

VAT—European legal principles

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VAT is a European tax. Council Directive 2006/112/EC (the VAT Directive) lays down the infrastructure for a common VAT system, which each Member State is required to implement in its home territory by means of domestic legislation.

References:

Council Directive 2006/112/EC

A Member State's responsibility extends beyond the correct implementation of the VAT Directive; it also has to ensure full application of the common VAT system even after adoption of the relevant domestic legislation.

Both the implementation and application of domestic VAT law are subject to a number of EU legal principles. Some of these are set out in treaties, some are an inherent part of the common VAT system itself and some are unwritten.

Examples include:

- the principle of subsidiarity and proportionality

References:

[TEU, art 5](#)

Ampafrance, Case C-177/99

- the principle of equality of citizens

References:

[TEU, art 9](#)

- the principle of non-discrimination on grounds of nationality

References:

[TFEU, art 18](#)

- the principle of [fiscal neutrality](#)

References:

[Council Directive 2006/112/EC, recital \(7\)](#)

Commission v France, Case C-481/98

- the principles of [legal certainty and the protection of legitimate expectations](#)

References:

Ampafrance (Case C-177/99)

- the principle of [equivalence](#)

References:

Fantask, Case C-188/95

Marks & Spencer, Case C-62/00

- the principle of [effectiveness](#), and

References:

Aprile, Case C-228/96

Marks & Spencer, Case C-62/00

- the principle in relation to the [abuse of rights](#) in the context of VAT

References:

Halifax, Case C-255/02

This Practice Note outlines some of the principles that regularly arise in practice (with the exception of the principle in relation to the abuse of rights, for more on which, see Practice Note: [VAT and abuse of rights](#)).

Fiscal neutrality

The principle of fiscal neutrality is a EU legal principle that is inherent in the common VAT system. By its nature, it encapsulates the following:

References:

[Council Directive 2006/112/EC, recital \(7\)](#)

Commission v France, Case C-481/98

- the principle of VAT uniformity, and
- the principle of elimination of distortion in competition

The principle of fiscal neutrality does not allow similar items (whether they are goods or services), which are in competition with each other, to be treated differently for VAT purposes.

References:

Commission v France, Case C-481/98

It applies, for example, where the exempt status of, or lower rate of VAT applicable to, one item has the effect of favouring the supply of that item over the supply of another (similar) item.

To determine whether two items are 'similar', one takes the point of view of a typical consumer.

References:

The Rank Group, Case C-259/10

Two items are 'similar' where they have similar characteristics and meet the same needs from the point of view of the consumer. The question is whether their use is comparable, and where the differences between them do not have a significant influence on the decision of the typical consumer to use one or the other, they are taken to meet the same needs.

References:

The Rank Group, Case C-259/10

It is not necessary to establish that the two items are actually in competition with each other, or that the difference in VAT treatment has actually resulted in distortion of competition.

References:

The Rank Group, Case C-259/10

Although the principle of fiscal neutrality does not allow businesses carrying out the same transactions to be treated differently for VAT purposes, this should not be confused with the situation where a taxpayer has the choice between achieving a particular economic goal by way of two different transactions, one taxable and the other exempt (such as a 'reverse assignment' and a sublease, both of which are means by which a tenant can grant occupation to a third party). In such a scenario, the taxpayer cannot choose one transaction and then seek to avail himself of the effects of the other by invoking the principle of fiscal neutrality—the principle would not apply.

References:

Cantor Fitzgerald, Case C-108/99

Fiscal neutrality—Member State discretion

The VAT Directive allows Member States a degree of latitude, and implementation of its provisions is left to a large extent to their discretion.

An example where this is stated expressly is the exemption provided for in art 135(1)(g), which reserves for Member States the task of defining what constitutes a 'special investment fund' for the purposes of the exemption.

References:

[Council Directive 2006/112/EC, art 135\(1\)\(g\)](#)

Although, in such a case, there is nothing on the face of the provision to restrict a Member State's discretion, the Member State is nevertheless bound to exercise its discretion in a way that is consistent with:

References:

Claverhouse, Case C-363/05

- the objectives pursued by the VAT Directive, and
- applicable EU legal principles (such as the principle of fiscal neutrality)

The Member State is not, for example, entitled to treat two 'similar' investment funds differently for VAT purposes, even if they are treated differently for the purposes of the financial regulatory regime of its home territory.

Proportionality

Art 131 of the VAT Directive confers a more general discretion on Member States, and allows them (for example) to subject the application of exemptions to conditions to prevent any possible evasion, avoidance or abuse.

References:

[Council Directive 2006/112/EC, art 131](#)

In such a case, where a Member State has the discretion to restrict a taxpayer's EU rights, it must make sure that, in exercising this discretion, it does not go beyond what is necessary to achieve the objective it is pursuing—ie that the means employed in pursuing the objective are proportionate to that objective.

References:

[TEU, art 5](#)

This is the principle of proportionality, and in relation to VAT it requires a Member State to ensure that the provisions in question, in addition to being necessary and appropriate for the attainment of the specific objectives it is pursuing, also have the least possible effect on the objectives and principles pursued by the VAT Directive.

