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Arthur Cox is one of Ireland's leading law firms. It comprises 300 lawyers including 91 partners. The firm's principal office is located in Dublin and we also have offices in Belfast, London and New York. The practice of the firm encompasses all aspects of corporate, business and finance law.

Arthur Cox's Pensions Group is one of the leading specialist teams in the Irish pensions sector. The Group has considerable experience providing advice on all aspects of pensions law to a wide range of corporate clients, public sector and former public sector clients, pension scheme trustees and scheme members.

Our practice involves advising on legal issues that relate to the establishment and operation of occupational pension schemes, providing advice on establishing trusts and the provision of legal advice to the trustees, and also dealing with the pensions aspects of commercial transactions.

UPDATE ON RECENT PENSIONS LAW ISSUES

Green paper; VAT cases; MiFID

This is a brief update of our general view on three matters which are currently giving rise to comment in the Irish pensions industry.

Green paper

You will no doubt be aware that the Irish Government has recently published a Green Paper in connection with proposals to reform the provision of pensions in Ireland. The Green Paper is a helpful summary of the current issues facing pensions in Ireland (such as adequacy of defined contribution accounts) and restates some long-standing suggestions (such as a State sponsored annuity product and mandatory basic defined contribution pension provision).

The Green Paper simply asks questions and aims to inform a debate rather than provide answers. Currently the consultation period is set to run until an unspecified date in mid to late 2008. Unless you wish to make a submission on a specific topic no action is required at this stage.

VAT cases:

(Cadbury - Irish case, Abbey National and JP Morgan - ECJ cases)

These cases are of interest and relevance to trustees of self administered schemes - particularly those who employ investment managers in other EU member states.

Cadbury case

A recent Irish VAT case (the *Cadbury* case) has raised the issue of whether Trustees of a defined benefit scheme where the employer was not a Trustee of the scheme were obliged to register and reverse charge themselves Irish VAT on investment management services received from the United Kingdom. The key issue for determination in the case was whether the Trustees were receiving the services from the UK Investment Manager for the purposes of a business carried on by them in Ireland. To the extent that they were, then the Trustees would be deemed to be taxable persons in Ireland in respect of those services and would be required to register and self account for Irish VAT on the services as if the

Trustees had supplied the services themselves.

The Cadbury case concluded that the Trustees were receiving the services for business purposes and were therefore obliged to register and self account for VAT on the services.

It was common ground in the Cadbury case that the investment management services were provided to the Trustees and not to the employer (which was not one of the Trustees). As this follows an earlier UK decision along similar lines it would appear that arguments that a pension scheme is an extension of an employer's business are no longer tenable where the employer is not a trustee of the scheme. Given that the employer does not receive the service, a VAT deduction may no longer be available to employers in relation to the VATable element of fund management expenses provided to trustees.

Where the employer is sole trustee of a pension fund it is unclear as a result of the case whether it is still possible for an employer to argue that such services are regarded as being supplied to the employer with the result that the employer should (depending on the general VAT recoverability position of the employer) be in a position to claim a VAT deduction on such costs where charged. It should be noted that this issue was not considered in the Cadbury case. However, we would suggest that all employers need to review their VAT recoverability position in light of the Cadbury case.

Where does this leave us?

The Revenue Commissioners' position that the Trustees of schemes (where the employer is not a trustee) are the recipients of the investment management services and not the company appears to have been conceded and affirmed in this case. Companies who pay for these services and seek input tax deductions are likely to be challenged and denied input credits by the Revenue in respect of such schemes.

Where an investment manager from another EU member state is involved the overseas nature of the supply means that Trustees of schemes would be obliged to register for VAT in Ireland and self-account to the Irish Revenue Commissioners for VAT on such services. Obviously this could create a VAT cost for the Trustees unless the Trustees were making VATable supplies in Ireland. To the extent that the Trustees were engaged in making VATable supplies in Ireland they should be able to recover this VAT with the result that there should

be no VAT cost to the Trustees. However, there is an administrative burden for such Trustees given that they would have to file bi-monthly VAT returns to be in a position to recover the VAT that they would have to charge themselves on such supplies.

Trustees of such schemes may wish to consider charging the employer a fee equating to their own external costs. Given that the Trustee would be obliged to charge VAT on the services supplied to the employer the Trustee would therefore be engaged in making VATable supplies in Ireland with the result that the Trustee could recover the VAT suffered on the investment management services. In addition such a structure if carefully implemented could enable the Trustee to pass the VAT cost on to the employers who depending on their VAT recoverability position may be able to claim a deduction in respect of the VAT it incurs on the Trustee fees. This will not assist all employers but it may assist some.

The VAT recoverability position of companies who are trustees of schemes is unclear but should be reviewed in light of the decision in this case.

In the light of the Cadbury case we recommend that clients check:

- (a) whether the employer is a trustee of the scheme;
- (b) whether the company or the trustees receive invoices from investment managers;
- (c) if so, to whom are invoices currently addressed? It is likely that these should properly be addressed to and paid by the trustees if the employer is not a trustee of the scheme. The Revenue may seek to deny a VAT deduction to employers reclaiming the VAT cost of such expenses; and
- (d) if there are invoices from managers in other EU member states, do those invoices include VAT? If not, the Trustees may be obliged to register and submit the VAT to the Revenue Commissioners.

