CHAPTER 4

TAX (INCLUDING VAT)

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Shortly after this chapter was completed, the Government published the European Union (Withdrawal) Bill (formerly known as the 'Great Repeal Bill') (on 13 July 2017).

4.1 BREXIT – THE TAX IMPLICATIONS

I cannot recall the last time I heard the government mention tax when discussing Brexit – it is not high on their agenda. Indeed, many are surprised to learn UK tax, and how it operates, would even be affected by Brexit.

In this Chapter, we look first at how EU law has interacted with UK tax to date, and then we explore how the position may change as and when the UK actually leaves the EU. We will focus on 'direct taxes' (such as income tax and corporation tax) and VAT. Although we will not be looking at any other taxes (or tax areas), that is not to say they will not be affected by Brexit. To provide an overview of how they may be impacted, we include an extract from Paper 18 (titled 'UK Tax') part of the Brexit Papers from the Bar Council Brexit Working Group (written 'to help the government evaluate a range of pressing public interest concerns arising from the UK's decision to withdraw from the EU ').[1] This is set out as Appendix 3, at p 377.

4.2 EU LAW AND 'DIRECT TAXATION'

The EU is a legal arrangement under which member states transfer their powers in certain areas to EU institutions and, in doing so, agree to limit their sovereign rights in those areas.[2] EU laws become an integral part of the legal systems of the member states, which their courts are obliged to apply, binding both their nationals and themselves.[3] In the UK, this was achieved via the European Communities Act 1972, which:

> 'creates a hierarchy of law within the United Kingdom's legal system, by making European Union law part of and supreme over United Kingdom law'.[4]

1 See http://www.barcouncil.org.uk/media-centre/publications/2017/2017/june/the-brexit-papers-third-edition.
2 See *Van Gend en Loos*, Case C-26/62.
3 See *Costa v ENEL*, Case C-6/64.
4 See House of Commons Library Briefing Paper number 7793, dated 23 February 2017 and titled 'Legislating for Brexit: the Great Repeal Bill' (or the Great Repeal Bill Briefing Paper), at page 12.

'Direct taxation' (the fiscal species that encompasses income tax, capital gains tax and corporation tax) is an area in which member states have retained their sovereign rights. Nevertheless, they do not have absolute discretion in the exercise of such rights. This is because they are still bound by the Treaties that form the constitutional basis of the EU – the Treaty on European Union (or TEU), for example, and the Treaty on the Functioning of the European Union (or TFEU) – and these Treaties set out certain principles (such as the principle of non-discrimination on grounds of nationality[1]) and provide for a number of fundamental freedoms. Each member state, as a signatory to these Treaties, is bound by these principles and freedoms, and thus obliged to exercise even its (retained) sovereign rights in compliance with them (and EU law generally).[2]

Where it is considered by one of its nationals that it has not done so – eg where it has introduced a tax measure that is considered to be incompatible with EU law – it may be challenged before one of its own courts, and the court must then either interpret the measure in such a way as to avoid inconsistency with EU law[3] or, if that is not possible, set the measure aside.[4] In doing so, the court may (and, in certain circumstances, must) refer questions on the interpretation of EU law to the European Court of Justice (CJEU).[5]

Where a measure is set aside, the member state has then to decide whether to abandon the measure altogether or revise its terms so as to bring it in line with EU law.

The European Commission can also challenge member states by bringing infringement proceedings itself where it considers they have introduced measures that are inconsistent with EU law.[6]

4.3 THE FUNDAMENTAL FREEDOMS

The fundamental freedoms are:

- the freedom of establishment;[7]
- the free movement of capital;[8]
- the free movement of goods;[9]
- the freedom to provide services;[10] and
- the free movement of persons.[11]

1 See TFEU, Article 18.
2 See *Manninen*, Case C-319/02.
3 See *Marleasing*, Case C-106/89.
4 See *Simmenthal*, Case C-106/77.
5 See TFEU, Article 267.
6 See TFEU, Article 258.
7 See TFEU, Articles 49 to 55.
8 See TFEU, Articles 63 to 66.
9 See TFEU, Articles 28 to 37.
10 See TFEU, Articles 56 to 62.
11 See TFEU, Articles 20 and 21, and 45 to 48.

Member states are generally prohibited from restricting fundamental freedoms.[1] This is to ensure that a member state does not discriminate against nationals of any other member state, or hinder the exercise by any of its own nationals of any right or freedom available under EU law in any other member state.

