

GUIDANCE FOR DETERMINING THE VAT LIABILITY OF ADVISER REMUNERATION

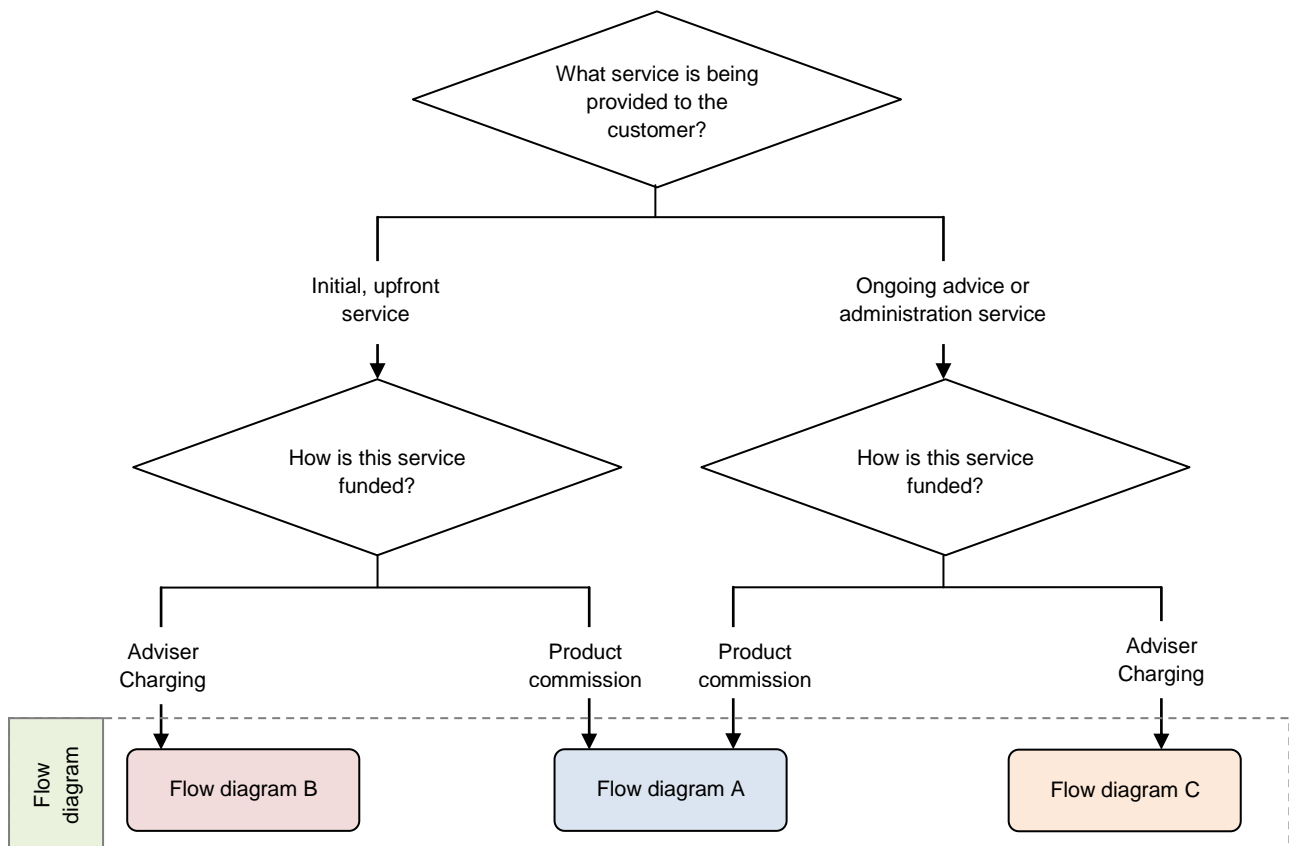
This guidance only applies to adviser remuneration received in connection with services relating to contracts for VAT exempt supplies

Introduction

This guide has been produced by the Association of British Insurers (ABI) to outline the VAT liability of a financial adviser's remuneration. The VAT analysis it contains has been agreed with HM Revenue & Customs (HMRC). It consists of five sections:

