

OLD SQUARE
TAX CHAMBERS

Recent EU cases

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WHAT IS COVERED IN THIS TALK

- *Routier v HMRC* [2017] EWCA Civ 1584
- *Trustees of P Panayi A & M Settlements v HMRC* (Case C-646/15)
- *Fisher v HMRC* (Case C-192/16)

Routier v HMRC [2017] EWCA Civ 1584

- Court of Appeal Decision dated 17 October 2017
- Adjourned Appeal (first half [2016] EWCA Civ 938)

Background Facts

- 2007: Gift by will to the Coulter Trust, a trust established under and subject to Jersey law.
- Executors liable to pay inheritance tax on legacy as gift as not entitled to relief under section 23 of the Inheritance Tax Act 1984 (“**IHTA**”).

SECTION 23 IHTA / THE RESTRICTION

23.— Gifts to charities.

(1) Transfers of value are exempt to the extent that the values transferred by them are attributable to property which is given to charities.

Section 23 IHTA on its true construction contains two requirements (“the Restriction”):

- that the trust was established under UK law; and
- that the UK courts would have jurisdiction over it (for that purpose there must be at least one trustee resident in the UK).

VIOLATION OF EU LAW?

- Was there a violation of Article 56 EC Treaty (Article 63 TFEU)?
- Common ground that:
 - Article 56 applies to gifts to charities; and
 - The limitation of tax relief to gifts to UK bodies restricts free movement of capital.
- 3 sub-issues:
 - Is Jersey to be treated as part of the UK or as a third country?
 - Is the Restriction treated as justified in EU law on the grounds of effective fiscal supervision?
 - If so, can section 23 be interpreted in conformity with EU law?

ISSUE 1: IS JERSEY PART OF THE UK FOR FREEDOM OF MOVEMENT OF CAPITAL PURPOSES?

Article 299(6) of the EC Treaty (now Article 355(5) TFEU):

(6) Notwithstanding the preceding paragraphs: (a) this Treaty shall not apply to the Faeroe Islands; (b) this Treaty shall not apply to the sovereign base areas of the United Kingdom of Great Britain and Northern Ireland in Cyprus; (c) this Treaty shall apply to the Channel Islands and the Isle of Man only to the extent necessary to ensure the implementation of the arrangements for those islands set out in the Treaty concerning the accession of new Member States to the European Economic Community and to the European Atomic Energy Community signed on 22 January 1972 ["the Accession Treaty"].

ISSUE: 1 CONTINUED

C-293/02 *Jersey Produce Marketing Organisation Ltd v States of Jersey* [2006] 1 CMLR 29 ("the Jersey Potatoes case"):

42 The referring court explained in the context of a previous case that Jersey is a semi-autonomous dependency of the British Crown, which is represented on Jersey by the Lieutenant Governor. The United Kingdom Government, on behalf of the Crown, is responsible for defence and international relations (see, in that regard, Case C-171/96 Pereira Roque [1998] ECR I-4607, paragraph 11).

43 Jersey does not form part of the United Kingdom. It is, for the purposes of Article 299(4) EC, a territory for whose external relations that Member State is responsible.

ISSUE 1: SUBMISSIONS

Executors

- Jersey is part of the UK for the purposes of the customs code but not freedom of movement of capital.

HM A-G for Jersey

- Every place must either be part of a member state or a third country for Article 56 EC.
- To determine for these purposes whether a territory is part of a member state or is a third country, it is necessary to ask whether EU law applies to the territory or not.
- Article 56 EC does not apply to Jersey. Therefore, it is a third country as regards to transfers to and from the UK.

HMRC

- Should be referred to CJEU for a preliminary ruling.
- Jersey is part of the UK for the purposes of the EC Treaty. The principle of free movement of capital cannot be relied on as against the UK in relation to Jersey.
- No reciprocity: Jersey is not bound by the principle of freedom of movement of capital so should not be able to benefit from it.

ISSUE 1: CONCLUSIONS

- From *Jersey Potatoes*, (1) Jersey is not part of the UK for the purposes of the constitutional arrangements of the UK, but (2) is to be treated as part of the UK for the purposes of those Treaty provisions which are applicable to it.
- For the purposes of Article 56 EC, an overseas country or territory is a third country.
- The question of reciprocity has been dealt with: “a lack of reciprocity in relations between member states and non-member states other than states party to the EEA Agreement cannot justify a restriction on the movement of capital between member states and those non-member states” (C-436/08 and C-437/08 *Haribo Lakritzen Hans Riegel BetriebsgmbH v Finanzamt Linz* [2011] STC 917).
- No doubt as to Issue 1 so no need for a CJEU reference.