The freedom of establishment, for example, confers a right on any national of any member state to set up and manage businesses in any other member state.[2] A company incorporated under the laws of member state Q, therefore, has the right to set up business in any other member state, including the right to transfer its business from member state Q to any other member state. If member state Q introduces a measure that subjects a company incorporated under its laws, on any transfer of its place of management, to immediate taxation on any unrealised capital gains on the assets being transferred – but only where the transfer is to another country – companies incorporated under the laws of member state Q may be deterred from transferring their businesses to another member state. They may be deterred from exercising their freedom of establishment. Notwithstanding, therefore, that it is within the retained sovereign rights of member state Q to introduce the measure, because it makes the exercise of a fundamental freedom less attractive, the measure would be treated as a restriction[3] in breach of member state Q's obligations under the Treaties.[4]

'Direct tax' measures in the UK that have been treated as restrictions include the group relief provisions (under which claims may be made to set the losses of one company against the profits of another member of the same corporate group for corporation tax purposes).

Example: Marks & Spencer had been incurring losses in its EU subsidiaries, and sought to set the losses of its subsidiaries established in Belgium, France and Germany against the profits of their parent company (established in the UK). Its claims were rejected by HMRC on the basis that the UK's group relief provisions (at the time) only permitted the use of losses of companies that were established in the UK. In response, Marks & Spencer claimed that such group relief provisions were a restriction on its freedom of establishment, and thus contrary to EU law. In 2005, the CJEU ruled[5] that the provisions were indeed such a restriction, but also that they were justified, although they went beyond what was appropriate and necessary in certain respects.[6] Perhaps not surprisingly, that was not the end of the story. Disputes continued between Marks & Spencer and HMRC.[7] To complicate matters even further, the European Commission

1 Although there are circumstances when restrictions pursue a legitimate objective compatible with EU law and are justified – eg where there is an overriding reason in the public interest. Such restrictions are permitted to stand (to the extent they do not go beyond what is appropriate and necessary to achieve the objective pursued). Discussion of these scenarios is, however, beyond the scope of this Chapter.

2 See TFEU, Article 49.

3 See *Caixa-Bank France*, Case C-442/02.

4 Although, as mentioned in footnote 2 (p 64), the restriction may be justified.

5 In *Marks & Spencer*, Case C-446/03.

6 See footnote 1.

7 See *Marks & Spencer* [2013] UKSC 30 and [2014] UKSC 11, for example.

challenged the legislation the UK introduced[1] in response to the 2005 ruling from the CJEU, on the ground that even that was in contravention of the freedom of establishment. This culminated in a second CJEU ruling (in favour of the UK, rejecting the Commission's arguments) – more than nine years after the first.[2]

Another 'direct tax' measure that has been treated as a restriction on a fundamental freedom is the UK's provisions on 'controlled foreign companies', which are provisions designed (broadly) to address the diversion of profits from the UK to lower tax jurisdictions. In 2006, the CJEU ruled[3] that the provisions at the time were a restriction on the freedom of establishment but also that they could be justified, but only if they were properly framed (which they were not at the time). In response, the UK introduced changes via FA 2007. The European Commission considered the changes to be inadequate. This led to further changes, and eventually, the introduction of a new, and extremely complex, 'controlled foreign companies' regime in FA 2012.

4.4 BREXIT AND 'DIRECT TAXATION'

On 2 October 2016, the Secretary of State for Exiting the European Union released a statement saying that the 'Great Repeal Bill' (the central plank in the Government's legislative package to implement Brexit):

> 'will convert existing [EU] law into domestic [UK] law, while allowing Parliament to amend, repeal, or improve any law after appropriate scrutiny and debate.'

EU law comprises its Treaties, laws in the form of Regulations and Directives, and CJEU rulings. Treaties and Regulations are directly applicable (and do not need to be implemented via any UK legislation to have effect in the UK), whereas Directives are not (and have to be implemented into UK law via primary or secondary legislation). Some EU laws are already in Acts of Parliament (or secondary legislation), while others are not, and these latter laws will cease to have effect in the UK on Brexit unless incorporated into UK law via UK legislation. This is what the Great Repeal Bill (eventually the Great Repeal Act) will do. The Great Repeal: White Paper[4] was published on 30 March 2017.