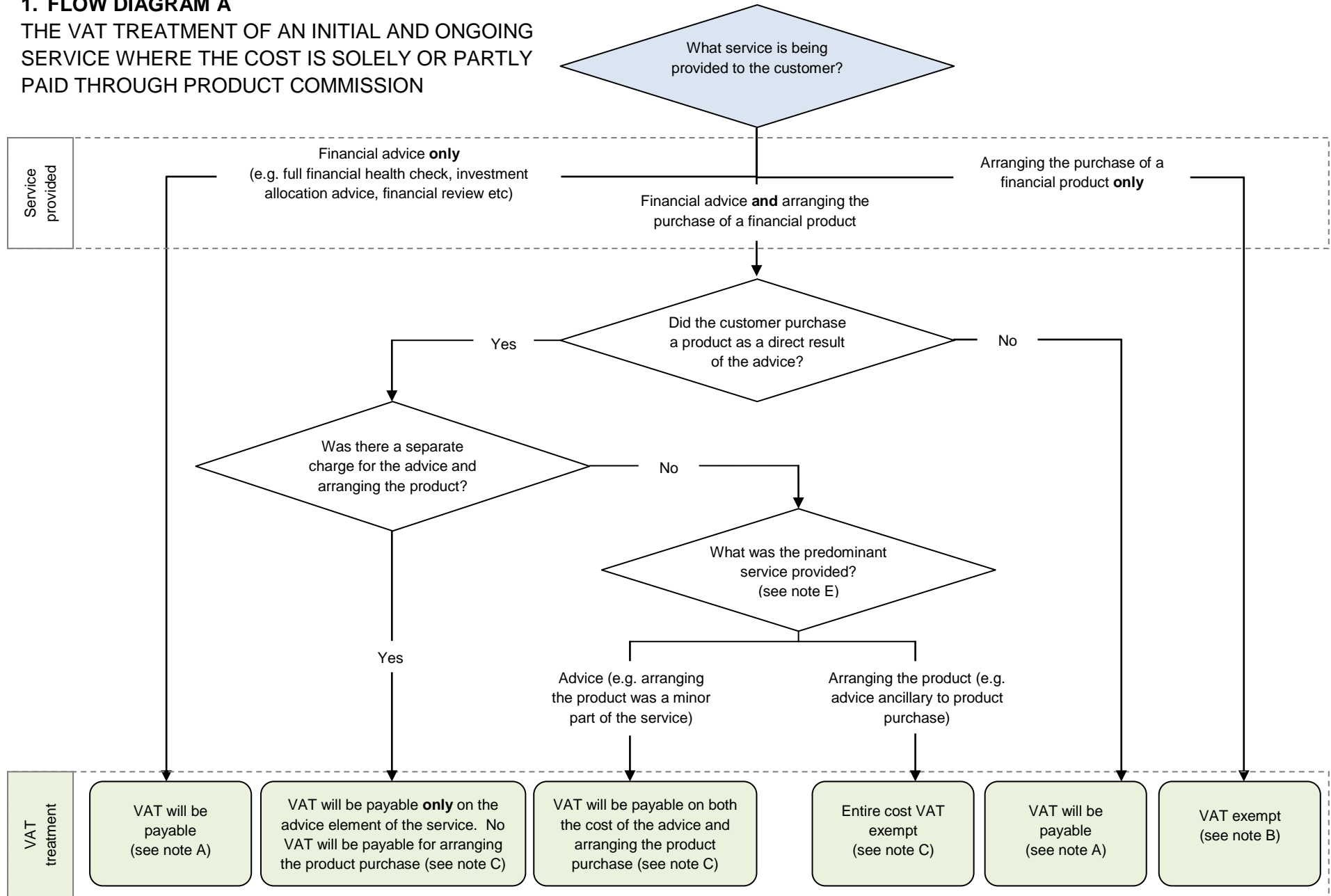
1. Flow diagram A – The VAT treatment of an initial and ongoing service where the cost is paid through product commission
2. Flow diagram B – The VAT treatment of an initial upfront service where the cost is paid through Adviser Charging
3. Flow diagram C – The VAT treatment of an ongoing service where the cost is paid through Adviser Charging
4. Notes to the flow diagrams
5. Frequently asked questions
6. Glossary of key terms

Which flow diagram should I use?



