



23 June 2025

VAT RECOVERY ON PENSION COSTS

HMRC ANNOUNCES MAJOR POLICY CHANGE ON VAT FOR PENSION FUND INVESTMENT COSTS

On 18 June 2025, HM Revenue & Customs (HMRC) changed its policy on the recovery of VAT on investment costs. Effective immediately, employers can now treat all VAT incurred on investment management services for occupational pension schemes as their own input tax and reclaim it, in line with standard input tax rules.

This significant simplification for occupational pension schemes and their sponsoring employers ends years of difficulty surrounding VAT recovery on investment management costs.

BACKGROUND: NAVIGATING THE MAZE OF VAT AND PENSION FUNDS

Historically, to recover VAT, employers had to demonstrate that they had both contracted for and paid for investment services. When investment costs were shared between the employer and pension scheme trustees (“dual use”), employers had to apply a fair and reasonable apportionment, creating significant administrative complexity and uncertainty.

The HMRC policy announcement does not alter the current position regarding administration services, such as scheme setup, legal, and actuarial advice. In this context, the employer can usually reclaim VAT, provided it receives the tax invoice, even if the trustee pays.

THE NEW REGIME: EMPLOYERS CAN RECOVER ALL INPUT VAT ON INVESTMENT COSTS

From 18 June 2025, all input VAT incurred on investment management costs for occupational pension schemes will now be treated as the employer’s input VAT. This means employers can recover all this VAT, subject to the usual VAT deduction rules, without needing to perform complex apportionment calculations.

For pension fund trustees who are VAT-registered and provide management services to the employer, the new policy also allows them to deduct input VAT incurred in delivering those services, in line with standard deduction rules.

Furthermore, it increases the likelihood of backdated claims extending up to four years for businesses with limited VAT recovery options.

IMPLICATIONS FOR PARTIAL EXEMPTION SPECIAL METHODS (PESMS)

This policy change may affect existing Partial Exemption Special Methods (PESMs) used by employers and pension schemes. HMRC has clarified that any new PESMs approved after this change will take effect from the start of the tax year in which the PESM was submitted.



FURTHER HMRC GUIDANCE DUE LATER THIS YEAR

HMRC has promised to issue further guidance on the new policy by autumn 2025, giving the industry time to adjust and seek clarity on any outstanding questions.

WHAT SHOULD EMPLOYERS AND TRUSTEES DO NOW?

Review current arrangements: Assess how investment management costs are contracted and paid, and whether existing VAT recovery processes need updating.

Check PESMs: Decide whether your current partial exemption method remains suitable or if a new process should be agreed upon with HMRC.

Consider whether to reclaim VAT on historic costs: eligible claims can be made retrospectively for up to four years.

Prepare for new guidance and be ready to implement any additional changes it may require: HMRC say they will publish guidance to explain the policy change "by autumn 2025".

CONCLUSION

By clarifying and broadening the scope for VAT deduction, HMRC is helping to reduce administrative friction and potentially improve outcomes for pension schemes and their members.

Please contact your usual Stephenson Harwood representative for specific advice on how this will affect you or your scheme.

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