Rough seas ahead

International Tax | Management of taxes



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Kate Ison, *Andrew Tuson* and *Rebekka Sandwell* explain what to consider if you have an ongoing tax dispute against HMRC in light of the UK's decision to leave the European Union

Key Points

What is the issue?

The UK’s decision to leave the EU may impact on both domestic tax disputes between taxpayers and HMRC which involve an element of EU law, and certain cross-border tax disputes.

What does it mean to me?

Brexit may have implications for taxpayers with pending disputes against HMRC or overseas tax authorities.

What can I take away?

Taxpayers with disputes which include a cause of action under EU law should consider how best to accelerate the resolution of any pending or unresolved claims whilst the UK remains a member of the EU.

Will Brexit impact on the co-operation between HMRC and European tax authorities in cross-border disputes?

A notable feature of the current tax environment is the increasing focus on cross-border co-operation between international tax authorities and the trend towards a global approach of tackling tax evasion and avoidance. In the EU, cross-border exchange of information and mutual assistance in the enforcement of overseas tax debts is facilitated by certain EU directives, including:

- The Directive concerning Mutual Assistance for the Recovery of Claims Relating to Taxes, Duties and other Debts (2010/24/EU) (‘MARD’). This is a multilateral treaty which allows a tax authority in one EU jurisdiction to request the assistance of a tax authority in another EU jurisdiction (a ‘foreign tax authority’) in recovering a tax or duty debt where the defaulting taxpayer is living in the jurisdiction of the foreign tax authority or has assets in that jurisdiction;
- The Directive for Administrative Co-operation in Taxation matters (2011/16/EU) (‘ACD’). This is a multilateral treaty which imposes an obligation on a tax authority in one EU jurisdiction to provide information in relation to income tax or corporation tax to a foreign tax authority in certain circumstances; and

- Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax (the 'VAT Cooperation Regulation'). This regulation aims to combat VAT fraud by governing EU member states' collection and storage of information and the sharing of that information between member states.

Exchange of information provisions are also often included in double taxation treaties ('DTTs') and in tax information exchange agreements ('TIEAs').

Where a taxpayer is involved in a cross-border dispute, the relevant overseas tax authority will frequently invoke the provisions of MARD or ACD in order to engage the assistance of HMRC in recovering and enforcing an overseas tax debt. Likewise, HMRC may do the same in relation to a UK tax dispute with an overseas taxpayer. The question therefore arises whether the ability of HMRC to call upon the mutual assistance of a tax authority in an EU member state will be restricted post-Brexit. Overall, we consider this to be unlikely.

MARD has been directly transposed into UK law through primary domestic legislation which will remain in force after Brexit. It would of course be possible for the UK to cease participation in the MARD frameworks after Brexit, by legislating to remove the relevant domestic legislation, although this seems unlikely at present.

ACD has been directly transposed into UK law through domestic secondary legislation which has effect by virtue of the European Communities Act 1972. This means that in principle such legislation would no longer have effect once the European Communities Act is repealed upon the UK leaving the EU, unless (as we would expect) there is some form of saving provision.

As an EU regulation, the VAT Cooperation Regulation is directly applicable in UK law and, once the European Communities Act is repealed, it will also cease to apply in the UK unless there is a saving provision.

In any event, the UK will continue to be subject to the terms of its DTTs and TIEAs after Brexit. It will also continue to be a member of the Organisation for Economic Co-operation and Development ('OECD'), and it is a signatory to the OECD's multilateral Convention on Mutual Administrative Assistance in Tax Matters, which aims to promote cooperation between tax authorities to prevent tax evasion.

We therefore anticipate that, notwithstanding Brexit, the UK will continue to want to cooperate with other European tax authorities in relation to the cross border exchange of information and enforcement of tax debts, provided that it receives reciprocal treatment from its counterpart European tax authorities in relation to enforcement of UK tax debts in overseas jurisdiction (who, strictly, would no longer be compelled to comply with any requests from HMRC under MARD and/or ACD in relation to the enforcement of UK tax debts overseas or the provision of information to HMRC, post Brexit).

Domestic claims

A significant number of tax cases involve EU law issues, particularly in relation to VAT. In such cases, the UK courts may make a reference to the European Court of Justice ('ECJ') to determine the relevant EU law issue.

What will be the role of the ECJ in the UK judicial system post-Brexit?

This will depend on whether the UK becomes a member of the European Economic Area ('EEA'), the European Free Trade Association ('EFTA'), or neither.

