommendation for a client to purchase a product such as an OEIC which whilst being run on a Discretionary basis does fall under the definition of a retail investment product, in this instance as the firm has undertaken the intermediation on behalf of the client any payments would be VAT exempt.

EXAMPLE 1

An individual has approached a financial adviser to review his investments. He decides that the client's objectives would be better served by the services being offered by a Discretionary Fund Manager and introduces the client to XYZ Discretionary Fund Managers. XYZ undertake their own appraisal of the client's circumstance and recommend a discretionary portfolio on behalf of the client. The client chooses to take up their recommendation and the Advisor receives an initial payment as well as an ongoing payment for introducing the client to them.

In this instance the payment would be a taxable payment for VAT purposes as the adviser was not involved in the intermediation; instead it was the DFM firm that executed the transactions.

EXAMPLE 2

An individual has approached a financial adviser to review his investments. He decides that the client's objectives would be better served by the services being offered by a Discretionary Fund Manager and recommends an OEIC where the funds mandate is run on a Discretionary basis.

In this instance the payment would be VAT exempt as although the fund is run on a discretionary basis it does constitute a RIP and therefore intermediation by the adviser has taken place.

The distinction here is that in example 1, the adviser is being remunerated for introducing the DFM to the client whereas in example 2 the payment is for acting as an intermediary between the client and the OEIC (and exempt RIP).

DFM charges are currently under review by HMRC and further guidance in this area is expected by the end of 2012.