References:

Ampafrance, Case C-177/99

Legal certainty and the protection of legitimate expectations

Certain principles inherent in the EU legal order protect both the Member State and the taxpayer.

One example is the principle of legal certainty, which:

- requires legislation to be certain, clear and precise, and its application to be foreseeable by taxpayers, and
- aims to ensure that situations and legal relationships governed by EU law remain predictable

especially in relation to rules that may have financial consequences.

Certain other principles can only be relied on by taxpayers, and not Member States.

One example is the principle of the protection of legitimate expectations (which is the corollary of the principle of legal certainty). This principle is generally relied on by businesses to whom a public authority has given justified hopes, for example through published guidance or correspondence (thus creating legitimate expectations). To allow a Member State to rely on the same principle against the taxpayer would jeopardise the taxpayer's protection against public authority conduct derived from unlawful rules.

References:

Ampafrance, Case C-177/99

Establishing breach

To establish whether domestic VAT law is in compliance with EU law, the provision in question should be tested against:

- the objectives pursued by the VAT Directive, and
- the general EU legal principles underlying the Directive

A purposive, or teleological, approach to interpretation must be applied.

In some cases, a breach of EU law is clear, eg where a Member State has neglected to include in domestic VAT law an exemption that is provided for in the VAT Directive.

In other cases the position is less obvious, eg where the question hangs on whether the provision in question has been implemented, or is applied, in accordance with applicable EU legal principles.

Challenging a breach—the European Commission

Where domestic VAT law is in breach of EU law, the relevant provision may be challenged, either by the European Commission or an individual taxpayer.

Where the European Commission considers that domestic VAT law has failed to give effect to the VAT Directive:

References:

[TFEU, art 258](#)

- it would send the Member State in question a formal letter to that effect
- the Member State would be given the opportunity to submit its observations
- the Commission would then deliver a reasoned opinion on the issue, and
- either:
 - the Member State would relent (and amend the relevant provisions of domestic law, as the UK did in relation to what amounts to a qualifying aircraft), or

References:

VATA 1994, Sch 8, group 8

- the Commission would refer the matter to the Court of Justice of the European Union (as it did in *Commission v Ireland*)

References:
Commission v Ireland, Case C-85/11

Challenging a breach—direct effect

Where:

References:
ECA 1972, s 2
Becker, Case C-8/81

- domestic VAT law has failed to implement the VAT Directive or to implement it correctly, or
- the VAT Directive is not applied in a way that is consistent with the objects pursued by it or with applicable EU legal principles

a taxpayer may (rather than waiting for the European Commission to take action) rely on the VAT Directive, or the provision in question (and not the domestic law), provided the provision is, as far as its subject matter is concerned, unconditional and sufficiently precise.

The above does not depend on:

References:
The Rank Group, Case C-259/10

- the Member State having carried out any deliberate wrongful act, or been negligent, in the transposition of EU law into domestic law, or
- the Member State having committed a sufficiently serious breach of EU law

Conforming interpretation and disapplication of domestic law

A Member State's obligation under a Directive is to give effect to the objectives pursued by that Directive.

That obligation extends to the courts of the Member State (for matters within their jurisdiction), it being their responsibility to provide the legal protection individuals derive from the rules of EU law and to ensure that those rules are fully effective.

References:
Pfeiffer, Case C-397/01

When applying UK VAT law, therefore, the UK courts are required to interpret the (UK) provision in question as far as possible in the light of the wording and purpose of the VAT Directive—ie they must interpret UK VAT law in conformity with EU VAT law.

References:
Marleasing, Case C-106/89

In some cases, applying a conforming interpretation to domestic law may avoid inconsistency with EU law. However, where this is not possible, a domestic court must set aside the (domestic) provision in question.

References:
Simmenthal, Case C-106/77

Remedies for breach—equivalence and effectiveness

Where domestic VAT law is in breach of EU VAT law, taxpayers will have paid the tax authorities amounts by way of VAT that the tax authorities were not entitled to collect. In such a case, the taxpayer would be entitled to recovery of the wrongly paid/collected amounts.

References:

San Giorgio, Case C-199/82

Although the detailed procedural rules for such recovery are normally a matter for the relevant Member State, the principle of equivalence requires that any conditions laid down by the Member State must not be less favourable than those governing domestic claims of a similar nature.

References:

Fantask, Case C-188/95

Marks & Spencer, Case C-62/00

Also, the principle of effectiveness requires that such conditions do not make it virtually impossible or excessively difficult for the exercise of the relevant rights conferred by EU law.

References:

Aprile, Case C-228/96

Marks & Spencer, Case C-62/00

For more information on remedies for a breach of EU law, see Practice Notes: [Overpaid direct tax and restitution](#) and [VAT—restitution and interest](#). For information on recovering VAT that has been overpaid (as a result of a breach of EU law or otherwise), see Practice Note: [VAT overpayments and under-deductions](#).