It explains[5] how the Great Repeal Bill will ensure that, wherever possible, the same rules and laws apply on the day after the UK leaves the EU as before by:

- converting directly-applicable EU law (such as Regulations) into UK law;
- preserving all the laws the UK has made to implement its EU obligations;

1 Via FA 2006.
2 See *Commission v UK*, Case C-172/13.
3 See *Cadbury Schweppe*, Case C-196/04.
4 Legislating for the United Kingdom's withdrawal from the European Union, Cm 9446.
5 In the box headed 'What does the Great Repeal Bill convert into UK Law?' on page 14.

- providing for the continued availability of Treaty rights that can be relied on directly in court by individuals (by incorporating these into UK law); and
- giving the same binding, or precedent, status in UK courts to historic CJEU case law as accorded to decisions of the Supreme Court.

The White Paper clarifies[1] that Regulations will not be 'copied out into UK law Regulation by Regulation. Instead, the Great Repeal Bill will convert Regulations as they apply in the UK the moment before it leaves the EU into domestic law, so they continue to apply until legislators in the UK decide otherwise.

Despite what is stated in the White Paper, it is not generally expected that the Great Repeal Bill will transpose all EU laws to UK law. In her Lancaster House speech, 'Plan for Britain'[2] the Prime Minster said what she was proposing in terms of post-Brexit Britain 'cannot mean membership of the single market' because being:

> 'a member of the single market would mean complying with the EU's rules and regulations that implement [the fundamental] freedoms, without having a vote on what those rules and regulations are', [and it would mean] 'accepting a role for the European Court of Justice that would see it still having direct legal authority in [the UK]. It would to all intents and purposes mean not leaving the EU at all.'

It follows from this that free movement of persons will not survive Brexit (especially given the political imperative of controlling immigration from the EU to the UK). As for free movement of goods (and the prohibition on customs duties on imports and exports within the EU), it is as yet unclear whether the UK will remain a member of the EU customs union, although the Prime Minister has said[3] she wanted some form of customs agreement with the EU:

> '[w]hether that means [the UK] must reach a completely new customs agreement, become an associate member of the Customs Union in some way, or remain a signatory to some elements of it'.[4]

The Prime Minister's speech highlights the key problem with Brexit. Ultimately, it is not a question of what the UK wants; it is a question of what it can agree. There is no immediately obvious economic or fiscal reason, for example, why it would want to discriminate against non-UK nationals carrying on business in the UK, or discourage UK nationals from setting up business in the EU. There is no reason, therefore, why the freedom of establishment should not be transposed to UK law. The concern is that for their part, the EU may feel less constrained discriminating against the UK and UK nationals. The Prime Minister even acknowledged in her 'Plan for Britain' speech[5] that 'there are

1 At para **2.8**.
2 On 17 January 2017.
3 In her 'Plan for Britain' speech on 17 January 2017.
4 The White Paper mentions (at paragraph 1.22) that the Government will introduce a customs bill to establish a framework to implement a UK customs regime.
5 On 17 January 2017.

some voices calling for a punitive deal that punishes Britain and discourages other countries from taking the same path [ie leaving the EU]'. She made clear that 'no deal for Britain is better than a bad deal for Britain', and that 'if [the UK] were excluded from accessing the single market – [it] would be free to change the basis of Britain's economic model'. Implicit in this is a veiled reference to (potentially aggressive) tax competition, in which case the focus would no longer be on how much EU law would be retained, abandoned or changed on or after Brexit, but how much the UK tax system as a whole could be and should be changed on a fundamental level. Even in that scenario, however, it is not easy to see how inherently protectionist measures such as restrictions on the freedom of establishment would help to 'attract the world's best companies and biggest investors'[1], as the Prime Minister wants, or be consistent with her stated vision of a 'profoundly internationalist' Britain.[2]

The White Paper acknowledges that EU law is not construed in the same way as English law. At paragraph 2.10, it states:

> 'For example, in interpreting an EU measure it may be relevant to look at its aim and content, as revealed by its legal basis as found in the treaties … Once we have left the EU, our courts will continue to be able to look to the treaty provisions in interpreting EU laws that are preserved.'

