The devil is in the detail

Indirect Tax



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Tarlochan Lall examines the legal implications of Brexit for VAT

Key Points

What is the issue?

The decision to leave the European Union will inevitably have consequences for VAT.

What does it mean to me?

Taxpayers and HMRC alike would undoubtedly test whether everything remains the same post Brexit on a case by case basis.

What can I take away?

This article attempts to shine some light on what Brexit is likely to mean for VAT given Theresa May's declared intention to incorporate all EU laws implemented in the UK into British law.

The House of Commons briefing paper *Tax after the EU referendum* carried the statement '… the relative importance of VAT to the Exchequer – accounting for around 17% of all government receipts – suggests that future governments would be unlikely to substantially increase… reliefs or abolish the tax, even while exit from the EU would give them this power.'

Although what is now the Value Added Tax Act 1994 ('VATA') was enacted to comply with the obligations to implement the VAT directives, it is nevertheless an Act of Parliament so it would remain effective notwithstanding Brexit unless and until it is changed by Parliament. There are many statutory instruments which take their vires from section 2(2) of the European Communities Act 1972, but the primary Value Added Tax Regulations 1995 take their vires from primary VAT legislation, so those regulations would also remain in place. The essential VAT code would remain in place without any additional legislative act. One clear exception would be the treatment of transactions between UK operators and those in the EU, which would become imports and exports unless the current status is preserved under a VAT union.

Bernard Jenkins, chair of the public administration and constitutional affairs select committee wrote in the *Financial Times* on 31 July 2016: 'Leaving the EU is in principle straightforward; much easier, in fact, than joining since it is not necessary to change domestic laws and regulations. All the laws and regulations that apply by virtue of Britain's membership can remain perfectly aligned with those of the rest of the EU until they may be changed at a later date. This is how the UK gave independence to the countries of the British Empire.'

That statement indicates thinking within Government on the approach to dealing with Brexit. No doubt matters of detail will receive due attention once the shape and form of Brexit becomes clear.

EU Regulations, which are binding and have direct effect in member states without any domestic legislation by virtue of article 288 of the Treaty on the Functioning of the European Union. Once the UK ceases to be a member of the EU, EU Regulations would cease to have effect in the UK. There are a number of VAT related regulations, for example the Implementing Regulation 282/2011/EU. The UK would have to decide whether any parts of those regulations need to continue to apply in amended or un-amended form for which some legislative action would be required.

It is understood that HMRC is considering whether the UK should remain a member of the VAT union in the same or similar way that some non-EU countries are members of the customs union. The mechanism by which that is achieved would be expected to preserve the VAT related regulations. In that case, unless something different is done, the case law of the Court of Justice of the European Union would be expected to remain binding. That would essentially preserve the VAT system as we know it, although even then differences or issues may be identified on points of detail.

Should the idea of a VAT union not meet approval, although the essential VAT legislative code would remain in place, questions begin to arise on what would happen to EU and domestic VAT jurisprudence. Firstly, it can be safely assumed in the period to Brexit taking effect, nothing would change. Post Brexit, things may well change, in some cases significantly.

Starting with the construction of VAT legislation that remains in place, decided relevant cases would at least give a starting point, if not the complete answer to how the VAT legislation should be construed going forward. However, taxpayers and HMRC alike may well consider whether opportunities arise for calling into question the application of previously decided cases. That would give rise to issues such as whether previous case law will remain binding post Brexit. If so, to what extent? Most significant issues would arise from cases which give effect to provisions of the VAT Directive and general principles of EU law which would cease to apply following Brexit unless preserved in some way. The extent to which such decisions remain binding could well be called into question. That question would potentially require proper analysis. Here the matter is introduced by reference to four categories of

issues, namely:

- is there a difference between business and economic activity?
- cases concerning real property;
- single and multiple supplies;
- abuse.

These four categories are by no means exhaustive. They have been selected simply to illustrate how issues of detail may arise post Brexit.

Business/economic activity

VATA refers to business. The VAT directive refers to economic activity. Lawrence Collins J in *Riverside Housing Association Ltd v Revenue and Customs Commissioners* [2006] STC 2072 said '[68] Section 4 refers to "business" and art 4 refers to "economic activity", but it is clear that the 1994 Act must be construed so as to conform with the Sixth Directive: *Institute of Chartered Accountants in England and Wales v Customs and Excise Comrs* [1999] STC 398 at 402, [1999] 1 WLR 701 at 705, applying *Marleasing SA v La Comercial Internacional de Alimentacion SA* (Case C-106/89) [1990] ECR 4135.'

