

HM Revenue & Customs is aggressively challenging private equity and funds clients on two VAT issues, which may give rise to retrospective and future VAT costs

An extract from Rain or Shine? July 2009

HM Revenue & Customs is aggressively challenging private equity and funds clients on two VAT issues,

which may give rise to retrospective and future VAT costs

Click on each PricewaterhouseCoopers author's name to contact them directly via email

By: [Stephen Morse](#), PricewaterhouseCoopers (UK), T: +44(0) 20 7212 2728 and [Antonia Sherratt](#), PricewaterhouseCoopers (UK), T: +44(0) 20 7804 1957

HM Revenue & Customs is aggressively challenging private equity and funds clients on two VAT issues,

which may give rise to retrospective and future VAT costs

Click on each PricewaterhouseCoopers author's name to contact them directly via email

By: Stephen Morse, PricewaterhouseCoopers (UK), T: +44(0) 20 7212 2728 and Antonia Sherratt, PricewaterhouseCoopers (UK), T: +44(0) 20 7804 1957

The issues are the use of offshore funds and deal fee VAT recovery made by portfolio companies on acquisition/ investment costs incurred within the last three years. Whilst you may have heard of these types of challenges before, they are much more focused and targeted challenges than those we have seen in the past, which have resulted in a large number of assessments being issued on clients for VAT plus the addition of interest, and in some cases, penalties.

Offshore funds

HMRC is challenging clients on the VAT treatment of operations which are located partly or wholly offshore. In one case this has led to an assessment by HMRC for £1m in back VAT, and in another to a refusal by HMRC to pay a client's back claim for £2m. This is likely to be a real issue for the vast majority of private equity fund and infrastructure clients which either have offshore funds or which manage offshore third party funds.

HMRC's challenge is on both specific VAT technical and broader 'tax avoidance' grounds. On the technical front, HMRC is arguing that the (fund) is properly established in the UK for VAT purposes based on the relationship between the onshore manager and the offshore fund and the various functions performed by each; the 'tax avoidance' argument focuses on the decision to have an offshore rather than an onshore fund. VAT case law and practice has developed in the past few years, and clients should review any offshore fund arrangements both from a structural and an operational perspective.

Deal fee VAT recovery

HMRC appear to be systematically carrying out an exercise to identify and then challenge deal fee VAT recoveries made by portfolio companies within the last three years. HMRC is being very robust in challenging VAT claims on a line by line basis, even where the VAT itself has already been repaid.

Assessments for repayment of VAT plus interest (and in some cases penalties) are following very quickly from the initial enquiry letter from HMRC.

Click on each PricewaterhouseCoopers author's name to contact them directly via email

By: Stephen Morse, PricewaterhouseCoopers (UK), T: +44(0) 20 7212 2728 and Antonia Sherratt, PricewaterhouseCoopers (UK), T: +44(0) 20 7804 1957

Assessments for repayment of VAT plus interest (and in some cases penalties) are following very quickly from the initial enquiry letter from HMRC. In some cases HMRC is challenging the whole portfolio; there is some experience of HMRC questioning the VAT liability of transaction fees charged by the PE House/fund manager which, if successful, would impact on the House/manager itself.

Clients should review both the strategies used to maximise VAT recovery and the transaction documentation itself to assess the relative strengths of the respective arguments. Care should be taken in responding to HMRC to ensure that the strongest arguments are put forward at the earliest

possible stage, to reinforce the strengths of the arguments in favour of VAT recovery. Equally, if VAT is not considered early enough in the deal, the deal fee VAT recovery position is at risk going forward and action such as ensuring engagement formalities and engagement terms are as robust as possible will be required to prevent further challenges from HMRC. It is not inconceivable that this could also lead to a similar review of the corporate tax treatment of costs incurred.

pwc.com

© 2009 PricewaterhouseCoopers. All rights reserved. PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

PricewaterhouseCoopers provides industry-focused assurance, tax, and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 155,000 people in 153 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

This report is produced by experts in their particular field at PricewaterhouseCoopers, to review important issues affecting the financial services industry. It has been prepared for general guidance on matters of interest only, and is not intended to provide specific advice on any matter, nor is it intended to be comprehensive. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers firms do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.