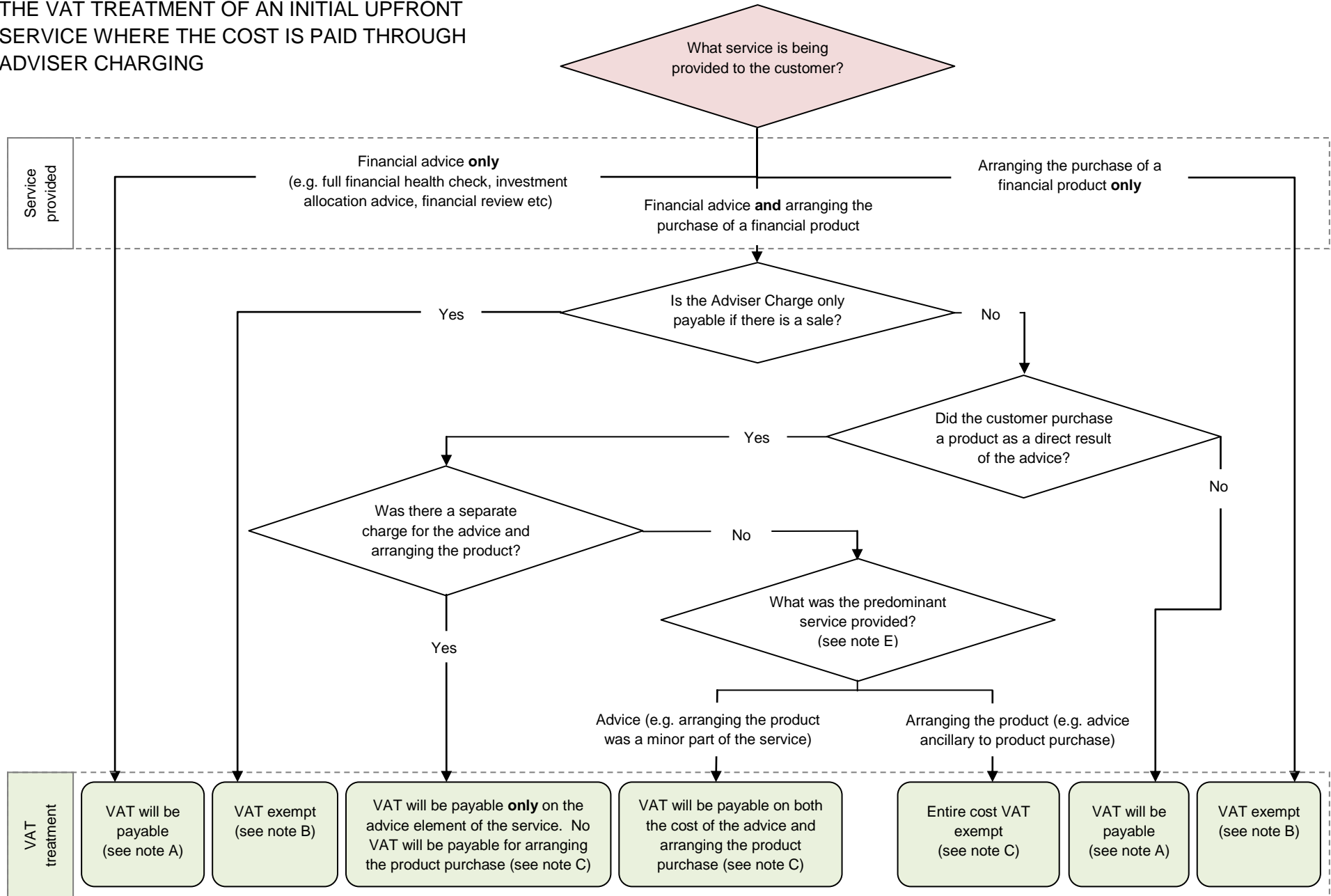
1. FLOW DIAGRAM A

THE VAT TREATMENT OF AN INITIAL AND ONGOING SERVICE WHERE THE COST IS SOLELY OR PARTLY PAID THROUGH PRODUCT COMMISSION



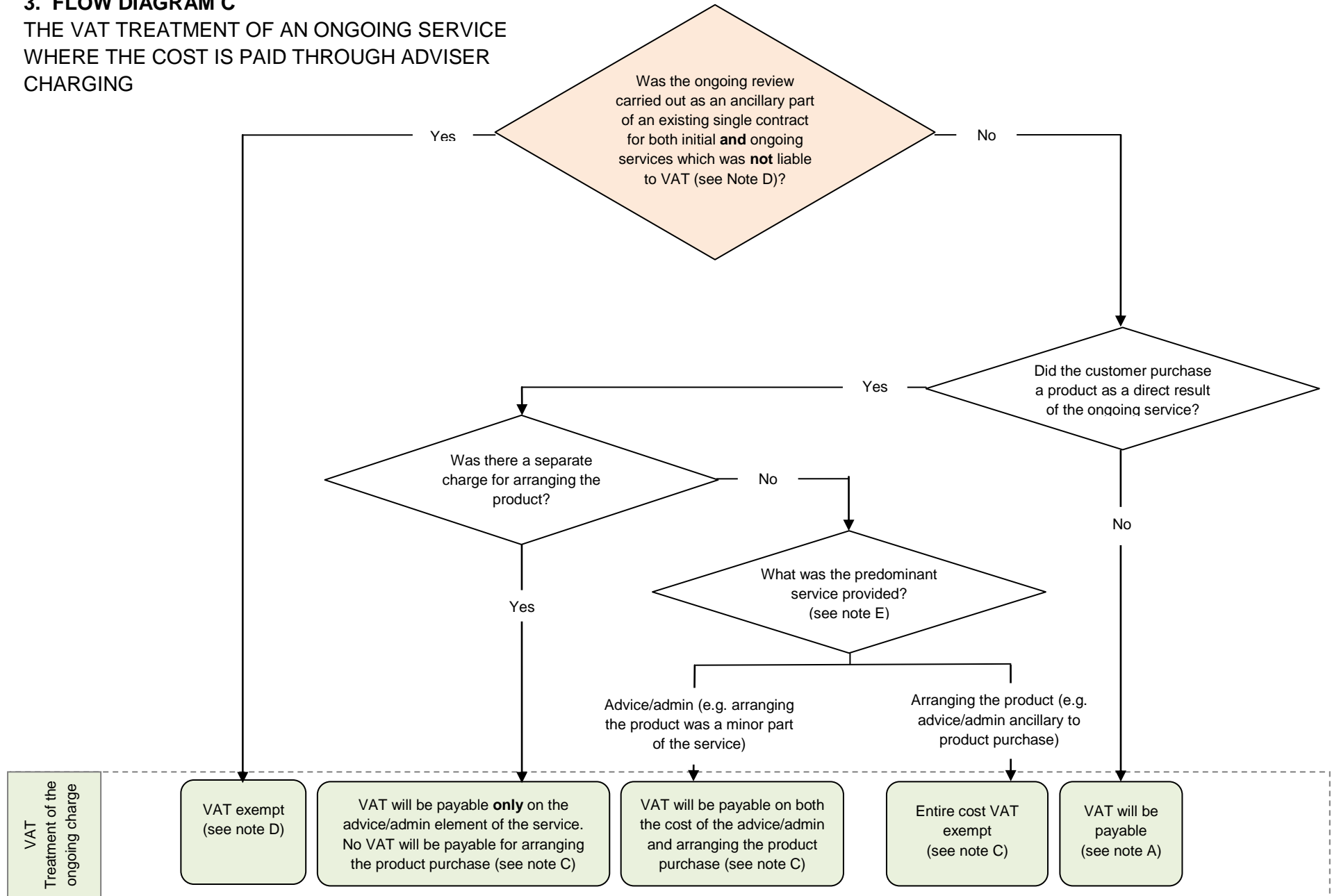
2. FLOW DIAGRAM B

THE VAT TREATMENT OF AN INITIAL UPFRONT SERVICE WHERE THE COST IS PAID THROUGH ADVISER CHARGING



3. FLOW DIAGRAM C

THE VAT TREATMENT OF AN ONGOING SERVICE WHERE THE COST IS PAID THROUGH ADVISER CHARGING



4. NOTES TO FLOW DIAGRAM

**This guidance only applies to adviser remuneration
received in connection with services relating to contracts
for VAT exempt supplies**

A. Customer only wants financial advice

The provision of advice is **taxable**.

Where the customer wishes for advice only, e.g. requests a valuation of current pension arrangements to enable them decide if they should make additional contributions, VAT will be due.

Where customer wishes their adviser to give them investment advice, VAT will be due.

B. Customer wants their financial adviser to arrange the purchase of a financial product (intermediary services)

The provision of intermediary services for arranging most financial and insurance products is **exempt from VAT**.

The intermediary service should contain 3 principle elements:

- ❑ bringing together a party seeking a financial service with a party that provides such financial services;
- ❑ acting **between** those parties; and
- ❑ undertaking work in preparation to the completion of a contract for the provision of financial services.