And although the Great Repeal Bill will not provide any role for the CJEU, even in relation to the interpretation of EU-derived law, and UK courts will no longer be required to consider the CJEU's jurisprudence, the White Paper accepts[3] that:

> '… for as long as EU-derived law remains on the UK statute book, it is essential that there is a common understanding of what that law means. The Government believes that this is best achieved by providing for continuity in how that law is interpreted before and after exit day. To maximise certainty, therefore, the [Great Repeal] Bill will provide that any question as to the meaning of EU-derived law will be determined in the UK courts by reference to the CJEU's case law as it exists on the day [the UK] leave[s] the EU. Everyone will have been operating on the basis that the law means what the CJEU has already determined it does, and any other starting point would be to change the law. Insofar as case law concerns an aspect of EU law that is not being converted into UK law, that element of the case law will not need to be applied by the UK courts.
>
> For example … CJEU case law has over the past four decades clarified what is and is not subject to VAT, and failing to follow that case law in [the UK's] own legal system would create new uncertainties about the application of VAT.
>
> This approach maximises legal certainty at the point of departure, but the intention is not to fossilise the past decisions of the CJEU forever. As such, [the Government] propose[s] that the [Great Repeal] Bill will provide that

1 See the Prime Minister's 'Plan for Britain' speech on 17 January 2017.
2 See her 'Plan for Britain' speech on 17 January 2017.
3 At paragraphs 2.14 to 2.17.

> historic CJEU case law be given the same binding, or precedent, status in our courts as decisions of [the UK's] own Supreme Court. It is very rare for the Supreme Court to depart from one of its own decisions or that of its predecessor, the House of Lords. The circumstances in which it will, exceptionally, do so, derive from a Practice Statement made by the House of Lords in 1966, and adopted by the Supreme Court in 2010. That Statement set out, among other things, that while treating its former decisions as normally binding, it will depart from its previous decisions "when it appears right to do so".
>
> … the Supreme Court [is expected] to take a similar, sparing approach to departing from CJEU case law. [The Government is] also examining whether it might be desirable for any additional steps to be taken to give further clarity about the circumstances in which such a departure might occur. Parliament will be free to change the law, and therefore overturn case law, where it decides it is right to do so.'

Irrespective of how much EU law is preserved by the Great Repeal Bill, it is inevitable that the relevant (EU-derived) provisions will, over time, become more UK and less EU. Long-running sagas such as what happened in *Marks & Spencer*[1] (with the group relief provisions) and *Cadbury Schweppes*[2] (with the 'foreign controlled companies' provisions) should be things of the past. The taxpayer will no longer be able to avail of the CJEU. Even if the freedom of establishment, for example, were transposed 'as is' to UK law on Brexit, Parliament would be 'free – subject to international agreements and treaties with other countries and the EU on matters such as trade – to amend, repeal and improve any law it chooses'.[3] The government would, therefore, have the power to qualify or override the freedom, or make exceptions to it for any new tax measures that may be considered a restriction.

And the European Commission will no longer have any standing to object.

4.5 DIRECTIVES

Directives that impact on 'direct taxation' include:

- the Parent-Subsidiary Directive;[4]
- the Interest and Royalty Directive;[5]
- the Merger Directive;[6] and
- the Anti-Tax Avoidance Directive.[7]

1 See Case C-446/03, [2013] UKSC 30 and [2014] UKSC 11 and *Commission v UK*, Case C-172/13.
2 See Case C-196/04.
3 See the Prime Minister's speech announcing the Great Repeal Bill on 2 October 2016.
4 Directive 2011/96/EU.
5 Directive 2003/49/EC.
6 Directive 2009/133/EU.
7 Directive (EU) 2016/1164.

The purpose and effect of these Directives are to harmonise (to an extent) the 'direct tax' rules in member states in the areas specified. For example, the Parent-Subsidiary Directive provides for a subsidiary in one member state to pay dividends and other profit distributions to its parent in another member state without having to withhold any amount from such dividends or distributions by way of tax. It also prevents such income from being taxed twice at the level of the parent (ie once in the member state of payment, and again in the member state of receipt).

There is little economic or fiscal reason to change the status quo, but Brexit is first and foremost a political initiative, and the extent to which the effect of the Directives would be preserved (both on Brexit, and in the medium term thereafter) will depend on how negotiations between the UK and the EU proceed.

Of particular interest is the Anti-Tax Avoidance Directive (or the ATAD). This was only adopted by the European Council on 12 July 2016. As a Directive, it is not directly applicable and needs, therefore, to be implemented into law by each member state. The deadline for implementation of the majority of the measures provided for in the ATAD is 1 January 2019.[1] This means that, in the normal course of events,[2] the UK would still be part of the EU by the time the deadline arrives.