ISSUE 2: IS THE RESTRICTION JUSTIFIED IN EU LAW ON THE GROUNDS OF EFS?

Executors

- As a matter of EU law, if there is no mutual assistance agreement, a taxing authority must offer taxpayers an opportunity to provide information that the taxing authority considers necessary in order to satisfy themselves that the charity is entitled to relief on section 23 IHTA and that they cannot simply rely on the absence of a mutual assistance agreement as a reason for refusing relief. The case law of the CJEU does not require there to be such an agreement in order for a non-UK charity to claim relief.

HMRC:

- HMRC are entitled to verify the information that they are given by a taxpayer claiming relief under section 23 IHTA. HMRC are entitled to have a reliable means of verifying that information in the form of mutual assistance agreements. They do not have one.

EFFECTIVE FISCAL SUPERVISION AS JUSTIFICATION FOR BREACH

11 A restriction on freedom of movement of capital can be justified where the aim of the restriction is to ensure the EFS. HMRC rely on this as justification for breach of the principle of freedom of movement of capital in this case.

12 In particular HMRC contend that they must have the right to verify any information about a person claiming relief on gifts about whether the donee is in reality a charity. They contend that the absence of the right to verify is one of the reasons why the principle of freedom of movement of capital does not apply and why this appeal must fail.

ISSUE 2: CONCLUSIONS

- The measure which restricts the freedom of movement of capital must be proportionate (there is no blanket rule).

76 Accordingly I reject the approaches of both parties in so far as they contend that (per the appellants) there is some blanket rule that where a member state must under Article 56 EC extend an exemption from tax to a taxpayer from a third country it may not make that exemption conditional on the existence of a mutual assistance agreement between the member state and the third country where the taxpayer can produce the desired information itself; or (per HMRC) that the taxing authority is always entitled to verify the information provided by the taxpayer from a third country. As I see it, it is always a question of proportionality: see Rimbaud, Haribo, Welte and other cases.

- The taxing authority should have the right to verify information for which there is no provision in section 23 IHTA.
- No need for a reference as a taxing authority can successfully justify a restriction on the movement of capital based on the need for a power to verify even if it does not need that power in every case.

ISSUE 2: CONCLUSIONS

87 Finally, I would add an observation of my own about the CJEU jurisprudence. A restriction on freedom of movement of capital cannot be justified on the grounds of efficiency of the collection of taxes. The reason for freedom of movement of capital is to create an open-playing field between member states. This, among other matters, facilitates the single market. It is not consistent with that purpose that a member state should be able to grant an exemption simply in its own national interest, whether because of efficiency in the administration of the fisc or for any other reason.

88 I therefore conclude that IHTA s 23 cannot in conformity be limited by the Restriction but that it would be justified for IHTA, s 23 to contain a right for HMRC to verify information about an overseas charity by reference to a mutual assistance agreement. That means that the present appeal must fail because at the date of Ms Coulter's death there was no mutual assistance agreement between the UK and Jersey.

89 Accordingly, in my judgment, the question is whether IHTA, s 23 can be interpreted so that relief can be extended to other bodies which are charitable if UK law had applied to them so far as necessary to enable IHTA, s 23 to comply with EU law. That matter falls under Issue 3, to which I now turn.

ISSUE 3: CAN IHTA, S 23 BE READ IN CONFORMITY WITH EU LAW?

Executors

- No submissions as their case was that there can be no conforming interpretation.

HMRC

- Section 23 IHTA should be interpreted in conformity with EU law on effective fiscal supervision.
- Section 23 IHTA should be interpreted so that it permits relief to be given from inheritance tax "where the relevant 'charity' both satisfied UK law requirements concerning a 'charity' and was based in (a) an EU country or (b) a third country which had an information exchange agreement with the UK."

ISSUE 3: CONCLUSIONS

94 In my judgment, contrary to Mr Mullan's submission, the interpretation proposed by HMRC does not go against the grain of the legislation. The purpose of the Restriction was to ensure that the valuable relief from inheritance tax which IHTA, s23 confers was not abused, as it might be if it could be claimed by an entity whose credentials as a charity HMRC could not satisfactorily check. Given that the UK is obliged by the EU Treaties to comply with Article 56 EC, and thus to extend the relief given by IHTA s23 to charities from other member states and third countries, in my judgment the proposed interpretation is in accordance with the underlying objectives of the Restriction.