The service of **arranging** life, pensions and investment products and mortgage loans is therefore exempt from VAT, an 'exempt supply'. This exemption applies regardless of whether remuneration for the service takes the form of fees or commission.

C. Customer wishes both advice and intermediation

In a number of cases, customers will approach their adviser with the intention of both receiving advice and purchasing a financial or insurance product.

In such cases, it is important to establish which of the two elements of the service predominates.

Where the advice provided directly results in the customer taking out a financial or insurance product, and the adviser meets all the criteria for intermediary services in section B above, the **whole** of the service (including the advice element) is **exempt from VAT**.

In this scenario, the advice is seen as *ancillary* to the overall exempt service of intermediation. If the adviser receives commission from the finance / insurance provider, it is consideration for a separate exempt supply by the provider of the intermediary services.

On the other hand, there will be occasions where the advice provided outweighs the work done to arrange a contract (for example, when a customer receives a general financial health-check, with advice covering a range of financial issues, but then only purchases a minor product requiring minimal intermediation).

For example, where a consumer seeks inheritance tax planning advice, an adviser may help the consumer put in place a valid will so that assets are distributed tax efficiently; help the client utilise their lifetime exemptions; and provide funding for any inheritance tax liability. As part of this advice, the adviser may arrange a Whole Life contract for the consumer to meet any IHT liability. Under this scenario, the advice would be the predominant service, as arranging the product was a minor part of the process. The cost of the advice would therefore be liable to VAT. This is in contrast to an adviser arranging a whole life policy where a consumer has sought advice to meet a specific protection need, such as paying any funeral expenses when they die.

In these circumstances, it is the intermediary service that is *ancillary* to the advice, and **VAT is due on the whole service.**

The predominant service in any supply is a question of fact and cannot be chosen solely to achieve the best result.

If a distinction is made between the advice given and the arranging of an investment or insurance contract, the advice is taxable up to the point when the client decides to proceed with the advice i.e. effect the contract. One way in which IFAs may seek to make a distinction is to charge a separate fee for advice only, however this treatment does not necessarily mean that there are separate supplies.

D. Customer wants both intermediation and ongoing review services

If there is a single contract where the predominant service provided within the terms of that contract is arranging the purchase of a VAT exempt financial or insurance product and that contract provides for ongoing review services to be carried out as an ancillary part of that contract, then the total consideration paid in respect of services provided under that contract will be VAT exempt. If however, the ongoing review services are the predominant element within the terms of the contract, then the total consideration paid for services provided under that contract will be VATable as a single supply of advice. In each case, all factors must be considered to establish the nature of the predominant service being provided under the terms of the contract in order to determine the correct VAT treatment of the supplies (see Note C below). To be exempt under a contract for predominantly exempt product arrangement services, payment for all services (i.e. both the arranging and ongoing review services) must be agreed at the time the contract is entered into and the nature of the review services to be provided (i.e. exactly what services the customer will be provided with and over how many years) must be clearly laid out in the contract.

E. Predominant Service – Single or Multiple Supplies

The European Court of Justice (ECJ) and the House of Lords decisions in the case of Card Protection Plan (CPP) confirms the way in which businesses are required to decide whether they are making single or multiple supplies for VAT purposes.

The decision recognised that there are a variety of situations in which the predominance question can arise, and therefore it laid down a number of tests intended to cover most circumstances. The same tests are to be applied in every case and they are to be applied as a package with no single factor being decisive.¹

The tests are to be applied to two stages.

¹ HMRC VAT Information 02/01

1. Identify the essential features of the transaction

This involves identifying what the customer is actually receiving. Is the customer receiving two or more supplies each distinct and independent from the other or is the customer receiving one supply made up of a number of contributing component parts?

2. Is there a principal supply to which the other services are ancillary

If stage one does not identify separate supplies, it is necessary to consider whether any of the parts can properly be regarded as a principal supply to which the other goods or services are ancillary (that is, they do not constitute an aim in themselves but rather a means of better enjoying the principal supply).

Where there are two or more distinct supplies each independent of the other, each part of the consideration is liable to tax at the appropriate rate.

Where there is one principal supply to which the other services are ancillary, the whole transaction will follow the tax treatment of the principal supply.

Factors that indicate separate supplies may include optionality, pricing and customer awareness.