The ATAD contains five measures to address what are regarded as 'common forms of aggressive tax planning' so as to ensure 'a fairer and more stable environment for businesses'.[3] The five measures relate to

- 'interest limitation' (ie restricting deductions of net borrowing costs by reference to EBITDA);[4]
- exit taxes (that bite on the transfer of businesses and assets cross-border);[5]
- a GAAR (ie a general anti-avoidance rule to address non-genuine arrangements);[6]
- 'controlled foreign companies';[7] and
- 'hybrid mismatches' (ie arrangements that result in an item being deducted twice for tax purposes (eg in two member states) or 'deduction without inclusion' (eg an item being deducted in the member state in which it is paid without also being taken into account for tax purposes in the member state in which it is received)).[8]

The extent to which implementation of the ATAD would impact on the existing tax system of a member state would depend on whether that member state already

1 See ATAD, Article 11.
2 As the Government notified the European Council (under TEU, Article 50) of its intention to withdraw on 29 March 2017, actual exit should occur two years later, on 29 March 2019.
3 See https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en.
4 See ATAD, Article 4.
5 See ATAD, Article 5.
6 See ATAD, Article 6.
7 See ATAD, Articles 7 and 8.
8 See ATAD, Article 9.

has provisions on the five areas to which the measures in the ATAD relate, and how aligned or divergent such provisions are with such measures. In the UK, its own GAAR,[1] for example, may be regarded as being already compliant with the GAAR measure in the ATAD, although its 'controlled foreign companies' provisions[2] may be regarded as being in need of amendment if they are to be in line with the corresponding measure in the ATAD.

While it is difficult to see the UK, which has been on its own campaign against aggressive tax planning, adopting a position after Brexit that is materially different from that provided for in the ATAD (at least in purpose and effect, if not in detail), it is also impossible to ignore the inherent competitiveness in having more taxpayer-friendly rules than the whole of the EU. Ultimately, it is a question of politics, and how negotiations between the UK and the other member states proceed.

4.6 VAT

In *Royal and Sun Alliance* [2003] UKHL 29, Lord Walker of Gestingthorpe said:

> 'Value added tax ('VAT') is essentially an EU tax …'

This is because it derives from a Directive (now, the Principal VAT Directive (or the PVD)[3]), implemented in the UK via (what is now) the Value Added Tax Act 1994 (or the VATA). Unlike 'direct tax', which only really intersects with EU law where a fundamental freedom is engaged or a Directive applies, almost every aspect of VAT is suffused with EU law.

The more fervent Brexiteer might have hoped that when the UK left the EU, it would also leave this EU tax behind. This will not happen, if only because VAT brings in so much for the Exchequer.[4]

Much of the VAT law applicable in the UK is already in the VATA and related secondary legislation; the rest will be transposed to UK law via the Great Repeal Bill. The expectation is that, in the main, the UK VAT system will continue to operate as if it were still part of the common EU VAT system, at least in the short to medium term following Brexit. Preserving the rules of the common EU VAT system, however, would itself result in changes in how certain VAT rules apply in the UK. This is because VAT law draws a line between the EU and the rest of the world, and on Brexit, the UK will find itself on the other side of the fence.

1 See FA 2013, Part 5.
2 See the Taxation (International and Other Provisions) Act 2010, Part 9A.
3 Directive 2006/112/EC.
4 According to the HMRC document dated 21 February 2017 and titled 'HMRC Tax & NIC Receipts: Monthly and annual historical record', '[o]ver the last decade IT, CGT & NICs (Income tax, Capital Gains Tax and National Insurance Contributions) combined made up on average 56 per cent of total receipts. Value Added Tax (VAT) and Corporation Tax, Bank Levy and Petroleum Revenue Tax (CT, BL and PRT) are the next biggest, contributing an average 20 per cent and 10 per cent of total receipts respectively' – see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/592842/Jan17_Receipts_NS_Bulletin_Final.pdf.