Although this case be construed as authority for the proposition that there is no difference between the meaning of business and economic activity, notably, the basis for the conclusion is that the VAT was construed so as to conform with the Sixth Directive. On Brexit, strictly, the obligation to conform would fall away. However, retention of VAT in the un-amended form would essentially imply that the purpose or aims of the VAT Directive would be retained as part of the VATA. Otherwise, what purpose or aims would VATA have? Article 4 of the Sixth Directive, and now article 9(1) of the VAT Directive 2006/112/EC, specifically directs economic activity remains whatever its purpose or results. There is no similar direction in the VATA. Not for profit operators, such as the Housing Association in case mentioned above, may well wish to have the point tested post Brexit whether their status alters the outcome.

Real property cases

In the early days of VAT, there were few references to EU law in tribunal decisions. In cases concerning real property in particular, domestic property law often had a bearing on the outcome. The Advocate General in *Stichting 'Goed Wonen' v Staaatssecertaries van Financien* [2003] STC 1137 recognised that 'Community law gives member states a great deal of discretion in determining the VAT treatment to be applied to immovable property…'. Cases such as *Lubbock Fine* (Case C-63/92) [1994] STC 101 started to alter the position. Following that case in 1995, surrenders of leases were incorporated into the definition of 'grant' in VATA, Schedule 9 Group 1, note (1). That type of provision would clearly remain. In other cases current constraints imposed by EU law, once removed, would have the scope of altering the outcome of cases. The most obvious example is the line of cases where a particular construction of UK legislation is considered to extend the scope of zero rating which is not permitted – see *Talacre Beach Caravan Sites Ltd v Customs and Excise Commissioners* (CC-251/05) [2006] STC 1671 line of cases. Once the constraint of EU law preventing the scope of zero rating being extended is lifted, a UK tribunal and court may well be persuaded that activity which otherwise comes within the scope of the zero rating provisions in VATA should qualify for zero rating.

Single and multiple supplies

This category of case is capable of generating a new lease of life without Brexit. Post Brexit, one question that would arise is whether the case law in this area upholds specific parts of EU law which cease to apply or whether the principles are such that they would continue to apply regardless of EU law, especially having established under the high authority of the English Courts.

The leading *Card Protection Plan* case C-349/96, although based on earlier CJEU cases (*Faaborg-Gelting Linien* Case 231/94 and *Madgett and Baldwin* joined cases C-308/96 and C94/97) was decided by the House of Lords when returning from the CJEU. The House of Lords followed the CPP principles in *Dr Beynon and Partners v CCE* [2005] STC 55 warning against artificial dissection of transactions and holding that the outcome was determined by the economic reality of transactions entered into. That approach is arguably not specific to EU law. Therefore cases such as *CPP and Dr Beynon* would be expected to remain binding. Evolution in the manner of undertaking transactions will continue and with it, there is scope of new issues arising, which may pave the way for a change in the approach of the English courts.

Abuse

The subject of abuse presents a difficulty for the tax authorities as a result of which it would be expected that something specific would be required rather than awaiting a decision of the courts. The principle of abuse is a principle of EU law. The CJEU in *Halifax plc and others v Customs and Excise Commissioners*–[2006] STC 919 held:

‘74. … in the sphere of VAT, an abusive practice can be found to exist only if, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions.

75. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage.

Earlier the CJEU had held

‘68. ... according to settled case law, Community law cannot be relied on for abusive or fraudulent ends (see, in particular *Kefalas v Greece and OAE* (Case C-367/96) [1998] ECR I-2843, para 20; *Diamantis v Greece* (Case C-373/97) [2000] ECR I-1705, para 33; and *I/S Fini H v Skatteministeriet* (Case C-32/03) [2005] STC 903, [2005] ECR I-1599, para 32).

