VAT focus

UK VAT post-Brexit: initial thoughts

Speed read

The nation has spoken. We are leaving the EU. VAT is a creature of the EU, defined by regulations, Directives and CJEU rulings. Does it still have a place in the UK? The government and HMRC have yet to address this, but abolition is not expected (it is projected to yield more than £100bn in the current tax year, after all). Nor is wholesale replacement by a domestic goods and services tax. But change is inevitable. This article looks at some of the areas that will be impacted and hazards a sketch of the shape of the changes to come.

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'Here's one we made earlier.'

If only someone had shown up with those words and an exit strategy in hand the day we voted to Brexit. Even if that had happened, I doubt this miracle strategy would have extended to a comprehensive explication of what happens with UK VAT.

The key thing to note is that nothing has happened yet. And nothing will, until we actually leave the EU. And actual exit is a protracted process. The UK will first need to notify the European Council of our intention to withdraw in accordance with article 50 of the Lisbon Treaty. Negotiations will then commence on the withdrawal arrangements. Actual exit will occur on the day the UK and the EU (acting by a qualified majority) agree the withdrawal agreement or two years after negotiations commence, whichever is the earlier (unless the UK and the EU, acting unanimously, agree to extend the two-year period). Current events would suggest we will not actually exit before 2019. Until then, question marks hang over UK VAT.

Not all is unknown, however. When we leave, acquisitions and dispatches (concepts that refer exclusively to the movement of goods within the EU) will no longer be relevant. All movements of goods into or out of the UK will simply be imports and exports. Anyone who has so far escaped having to consider triangulation (the rules that govern acquisitions where there are three parties) can breathe a sigh of relief as they will now never have to grapple with this wondrous concept.

The mini-one stop shop

Unfortunately, the same cannot be said about the mini-one stop shop (MOSS) (the regime applicable to business-to-consumer supplies of electronically supplied, telecommunication and broadcasting services, or 'MOSS-covered supplies' for convenience). From actual exit, the UK will become a non-union country, and will no longer be able to offer MOSS. Non-EU businesses that have registered in the UK to account for MOSS-covered supplies they make across the EU will need to register for MOSS in another (i.e. EU) country, as will UK businesses selling MOSS-covered services to EU consumers (unless, perversely, they wish to register for VAT in every EU country to which they sell).

As for MOSS-covered services supplied to UK consumers from outside the UK, we will be free to introduce a new registration regime – perhaps one that deals not only with these services, but also inbound distance sales from outside the UK. This would be a welcome simplification. The question is whether we would do this.

And that is the big question.

Which part of the existing UK VAT regime will stay, which part will go and which part will change (and how)?

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VAT will survive

Like the country itself, VAT as a tax will go on after Brexit; it will survive. Although it is a wholly EU construct, VAT is worth too much to the Treasury to abolish. It will not be completely rewritten. Fun as that sounds – a brand new goods and services tax! – it will be too disruptive, and the experience to date with the son of stamp duty – SDLT – is hardly inspiration for more fiscal reinventions. The odd nip and tuck are, however, inevitable. Although it is in theory possible that, as part of our withdrawal agreement, we agree to continue applying EU VAT, it is inconceivable from a political perspective, and thus, practically impossible.

So what will UK VAT look like when it finally flies from the nest of its EU progenitor?

The 'umbilical cord' that links UK VAT to the EU is made of three prime components: regulations, Directives and CJEU rulings.

The impact on regulations

Regulations have direct effect, and do not need to be implemented by way of domestic legislation. Electronically supplied services, for example, are not defined in UK legislation; there is a non-exhaustive definition in Implementing Regulation 282/2011 article 7. If we want article 7 (and similar provisions) to have continued currency, we would need to incorporate them in UK law by legislation. The question is whether we want to do this, and it is particularly pertinent with immovable property and services connected with immovable property, new definitions for which are contained in articles 13 and 31 of Implementing Regulation 282/2011. These are close, but not identical, to how we currently understand these concepts in the UK. They come into effect on 1 January 2017. We will still be part of the EU then, and will have to them. It is not clear, however, whether that will be for the short term only or if it will all change again on actual exit (through replacement by domestically-produced definitions, for example), and it would be helpful if the government or HMRC could indicate what their intentions are as regards

regulations and UK VAT law. That is, unfortunately, unlikely in the immediate future.

The impact on Directives

Unlike regulations, Directives do need to be implemented by way of domestic legislation. For VAT, we have VATA 1994. It is common now for discussions on VAT (whether in practice or in tribunal or court) to refer to the provision in the Principal VAT Directive (PVD), and not the one in VATA 1994.

This will change, and instead of 'transactions concerning payments' within PVD article 135(1)(d), for example, we will go back to referring to 'dealing with money' within VATA Sch 9 Group 5 item 1 (as we did in the 1990s). This will take time, if only because old habits die hard.