For example, where goods are removed from one country to another, a layman may describe the transaction as an export/importation, but for VAT purposes, it would only be an export/importation where one country is in the EU and the other is outside the EU; where both are in the EU, the transaction would be a dispatch/acquisition (and not an export/importation).[1] On Brexit, transactions between the UK and the EU would no longer be dispatches / acquisitions – they would all be exports/importations – and the rules that apply will be different.[2]

Another example is where 'digital services' (such as the sale of music, films, games, magazines or books via download) are supplied to 'consumers' (ie non-business customers) in the EU. A business, whether it is established in or outside the EU, that provides such services is required to register for, and pay, VAT in each EU country in which it has 'consumers'; alternatively, it could opt to take advantage of the Mini One Stop Shop (or MOSS).[3] A business established in the US that is registered under the UK MOSS scheme, for example, would submit only one return (the MOSS return), as opposed to one return in every relevant EU country, and make only one VAT payment to (in this example) HMRC, with HMRC then forwarding the relevant parts of the return and the relevant portions of the payment to the tax authorities in the relevant EU countries.[4] The MOSS scheme, therefore, saves the US business the administrative burden of having to register, and account, for VAT in what could be a large number of countries. On Brexit, the UK itself will be outside the EU, and it will no longer be able to offer MOSS. The US business in the above example will have to re-register under the MOSS scheme of another – ie an EU – country. Businesses established in the UK that provide 'digital services' would be in the same position, and will have to decide whether to register, and account, for VAT in each EU country in which it has 'consumers' or opt for the MOSS scheme of a particular EU country.

Another area where UK VAT laws will need to be modified on Brexit is where certain types of services (such as most financial or insurance services) are provided to a client in another country. Under the common EU VAT system, how that transaction is treated for VAT purposes depends on whether the client is established in a EU country or outside the EU. Pre-Brexit, a bank established in the UK making a loan to a borrower established in France, for example, would be making an exempt supply of services for VAT purposes,[5] and it would not be able to recover any of the VAT it incurs for the purposes of making that loan.[6] A bank established in France making a loan to a borrower established in the UK would be in the same position. Post-Brexit, the bank established in France would be treated as making a supply of services that falls outside the scope of VAT[7] and it would be entitled to recover the VAT it incurs for the purposes of

1 See https://www.gov.uk/guidance/vat-exports-dispatches-and-supplying-goods-abroad, for example.
2 See https://www.gov.uk/guidance/vat-exports-dispatches-and-supplying-goods-abroad, for example.
3 See https://www.gov.uk/guidance/register-and-use-the-vat-mini-one-stop-shop, for example.
4 See https://www.gov.uk/guidance/register-and-use-the-vat-mini-one-stop-shop, for example.
5 See PVD, Articles 44 & 135 and VATA, section 7A & Schedule 9, Group 5.
6 See PVD, Article 168 and VATA, section 26.
7 See PVD, Articles 44 and VATA, section 7A.

making the loan.[1] It is expected that UK VAT law will be modified so that the bank established in the UK would be in the same position.

4.7 WHAT WAS OLD IS … NEW AGAIN?

The above is a (non-exhaustive) list of changes that will need to be made to UK VAT laws in order for the UK VAT system to continue functioning in parallel to the common EU VAT system (which is considered preferable – ensuring consistency so as to promote certainty and avoid double or no taxation, at least for the short or medium term). The more intriguing question, of course, is whether, in the long term – ie once Brexit has settled – UK VAT law will change more significantly in a deliberate move away from the common EU VAT system.

There have been a number of cases where the UK wanted to frame its VAT laws in a particular way but was prevented from doing so because the measures in question were in breach of EU VAT laws. The provision of construction services, for example, is standard rated. There are exceptions – for example, where they are provided in the course of constructing a building that is intended solely for use by a charity for a 'non-business' purpose, in which case their supply is zero-rated – ie charged to VAT at 0% – and not standard rated.[2] However, once upon a time, construction services provided in the course of constructing any new building were zero-rated, even a building intended for wholly commercial or industrial use. The relevant provisions were changed after the CJEU ruled they were in breach of EU VAT law.[3] After Brexit, it would be possible for the UK to reinstate the original provisions. Charities that currently have to pay VAT on construction services – for example, where they are not using the building for a purpose that is considered 'non-business' for VAT purposes – would no doubt welcome such a change-back (because in most cases, they are not able to recover VAT, and so would prefer not to pay any). The issue, of course, is that if the UK made too many generous change-backs in favour of the tax bearer, the very reason for retaining the tax in the first place would be undermined.[4]

Change-backs do not, however, have to favour the tax bearer. The UK used to exempt management services supplied to open-ended investment companies, but not management services supplied to investment trust companies (or ITCs). This was ruled by the CJEU to be incompatible with EU VAT law,[5] and the UK had to extend the exemption to management services supplied to ITCs. If, after Brexit, the UK were to change the relevant provisions back to what they were before the CJEU ruling, that would be one instance where the change-back would be unlikely to reduce the tax-take.