…

70. That principle of prohibiting abusive practices also applies to the sphere of VAT.’

As can be seen, the principle of abuse is a concept of EU law. In *Halifax* it was extended to VAT. The concept of abuse is distinct from the concepts of tax avoidance or tax evasion. Essentially, if there is no abuse of community law, the principle does not apply. Although VATA implements provisions of the VAT directives, the question is whether the UK provisions inherit all the purposes of those provisions. The answer may well be obvious that they do. On the other hand that may be going too far. The issue for both HMRC and economic operators is whether something should be done to make that clear rather than awaiting a decision of the English courts on that point, which may take a number of years thereby prolonging uncertainty.

There are related issues. The first is whether the *Ramsay* doctrine (see *Ramsay (WT) Ltd v IRC*, *Eilbeck (Inspector of Taxes v Rawling)* [1981] STC 174) which applies to direct taxes would apply to VAT. From a practical perspective, that issue involves the self-same difficulties that a court decision to confirm that may well take time and involve uncertainty. The *Halifax* principle is also a substantial part of the basis for the CJEU's decision in *Kittel v Belgium*; *Belgium v Recolta Recycling SPRL* (joined cases C-439/04 and C-440/04) [2008] STC 1537. HMRC rely heavily on that decision for dealing with missing trader fraud. Any doubts over the applicability of the *Halifax* principle which extends to the *Kittel* principle would create uncertainty for HMRC and taxpayers alike. A further issue is that incorporating these types of principles into UK law would be challenging.

General principles of EU law

There are a number of general principles of EU law, applied in the context of VAT which will strictly cease to apply to the UK. It is, however, difficult to imagine how the principles of fiscal neutrality, equal treatment, legal certainty, proportionality, legitimate expectation could cease to apply in the UK or that they would do so. Assuming no fundamental changes are made to the system of VAT, the pre-Brexit system of VAT will remain in place. Furthermore, VAT is adopted over 114 countries outside the EU. The OECD's International VAT/GST guidelines published in November 2015 recognised that: 'Basic VAT principles are generally the same across jurisdictions insofar as they are designed to tax final consumption in the jurisdiction where it occurs according to the destination principle.'

Those guidelines also recognised the following common features of VAT systems adopted in non-EU countries. Their overarching purpose is to impose broad based tax on consumption. Their central design feature is that tax is collected through a staged process. A fundamental principle is that the tax burden should not rest on businesses and systems require a mechanism to relive that burden. The principle of neutrality achieves that purpose. That principle was said to have a number of dimensions, namely

- the tax burden 'should not lie on business except where explicitly provided for in legislation', e.g. exempt and outside the scope activity;
- the absence of discrimination in a tax environment: 'businesses in similar situations carrying out similar transactions should be subject to similar levels of

taxation';
- the elimination of disproportionate and inappropriate compliance costs.

The OECD guidelines also recognised other principles, in particular that the VAT system requires certainty and simplicity, such that it is 'clear and simple to understand… including knowing when, where and how the tax is to be accounted'.

Those guidelines are not binding. However, they would lend support to arguments that the fundamental principles referred to above having applied by the courts in the UK pre-Brexit would continue to apply post Brexit and probably have binding force post Brexit. The principles of legal certainty, proportionality and legitimate expectation can be found in other parts of the common law should it become necessary to find other authority.

Conclusion

There is much support for the proposition that post Brexit, as far as VAT is concerned, it will be business as usual and pre-Brexit law will continue to apply post Brexit. However, we do not know what Brexit yet means. Bernard Jenkins suggested: 'There are two crucial legal components of Brexit. The first is Article 50, the procedure laid down by the EU treaties by which we disapply these treaties to the UK in international law. This is implemented by an act of Parliament, which is the second component. This need be no more than a few clauses, including one to repeal the European Communities Act of 1972, which currently implements EU law into our domestic law, and another to incorporate all the EU laws that apply directly in UK law into UK statute. That is what Brexit is; there is no "hard" or "soft" option.'

Pragmatic government thinking appears to be to incorporate existing applicable EU law into domestic law and change parts of it as may become necessary or desirable in the future. As shown above there will be changes, such as EU regulations ceasing to apply, thereby necessitating consideration of whether something needs to be or indeed should be done to replace them. A few clauses '*to incorporate all the EU laws that apply directly in UK law into UK statute*' may, on their face, answer many questions. They would be scrutinised closely. Taxpayers and HMRC alike would undoubtedly test whether everything remains the same post Brexit on a case by case basis. As always, the devil will be in the detail.