Some deviations from EU VAT law are likely to be more immediate. The spectre of the CJEU ruling in *Andersen* (C-472/03), for example – which HMRC has always acknowledged meant the insurance exemption in VATA Sch 9 Group 2 was wider than the PVD allowed – which has hung over the insurance industry since March 2005, can finally be laid to rest. The CJEU ruling in *Skandia* (Case C-7/13), which suggests that the territorial scope of the UK VAT grouping rules may be too extensive, may be similarly disregarded. These are both examples of changes both taxpayer and HMRC would welcome. By way of a more one-sided example: query whether, instead of trying (and consistently failing) to give proper effect to the CJEU ruling in *PPG* (Case C-26/12) (on the extent to which an employer is able to deduct input tax on pension-related services), HMRC might be tempted to use its newfound freedom to deviate to revert to the pre-*PPG* position (i.e. its old policy).

Claims based on the direct effect of Directive provisions (where domestic legislation has failed to fully implement), as in the *BFI* referral to the CJEU, for example, will no longer be available. The UK will be free to set its own rates, its own exemptions. The press may be focused on sanitary products, but for the practitioner, there are more intriguing possibilities, such as whether we bring zero-rating back for the grant of a major interest in commercial buildings, to name but one. Or to treat the supply of financial services to EU persons in the same way as where they are supplied to non-EU persons, i.e. as outside the scope supplies with the right to recover related input tax. These will no doubt be welcome changes to the affected sectors, but too many taxpayer-friendly changes will undermine the very purpose of retaining the tax (i.e. healthy revenue generation).

The common EU VAT system will continue to evolve. We will not be bound to follow, but it is likely we will keep a close watch, and where appropriate, carve our own parallel path. One reason we would not want to deviate too much, at least where fundamental principles are concerned, is because it would be in no one's interest – in the case of cross-border transactions especially – for double or non-taxation to arise.

... and on CJEU rulings

The European Communities Act 1972 (ECA) is expected to be repealed on actual exit, and we will no longer be bound by CJEU rulings. What this means precisely is not entirely clear. CJEU rulings on VAT are already part of UK VAT law through incorporation in UK decisions. One would be hard pressed to find a significant 21st century UK VAT decision that does not refer to a CJEU ruling or an applicable European principle. CJEU rulings delivered post-actual exit can be ignored, but that may not always be sensible, especially with rulings that clarify or further develop previous rulings we have adopted. We will undoubtedly pick and choose, but on what basis? What defines a cherry? In *Colaingrove* [2015] UKUT 2, after holding there was no dichotomy between the principles on single composite supplies as laid down by the CJEU in (and since) *CPP* (C-349/96) and the principles that were developed in the same area in the UK before *CPP*, the UT said: 'There is never any need to have recourse to the pre-*CPP* approach of the domestic courts, and in doing so the FTT erred in law'.

> We will no longer be bound by CJEU rulings. But what this means precisely is not entirely clear

Will the reverse now be the norm, with domestic decisions regaining primacy and CJEU rulings being only of (possibly diminishing) persuasive value? It is inconceivable that, after actual exit, the CJEU will be to us what the Privy Council is to the Commonwealth. Will there still be a place for inherently European principles such as fiscal neutrality or the abuse of rights? Would even HMRC want to extend the GAAR (general anti-avoidance rule) to VAT? Or would they instead unearth and reanimate the original *Halifax* test (LON/00/977) before the case was referred to the CJEU? Sadly, these are not academic questions, but live ones with real world consequences. Should the Court of Appeal decide in *Longridge* (heard in April) that the CJEU ruling in *Commission v Finland* (Case C-246/08) meant that *Yarburgh* [2001] EWHC 2201 and *St Paul's Community Project* [2004] EWHC 2490 (two domestic decisions) were no longer good law would actual exit affect how this issue would be considered on appeal? What about *Bookit*, where on 26 May 2016, the CJEU (C-607/14) overruled the Court of Appeal judgment [2006] EWCA Civ 550? The case was only in the FTT when the referral was made. Does the final outcome now depend on whether appeals can outpace the clock on the ECA? And what about that glorious 800lbs gorilla – or the £1.2bn question – *Littlewoods*? The Court of Appeal [2015] EWCA Civ 515 held that the taxpayer's restitution claims were barred under domestic law, but that exclusion was contrary to EU law. The case is on appeal to the Supreme Court. Actual exit is unlikely to happen before the appeal is heard, but the notion that the result may be different pre- and post-actual exit can hardly be satisfactory. Will there be a transitional period? Will taxpayers have accrued rights?

These are some initial thoughts. And loath as I am to end on a raft of unanswered questions, a cliffhanger is perhaps the most appropriate ending given the general uncertainty in the country at large. Let's hope the coming weeks will bring greater clarity and firmer guidance from the government. ■

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