1 See PVD, Article 169 and VATA, section 26.
2 See VATA, Schedule 8, Group 5.
3 See *Commission v United Kingdom*, Case C-416/85.
4 As noted in House of Commons Library Briefing Paper number CBP7630, dated 6 February 2017 and titled 'Tax after the EU referendum', 'the relative importance of VAT to the Exchequer … 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'.
5 See *Claverhouse*, Case C-363/05.

The provisions discussed above are UK provisions that were challenged, either by the European Commission or UK nationals, and which had to be changed because, as drafted at the time, they were incompatible with EU VAT law. There are also cases where the provisions under challenge were not UK provisions, but provisions under the VAT laws of another EU country. Where the provisions under challenge are not UK provisions, when they are ruled by the CJEU to be incompatible with EU VAT law, there is less need for a direct and immediate response from the UK. However, the UK must still take account of the ruling, because it may mean that the corresponding UK provisions, too, are incompatible with EU VAT law and have to be changed.

Arthur Andersen,[1] for example, was a Dutch referral, on which the CJEU ruled as far back as 2005. HMRC has long acknowledged that the ruling meant the exemptions provided under UK VAT law for certain insurance transactions[2] were wider than the PVD allowed. No changes have, however, been made. Brexit could mean that no such changes would ever be made, should the UK so choose.

Similarly, following the more recent CJEU ruling on a Swedish referral,[3] questions have arisen as to whether the UK rules on VAT grouping are impacted and need to be changed.[4] HMRC already takes the view that the ruling does not require any changes to the UK rules.[5] The European Commission or the CJEU may, however, disagree. This, of course, would fall away as a viable concern on Brexit.

4.8 EUROPEAN PRINCIPLES

The common EU VAT system is built on a bed of EU legal principles. Some of these are set out expressly in Treaties, while others are unwritten (or, at least, not written in any statute book). They include:

- the principle of fiscal neutrality;[6]
- the principles of legal certainty and the protection of legitimate expectations;[7]
- the principle of subsidiarity and proportionality;[8]
- the principle of equivalence;[9]
- the principle of effectiveness;[10] and
- the principle of VAT and abuse of rights.[11]

1 See Case C-472/03.
2 See VATA, Schedule 9, Group 2.
3 See *Skandia America Corp*, Case C-7/13.
4 See https://www.gov.uk/government/publications/revenue-and-customs-brief-2-2015-vat-grouping-rules-and-the-skandia-judgment/revenue-and-customs-brief-2-2015-vat-grouping-rules-and-the-skandia-judgment, for example.
5 See https://www.gov.uk/government/publications/revenue-and-customs-brief-18-2015-vat-grouping-rules-and-the-skandia-judgement/revenue-and-customs-brief-18-2015-vat-grouping-rules-and-the-skandia-judgement.
6 See PVD, Recital 7, and *Commission v France*, Case C-481/98, for example.
7 See *Ampafrance*, Case C-177/99, for example.
8 See TEU, Article 5 and *Ampafrance*, Case C-177/99, for example.
9 See *Fantask*, Case C-188/95, for example.
10 See *Aprile*, Case C-228/96, for example.
11 See *Halifax*, Case C-255/02.

The Great Repeal Bill is expected to transpose most of these principles to UK law. Some, like the principle of equivalence (which requires member states to ensure that the remedies and procedural rules in relation to claims based on EU law are at least equivalent to (ie no less favourable than) those in relation to claims based on national law) and the principle of effectiveness (which prohibits member states from making it practically impossible (or excessively difficult) for their nationals to exercise EU rights), would probably not be transposed, because, after Brexit, UK nationals are expected no longer to be able to invoke EU laws or rights.[1]

Other principles, such as the principle of fiscal neutrality, are central to the common EU VAT system, and is expected to be transposed in whole to ensure the proper functioning of the UK VAT system. The question is how this will be achieved.