OVERALL CONCLUSION

97 For the reasons given above, I would hold that Jersey is to be treated as a third country for the purposes of Article 56 EC (now Article 63 TFEU) (Issue 1); that HMRC is entitled to refuse to grant relief on gifts to non-UK charities unless there is a mutual assistance agreement between the UK and the country in which the charity is based (Issue 2). As explained above, I would not make any reference in view of my conclusion on Issues 1 or 2. I would adopt the conforming interpretation proposed by HMRC, which involves charities from other member states or third countries being governed by the law of that state or country and being subject to the jurisdiction of its courts, and which requires, in the case of third countries, the existence of a mutual assistance agreement between the UK and that country. Such agreements are already in place between the member states.

IMPORTANCE

- The Jersey Island's Law Officers' Department say that this ruling is a "*landmark constitutional decision for Jersey*". They go on:

"This case has particular significance as to how the term 'third country' is to be understood and applied and the judgment will prevent unnecessary uncertainty for Jersey as Brexit negotiations continue.

Free movement of capital is the only EU freedom which expressly benefits third countries as well as member states.

The Attorney General argued that Jersey's status was that of a 'third country'.

But HMRC argued that Jersey was not a third country and that the Island's constitutional relationship with the United Kingdom meant that the relationship was a purely internal one for the purpose of capital movement.

This could have meant that Jersey might be denied the protections with respect to capital movements guaranteed to third countries."

<https://jerseyeveningpost.com/news/2017/10/19/landmark-court-ruling-has-brex-it-implications/>

- This case confirms that the provision on free movement of capital apply as between the UK and Jersey which has significant consequences beyond this case. EU law defences are available to Jersey trusts.

Trustees of P Panayi A & M Settlements v HMRC

(Case C-646/15)

- Four trusts created in 1992 when settlor and his family were UK resident. The initial trustees were a UK trust company.
- 2003: Settlor's wife was added as an additional trustee.
- 2004: Settlor and wife decided to leave the UK for Cyprus but resigned as trustees before. They were replaced by three new Cyprus resident trustees.
- 2005: Panayi trustees sold assets held in trust fund and made significant gains.
- HMRC assessed under section 80 of the Taxation of Chargeable Gains Act 1992 (Trustees ceasing to be resident in the UK).

QUESTION REFERRED

22 *By its questions, which can be examined together, the referring court seeks to ascertain, in essence, whether the provisions of the FEU Treaty relating to freedom of establishment preclude, in circumstances, such as those in the main proceedings, where the trustees, under national law, are treated as a single and continuing body of persons, distinct from the persons who may from time to time be the trustees, legislation of a Member State, such as that at issue in the main proceedings, which provides for the taxation of unrealised gains in value of assets held in trust when the majority of the trustees transfer their residence to another Member State, and fails to permit deferred payment of the tax thus payable.*

23 *In order to answer the questions referred, it is necessary, first, to determine whether trusts, such as those in the main proceedings, fall within the scope of freedom of establishment and, if so, whether that freedom is applicable to a situation such as that at issue in the main proceedings.*

THE APPLICATION TO TRUSTS OF THE FREEDOM OF ESTABLISHMENT

24 *Article 49 TFEU requires the elimination of restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State. Under the first paragraph of Article 54 TFEU, companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union are, for the purposes of the Treaty provisions relating to freedom of establishment, to be treated in the same way as natural persons who are nationals of Member States.*

25 *Under the second paragraph of Article 54 TFEU, ‘companies or firms’ means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.*

THE APPLICATION TO TRUSTS OF THE FREEDOM OF ESTABLISHMENT

Factors considered:

- The Trusts have been established in accordance with UK law.
- They are not deemed in accordance with that law to be companies or firms constituted under civil or commercial law.
- Other legal persons extends to an entity which under national law possesses rights and obligation that enable it to act in its own right within the legal order concerned, notwithstanding the absence of a particular legal-form, and which is profit-making (para 29).