If the UK becomes a member of the EEA, it will be subject to the decisions of the EFTA court which is expected to closely follow the ECJ's jurisprudence in relation to laws of EEA states which are equivalent to EU law. If, however, the UK does not become a member of the EEA/EFTA, then the UK courts could conceivably diverge in their judicial interpretation of laws, even if they originated from the UK's membership of the EU or were equivalent to EU laws.

Going forward, it is likely that ECJ judgments will be persuasive but not binding on the UK courts in relation to EU-derived legislation that is retained by the UK.

Where a taxpayer's case includes a point of EU law which the UK court has referred to the ECJ, what will happen if Brexit occurs whilst the referral is pending?

This will, again, depend on the UK's post-Brexit relationship with the EU. It is likely that the ECJ would decline to hear a referral which had been made from a UK court but not determined prior to the UK leaving the EU, or that the referral would be withdrawn. It is possible, although unlikely, that the ECJ would answer the question (whether or not the referral is explicitly withdrawn) in order to provide some precedent value for the remaining member states. In such circumstances, although the UK court would not strictly be obliged to pay any regard to the ECJ's decision, it is likely to follow it where EU law was the applicable law at the time that the facts giving rise to the claim occurred.

What will be the impact of Brexit on pending domestic claims (such as those stayed behind Littlewoods and ITC) where the cause of action arises from an EU decision?

Brexit is likely to impact on pending domestic claims involving a point of EU law. In particular, there are a significant number of cases claiming restitution of VAT which was levied by the UK in breach of EU law, and compound interest on such overpayments. These cases have been stayed before the High Court pending the outcome of the cases of *Investment Trust Companies v HMRC* ('*ITC*') and *Littlewoods Retail Limited v HMRC* ('*Littlewoods*'), both of which involve matters of EU law. The ITC case concerns claims for repayment of VAT which was levied by HMRC in breach of EU law on investment management fees charged by fund managers for services supplied to closed-end investment trusts, taking into account the funds' rights to an effective remedy under EU law. The Supreme Court's judgment is awaited following the appeal from the decision of the Court of Appeal in February 2015.

The Littlewoods case deals with whether simple interest paid by HMRC to taxpayers in respect of VAT that was incorrectly charged in breach of EU law constitutes adequate compensation for the taxpayer under EU law, or whether compound interest is required to be paid in order for the taxpayer to be adequately compensated. Permission to appeal to the Supreme Court has been granted, and the case is listed for hearing before the Supreme Court in July 2017.

If the Supreme Court finds in favour of the taxpayer in the ITC and Littlewoods cases in accordance with EU principles, then absent Brexit, taxpayers whose claims are stayed pending these lead cases would expect to resolve their outstanding claims directly with HMRC through negotiation (or, if necessary, through continuing their claims to judgment).

There is now a risk that such claims may not be settled with HMRC or proceed to judgment until after the UK has left the EU. This leaves open the possibility that Parliament could, following Brexit, introduce legislation which retrospectively removes taxpayers' accrued rights under EU law or enact legislation which could otherwise adversely impact taxpayers who are seeking to rely on rights conferred by EU law. However, the UK should continue to be bound by the European Convention of Human Rights ('ECHR') once it leaves the EU, and introducing legislation which retrospectively interferes with taxpayers' accrued rights may conflict with the UK's responsibilities under the ECHR, notwithstanding general rule of law considerations.

What should taxpayers likely to be affected by these issues do next?

Given the current uncertainties over the UK's future relationship with the EU, taxpayers with disputes which include a cause of action under EU law should consider how best to accelerate the resolution of any pending or unresolved claims. In particular, those taxpayers who have claims which are stayed behind either the ITC and/or Littlewoods cases (or other similar lead cases) may wish to accelerate the preparation of their claims, by taking steps now to compile all relevant information and evidence necessary to quantify their claim, prior to the release of the decision of the Supreme Court in each of these cases.

With the future of previously binding EU laws now unknown, as the nature of the UK's post-Brexit relationship with the EU remains uncertain, taxpayers with ongoing disputes against HMRC are at risk of experiencing moving legal goalposts. Early preparation of the factual evidence should enable those taxpayers to apply to lift their stays and particularise their claims as soon as possible if and when the Supreme Court hands down judgments in favour of the claimants. This will strengthen those taxpayers' prospects of securing a favourable judgment prior to the UK ceasing to be an EU member state.