Schemes not previously registered for VAT should now consider registering and making payments to the Revenue on account of VAT due in respect of investment management services received from overseas managers.

In the light of the ECJ cases below we understand that some schemes are attempting to reserve the right to reclaim the VAT if a challenge to VAT on pension scheme investment management charges is successful. This is discussed further below.

ECJ cases (Abbey National and JP Morgan)

The IAPF has circulated an email referring to the possibility of pension funds being exempt from VAT on investment management services. This follows an article by PwC in the Autumn 2007 Irish Pensions magazine.

Two very specific ECJ cases concerning collective investments known as “special investment funds” for the purposes of the VAT Directives were decided in 2006. The cases concerned the meaning of the expression “management of special investment funds” because the provision of investment management services to such funds is exempt from VAT. The ECJ decided for technical reasons that Member States in effect did not have the right to restrict the interpretation of the phrase so as to lead in imbalances in the overall management costs for competing collective investment vehicles.

The cases are not of immediate application to occupational pension schemes because such schemes are not regulated collective investment funds. Occupational pension schemes are at this point outside the scope of the VAT exemption as it is currently drawn. A number of commentators in Ireland and the UK feel that these judgments open the way for pension schemes to claim that they should be entitled to a similar exemption and there are rumours that test cases are being contemplated.

The fact that the cases did not take a narrow view of the terms is consistent with the fact that the VAT treatment of financial and insurance services is being reviewed. In the event that a challenge is mounted on behalf of pension schemes and is successful it may be possible to reclaim VAT paid within the last four years of any resulting decision. It is on these (at this stage somewhat hopeful) grounds that some schemes now paying VAT are reserving their right to reclaim it in the event of a change in the law. In this regard it is instructive to note that HMRC in the UK has very recently confirmed that it continues to be of the view that the JP Morgan and Abbey cases do not extend to pension schemes. There is clearly no harm in attempting to reserve this right but equally there is, at this stage, little prospect of an early exemption from such VAT.

MiFID – The “investments” Directive

MiFID is the EU’s Markets in Financial Instruments Directive. This Directive has reformed the “Conduct of Business” rules which applied to regulated investment managers in their dealings with other parties. The Directive came into force on 1 November 2007 and was widely expected to make little difference to the way in which pension moneys are invested.

This has broadly speaking turned out to be the case but some schemes/trustees are now being asked to sign off on certain aspects of their investment managers policies or to give explicit consents to certain approaches to dealing or the provision (or non-provision) of information. This is because the MiFID rules place a greater burden on investment managers to show that they have properly categorised their clients and have taken steps to obtain express consents before engaging in certain activities (e.g. trading outside a regulated exchange).

Most if not all pension scheme trustees will now be automatically categorised as “Professional Clients”. As such they have essentially the same protection but with slightly greater involvement and information and the opportunity to request that in respect of some trades or types of business that they be treated as Retail Clients.

The additional protections for Retail Clients involve the investment manager in obtaining information from the client to assess their investment experience in order to provide them with appropriate information as to the proposed investments. Also the onus is on the investment manager to consider (and to prove that they have considered) the suitability and appropriateness of the investment for that Retail Client. In particular the “suitability” test requires the manager to gather information on the investor’s financial situation and investment objectives. Without obtaining this information the manager is prevented from providing the service. It is clear that most pension scheme trustees would neither want nor need to be classified as Retail Clients in respect of the substantial majority of investment management services.

The more hands on approach under MiFID has three important consequences:

- “Professional clients” can elect to be treated as “Retail clients” for some or all of their business even on a trade by trade basis. This might be appropriate if the manager

was proposing engaging in a form of investment of which the trustees had no experience; or, the Trustees were engaging in a new service - such as stock-lending or hedge fund investment. A client must be notified by the manager that it is being treated as a professional client.

- Clients can also be categorised as “eligible counterparties” provided they consent to be so categorised by the manager. Eligible counterparties are a form of super professional clients and are owed fewer disclosure obligations than professional clients. Very few, if any, pension scheme trustees would want to be included in this category.
- The greater degree of transparency under MiFID means that managers are required in some circumstances to obtain express consents to certain actions. Depending on the nature of the investments and the way in which a particular investment house trades in order to get best execution it may be necessary for the manager to receive an express consent in order to continue to act in exactly the same way as it was acting before MiFID came into force by, for example, buying securities off a regulated market.

Over the next while some trustees of self administered schemes will receive requests from managers:

- to accept additional disclosures under their investment management agreements; or
- to approve execution policies on how investments are traded for the scheme; and/or
- to expressly consent to certain types of investment activity/ means of executing trades etc.

In many cases these requests will not result in any material change to pre MiFID activities. However it may be prudent, as with any new wording, to review the new proposed consents/wording to ensure that they do not conflict with or amend existing agreement provisions and they are not wider in scope than the trustees would be happy with.

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The comments above are a general summary of developments and are not a complete or definitive statement of the law. Specific legal advice should be obtained before taking action on the points set out above.

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