THE APPLICATION TO TRUSTS OF THE FREEDOM OF ESTABLISHMENT

32 Accordingly, it appears that the legislation at issue in the main proceedings, for the purposes of that legislation, holds the trustees as a body, as a unit and not individually, to be liable to pay the tax due on the unrealised gains in value of assets of the trust when that trust is deemed to have transferred its place of management to a Member State other than the United Kingdom. Such a transfer occurs when a majority of the trustees are no longer resident in the United Kingdom. The activity of the trustees in relation to the trust property and the management of its assets are therefore inextricably linked to the trust itself and, therefore, the trust and its trustees constitute an indivisible whole. That being the case, such a trust should be considered to be an entity which, under national law, possesses rights and obligations that enable it to act as such within the legal order concerned.

THE APPLICABILITY OF FREEDOM OF ESTABLISHMENT

39 ...the Court's case-law relating to the taxation of gains in the value of assets of a company or firm on the occasion of the transfer of the place of effective management of that company or firm to another Member State also applies in a situation where a Member State taxes gains in the value of assets held in trust by reason of the transfer of the place of management of the trust to another Member State. It follows that freedom of establishment is applicable to a situation such as that at issue in the main proceedings.

IS THERE A RESTRICTION ON FREEDOM OF ESTABLISHMENT?

- It is settled that eliminating restrictions on the freedom of establishment (Article 49 TFEU) includes for companies established in one Member State to be able to exercise their activity in other Member States through a subsidiary, branch or agency (para 41).
- Freedom of establishment goes both ways (para 42).
- All measures which prohibit, impede or render less attractive the exercise of the freedom must be considered to be restrictions on freedom of establishment (para 43).

THE RESTRICTION IN PRACTICE

44 In this case, it is apparent from the documents submitted to the Court that it is solely in the event of a transfer of the place of management of a trust to a Member State other than the United Kingdom that the legislation at issue in the main proceedings provides, first, for the taxation of unrealised gains in value of the assets held in trust on the occasion of that transfer and, second, for the immediate payment of the tax payable in relation to those gains. In contrast, that does not apply when there is a similar transfer within the national territory.

45 It follows that, as is acknowledged by the United Kingdom government, the unrealised capital gains at issue in the main proceedings would not have been liable to taxation in the United Kingdom if the newly appointed trustees had been resident in that Member State.

CLEAR DIFFERENCE OF TREATMENT

IS THE RESTRICTION PERMISSIBLE?

- Are the situations objectively not comparable? NO (para 49)
- Is the restriction justified?
 - UK says yes because it is linked to the preservation of a balanced allocation of powers of taxation between Member States. This is a legitimate objective (para 51).
 - A Member State is entitled to charge tax on gains at the time a taxpayer leaves the country to prevent situations capable of jeopardising the right of the Member State of Origin to exercise its powers of taxation in relation to activities carried on within its territory.
 - HOWEVER, the Court has made it clear that the objective of preserving the allocation of powers of taxation between the Member States can justify a national measure only where the Member State in whose territory income was generated is actually prevented from exercising its power of taxation in respect of such income.
 - Consider section 87 TCGA – Court agreed with AG - it is not sufficient to rely on taxation that is entirely dependent on the discretion of the trustees and beneficiaries.
 - Yes this is a suitable means provided it does not go further than what is necessary to attain the objective.

PROPORTIONALITY?

- The fact that the Member State of origin, for the purpose of safeguarding the exercise of the powers of taxation, determines the amount of tax due on the unrealised capital gains that have arisen in its territory when its power of taxation ceases to exist is subject to the principle of proportionality (para 57).
- The legislation in the main proceedings provides only for the immediate payment of the tax concerned. Therefore it goes beyond what is necessary to achieve the objective of preserving the allocation of powers of taxation between Member States and is therefore an unjustified restriction on freedom of establishment (para 59).

CONCLUSION

The provisions of the FEU Treaty relating to freedom of establishment preclude, in circumstances, such as those in the main proceedings, where the trustees, under national law, are treated as a single and continuing body of persons, distinct from the persons who may from time to time be the trustees, legislation of a Member State, such as that at issue in the main proceedings, which provides for the taxation of unrealised gains in value of assets held in trust when the majority of the trustees transfer their residence to another Member State, but fails to permit payment of the tax payable to be deferred.

IMPORTANCE

- Confirms that the freedoms apply to trusts.
- The fact that section 80 infringed EU law could have wider implications.
- Perhaps each potentially non-compliant provision will need to be challenged separately?