The principle of fiscal neutrality encapsulates:[2]

- the principle of VAT uniformity; and
- the principle of elimination of distortion in competition.[3]

It prohibits treating 'similar' items (whether they are goods or services), which are in competition with each other, differently for VAT purposes.[4] It applies, for example, where the supply of item A is subject to VAT at the standard rate, whereas the supply of item B, being a 'similar' item, is treated as exempt from VAT or subject to VAT at only the zero rate (or the reduced rate) – the overall effect being that the supply of item B is favoured over the supply of item A. To determine whether any two items are 'similar' for these purposes, one takes the point of view of a typical consumer, the question being whether the items have similar characteristics (ie whether their use is comparable) and whether they meet the same needs from the consumer's point of view (ie whether the differences between them have a significant influence on the consumer's decision to use one or the other).[5] It is not necessary, however, to show the two items are actually in competition, or that the difference in VAT treatment has actually resulted in distortion of competition.[6]

The above is only a high-level description of the principle. A single clause in the Great Repeal Bill saying simply that the EU principle of fiscal neutrality as it exists on Brexit Day is transposed to UK law in its entirety would clearly be unsatisfactory – it would beg too many questions – but it would appear from the White Paper that that is precisely what is intended.

1 Subject to any transitional provisions the UK and the EU may agree as part of any withdrawal agreement.
2 See *Ampafrance*, Case C-177/99, for example.
3 See PVD, Recital 7 and *Commission v France*, Case C-481/98, for example.
4 See *Commission v France*, Case C-481/98.
5 See *The Rank Group*, Case C-259/10.
6 See *The Rank Group*, Case C-259/10.

4.9 EUROPEAN COURT OF JUSTICE

The PVD has been enacted into UK law via the VATA. There is, therefore, no need for it to be transposed again (by the Great Repeal Bill) on Brexit. One question that arises is what should happen if it only transpires after Brexit that a provision in the VATA has not correctly implemented the corresponding provision in the PVD.

Pre-Brexit, a taxpayer may seek to rely on the provision in the PVD directly, and not the provision in the VATA, and they would be entitled to do so provided the provision in the PVD is unconditional and sufficiently precise.[1] In theory, the taxpayer would continue to be able to do so, by relying on the (expected) effect of the Great Repeal Bill, and the fact that, at the time the provision in the VATA was enacted, the UK was still part of the EU (and subject to EU VAT law). The White Paper states[2] that:

> 'If, after exit, a conflict arises between two pre-exit laws, one of which is an EU-derived law and the other not, then the EU-derived law will continue to take precedence over the other pre-exit law …'

However, the taxpayer will no longer be able to avail of the CJEU. Nor will the UK courts be bound to follow any rulings handed down by the CJEU after Brexit (even though they may, and are in the short to medium term likely to, find them of persuasive value).

The common EU VAT system will continue to evolve, as would the UK VAT system. The question is whether the two will develop in tandem.

For example, a concept used in EU law where the relevant provision does not refer expressly to the law of the member states for its meaning and scope would normally be given an independent and uniform interpretation throughout the EU, so as to ensure uniform application of EU law across all the member states.[3] The exemptions provided for under EU VAT law[4] are examples of such a concept.[5] It is almost certain that, immediately after Brexit, the UK will continue to take account of the 'independent and uniform interpretation' that applies across the EU; the question is how long it will continue to do so.

4.10 OPPORTUNITIES

Because, pre-Brexit, UK VAT law has to cleave to EU VAT law, there has until now been little point in lobbying the Government for fundamental changes to the UK VAT system – it just cannot happen without also making the same fundamental changes to the common EU VAT system. This all changes, of course, on Brexit.

1 See *Becker*, Case C-8/81, for example.
2 At paragraph 2.20.
3 See *EKRO*, Case C-327/82, for example.
4 See PVD, Articles 135 and VATA, Schedule 9.
5 See *CPP*, Case C-349/96, for example.

For example, in *Longridge on the Thames,*[1] the Court of Appeal noted:

> 'There is no special rule for a charity. A charity does not enjoy blanket relief from VAT for its activities. Its liability to VAT will depend on whether its activities are economic activities. It may not be able to claim relief simply because it is carrying out a charitable activity …'

With Brexit now visible on the horizon, there is no reason why the charities sector should not consider lobbying the government now for special rules to be introduced in two years' time to confer charities-specific reliefs (for example).

The opportunity for change is not, of course, restricted to the charities sector – it is open to any taxpayer or any tax bearer in any sector, and even HMRC itself.

In this connection, the White Paper states[2] that:

> 'The Great Repeal Bill will not aim to make major changes to policy or establish new legal frameworks in the UK beyond those which are necessary to ensure the law continues to function properly from day one …'

The future is almost here, and if the referendum has shown us anything, there will be surprises.

1 [2016] EWCA Civ 930.
2 At paragraph 1.21.