Diagram C contents two situations:

1. One where an individual has already purchased a review to be held in the future as part of a composite supply that was predominantly the purchase of a product (this would typically happen when the single fee charged by the intermediary for arranging the product also included an ancillary performance review element at a later date), and;
2. Alternatively the situation in which an individual purchases a review separately at a later date, which would need to be considered for VAT purposes separately on the basis of the service being provided by the intermediary for that separate charge.

5. FREQUENTLY ASKED QUESTIONS

(Answers provided assume that the adviser firm is registered for VAT)

1. A financial report is produced for a client but no investment / insurance contracts are arranged. Is VAT applied to the fee charged for the meeting and report?

YES – this is a service to the client which attracts VAT.

2. A firm advises a client and subsequently arranges investment / insurance contracts based on the recommendations made. Is VAT applied to the fee charged for the meeting, report and contractual arrangement?

If a client knows what he wants before any general advice is given i.e. “I need life cover”, “I want to start a pension”, then the advice and arrangement of the contracts are exempt.

However, if at the outset, the client does not have certain products in mind, but further to receiving advice subsequently purchases a product based on the recommendations made, then the predominant nature of the whole supply needs to be ascertained (see note D).

3. A firm agrees with a customer that a fee of £250 will be charged for a financial planning report unless any of the recommendations are acted upon, in which case the commission generated will be offset against the fee. Investment / insurance contracts based on recommendations made are subsequently arranged and generate enough commission to negate the original fee for the report. Is VAT applied to any part of the commission received by the adviser?

If the fee for the report is part of the whole supply which is predominantly the arrangement of a product then the entire amount is exempt.

4. What happens if the customer changes their mind?

If the customer intended to take out a product arranged by the adviser but changed their mind at the last minute, the supply of services may still be exempt. Where the adviser has started work in arranging for their customer to receive a financial product and that has been the predominant element of the service, the whole of the supply is exempt from VAT.

5. What happens in the case of charging separately for a financial review and implementing this review?

If an adviser charges separately for a financial review and then for implementing the review findings, liability will depend on the precise nature of the services provided. We would consider that a ‘financial review’ would appear advisory in nature, whereas ‘implementation’ would predominantly involve intermediation in the underlying investment transactions identified as required to implement the review conclusions. If the review and implementation are taken together then the usual predominance criteria would apply.

6. What happens if an adviser was restricted, such as a single or multi-tied adviser, and only considers a limited range of products as part of the intermediation process?

If an adviser was a single or multi-tied adviser, and therefore restricted to considering a limited range of products as part of the intermediation process (rather than potentially the “whole range market”), conceptually this should not impact on whether the supply is intermediation.

7. What happens if the service has been positioned/advertised as intermediation at the beginning of the process?

Where the service has been positioned/advertised as intermediation at the beginning of the process by the adviser, nothing should turn on this. The key question remains ‘what is the fundamental nature of what is being supplied?’, as opposed to what ‘what is the supply called?’.

8. Does the method in which the customer uses to pay an Adviser Charge effect the VAT liability?

It is recognised that there are a wide range of ways a customer could pay an Adviser Charge which will be agreed between the adviser and their client. The method of payment does not affect the liability treatment of this charge.

6. GLOSSARY OF KEY TERMS

Administration or performance review:	Where an adviser undertakes administrative duties such as providing portfolio evaluations, providing information the customer has requested or passing correspondence between product providers and the customer.
Adviser Charging:	A form of adviser remuneration where advisory firms are required to set and disclose the cost of their advice separate from the cost of the product. This Adviser Charge can be paid directly by the customer or paid out of a product or investment on a one-on-one matched basis.
Financial advice / financial review:	Where an adviser undertakes an assessment of a consumer's financial needs to deliver a recommendation. This could include a financial check up, investment allocation advice or a financial review.
Initial, upfront service:	Where an adviser undertakes a full assessment of a customer's financial needs to deliver a recommendation. Customers are likely to be new to the advisory firm, or existing clients who require more than administrative or performance related reviews.
Ongoing advice or administration service:	Where an adviser provides an ongoing service to an existing client. This ongoing service is likely to include administrative and performance related reviews or adjusting a client's portfolio.
Product commission:	A form of adviser remuneration where the product provider pays the adviser a fee for arranging the product.
Product purchase:	Where an adviser arranges a product purchase for a customer.