FISHER C-192/16 (12 OCTOBER 2017)

- Order of the Court (under Article 99 of the Court's Rules of Procedure)
- Preliminary ruling on the interpretation of Articles 355(3), 49 and 63 TFEU
- Crux of question para 20:

By its questions, which it is appropriate to consider together, the referring court asks, in essence, whether Article 355(3) TFEU, in conjunction with Article 49 TFEU or Article 63 TFEU, is to be interpreted as meaning that the exercise of the freedom of establishment or of free movement of capital by British nationals between the United Kingdom and Gibraltar constitutes, as a matter of EU law, a situation confined in all respects within a single Member State.

BACKGROUND

- 1998: Fisher family were the 100% shareholders in a company that was engaged in bookmaking and telebetting. It was established in the UK but also had a branch in Gibraltar.
- In 1999, a change in betting duty law resulted in a 9% charge on customers in addition to the amount staked for bookmakers established in the UK. It was possible for a bet to be placed by a customer in the UK with a bookmaker established in another state resulting in no liability for that duty.
- In 1999 bets were taken by UK customers through the Gibraltar branch.
- In 2000 the UK company transferred its business to a Gibraltar resident and incorporated company.
- The Fishers were assessed under the TOAA provisions.
- The Fishers sought to rely on an EU law defence.
- Was the situation a cross-border situation to which EU law applies?

STATUS OF GIBRALTAR

1. Gibraltar is a colony of the British Crown. It does not form part of the UK (para 4).
2. Under international law, Gibraltar is classified as a non-self-governing territory within the meaning of Article 73 of the Charter of the United Nations (para 5):

“Members of the United Nations which have or assume responsibilities for the administration of territories whose peoples have not yet attained a full measure of self-government recognize the principle that the interests of the inhabitants of these territories are paramount, and accept as a sacred trust the obligation to promote to the utmost, within the system of international peace and security established by the present Charter, the well-being of the inhabitants of these territories”

STATUS OF GIBRALTAR

3. Under EU law, Gibraltar is a European territory for whose external relations a Member State is responsible within the meaning of Article 355(3) TFEU (para 6):

“The provisions of the Treaties shall apply to the European territories for whose external relations a Member State is responsible.”

4. Gibraltar does not form part of the EU customs territory (para 8).

THE GIBRALTAR BETTING AND GAMING ASSOCIATION (C-591/15)

56 It follows from all the foregoing considerations that the answer to the first question is that Article 355(3) TFEU, in conjunction with Article 56 TFEU, is to be interpreted as meaning that the provision of services by operators established in Gibraltar to persons established in the United Kingdom constitutes, as a matter of EU law, a situation confined in all respects within a single Member State.

REASONING

- The content of the old version and the new versions of the EU Freedoms provisions corresponds (para 24).
- The freedom to provide services, of establishment and the free movement of capital do not apply to a situation which is confined in all respects within a single Member State (para 25).
- Those freedoms apply to Gibraltar by virtue of Article 355(3) TFEU (para 26).
- It is therefore not possible to accept an interpretation of article 355(3) TFEU in conjunction with Articles 49 and 63 which differs from the judgment in *The Gibraltar Betting and Gaming Association* (para 27).

REASONING CONTINUED

- The fact that Gibraltar is not part of the United Kingdom is not decisive in establishing whether for the purposes of the applicability of the four freedoms, they are to be treated as one Member State (para 28).
- It is irrelevant that the freedoms apply to the United Kingdom as a Member State and to Gibraltar as a European territory for whose external relations a Member State is responsible for the purposes of Article 355(3) TFEU (para 30).
- To treat trade between Gibraltar and the United Kingdom in the same way as trade between two Member States would be tantamount to denying the connection recognised in Article 355(3) TFEU, between that territory and a Member State (para 31).
- Article 355(3) in conjunction with Article 49 or 63 is to be interpreted as meaning that the exercise of those freedoms by British national between the UK and Gibraltar constitutes, as a matter of EU law, a situation confined in all respects within a single Member State.

CONCLUSION AND IMPORTANCE

Article 355(3) TFEU, in conjunction with Article 49 TFEU or Article 63 TFEU, is to be interpreted as meaning that the exercise of the freedom of establishment or of free movement of capital by British nationals between the United Kingdom and Gibraltar constitutes, as a matter of EU law, a situation confined in all respects within a single Member State.

CJEU confirmed that the scope of this rule was limited to British nationals.