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COMPLIANCE – EU LAW

Rapid conformity

Rory Mullan reinforces the importance to being aware of underlying EU law

Key points

- **What is the issue?**

The adoption of principles of interpretation developed to give effect to human rights in the tax sphere can lead to considerable uncertainty where there is underlying EU law

- **What does it mean to me?**

It is becoming increasingly important to be aware of underlying EU legislation. *Rapid Sequence* suggests that the courts and HMRC are willing to apply extreme conforming interpretations in straightforward cases

- **What can I take away?**

Although recent developments are concerning, in appropriate cases it may still be possible to rely on the clear words of UK legislation by relying on EU principles of legal certainty and the protection of legitimate expectations

Although the approach of the CIOT is a sensible one which is to be welcomed by taxpayers, that it is needed at all is a deeply unsatisfactory state of affairs and begs the question how have we arrived here and what is to be done if HMRC don't follow the CIOT recommendations.

Safeguards on direct effect

Directives impose an obligation on member states to enact relevant national law but do not of themselves purport to impose obligations as a matter of national law (Article 288 of the Treaty on the Functioning of the EU (TFEU)). There are, however, two important exceptions to this general position:

1. where a directive is unconditional and sufficiently precise it can be relied upon by a person against a member state which has failed to implement it (direct effect); and

its own failure to comply with EU law, and a directive cannot be relied on as against a private person (*Faccini Dori v Recreb Srl* [1994] ECR I-3325, paras 22 and 23, case C-91/92). This should mean that an emanation of the state, such as HMRC, cannot rely on a directive to impose a charge to tax. Furthermore, directives should not operate to affect the legal position as between private persons.

The reasons for this are relatively plain. Requiring individuals to be aware of EU legislation that is not directly enacted into UK law imposes an intolerably high burden on the individual. Citizens should be able to depend on the plain meaning of enacted legislation representing the law and they should be entitled to place reliance on that.

In contrast, the state (on whom Article 288 TFEU places an obligation in relation to the directive) should be aware of what is required and is in a position to ensure

Is the law not the law?' Richard Wild highlighted the unfairness inherent in the HMRC approach in the *Rapid Sequence Limited v HMRC* [2013] UKFTT 432 (TC) whereby the First-tier Tribunal departed from the clear words of UK legislation to give effect to the underlying EU directive. In response to this, the CIOT wrote to HMRC suggesting a series of sensible safeguards to deal with the unsatisfactory situation.

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2. national legislation should be interpreted in conformity with EU law (conforming interpretation).

A significant difference between these is that although direct effect is subject to important limitations, conforming interpretation, as currently applied by the UK courts, appears not to be subject to any safeguards.

It is well established that directives are binding only on member states, that a member state cannot take advantage of

that national legislation is compliant. There is no unfairness in holding the state to its obligations.

What *Rapid Sequence* showed, however, was that HMRC could rely on a directive to alter the apparently plain meaning of legislation by reference to an underlying directive which had not been properly implemented. In doing so, a charge to tax was imposed on a private person. Perhaps more concerning is that this approach was adopted in a relatively straightforward

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case and not one where tax avoidance was in issue.

Conforming interpretation – current approach

How have we reached this position? It has been a consequence of the adoption of two different lines of authority, neither of which arose in the field of taxation and neither of which is particularly suited to that field.

Applying an equivalent interpretation

The principle of confirming interpretation requires national courts to interpret domestic law insofar as possible in light of the wording and purpose of the directive that it is implementing. However, the CJEU joined cases *Pfeiffer and Others* [2004] ECR I-8835 C-397/01 to C-403/01 the CJEU (although reiterating the limitations on direct effect) developed the principle of conforming interpretation by applying the principle of equivalence. This holds that a national court must use any interpretative methods recognised by national law in construing national law in conformity with a directive.

HRA 1998 s 3

What interpretative methods, then are available to the UK courts? In *Ghaidan v Godin-Mendoza* [2004] 2 AC 557 the House of Lords was faced with legislation which on its face was not compatible with the European Convention on Human Rights. As HRA 1998 s 3 requires that 'so far as it is possible to do so, primary legislation and subordinate legislation must be read and given effect in a way which is compatible with the convention rights' the House of Lords was faced with a consideration of the scope of that interpretative obligation.

Lord Nicholls described the interpretative obligation as 'unusual and far-reaching' which might require a court to depart from unambiguous words and/or the intention of parliament. In effect, the only limitation was that, whatever interpretation was reached, it should 'go with the grain of the legislation'.

Marriage of two principles

Subsequently in *HMRC v IDT Card Services Ltd* [2006] STC 1252 the Court of Appeal, unimpressed with VAT avoidance arrangements, married the two strands of authority applying the extreme approach

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profile Rory is a member of the CIOT's EU and Human Rights Sub Committee. He was called to the Bar in 2000 and since then has

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the added constitutional complications of parliamentary sovereignty the approach in *Ghaidan* was not an unreasonable approach to take. It is, however, difficult to suggest that the public policy issues applicable to determining the scope of an exemption to tax are in any way comparable to those that apply to ensuring that the UK complies with its convention obligations. Nevertheless, that appears to be the position in which we now find ourselves.

Unfortunately, while *IDT* might be explained as the court stretching matters to prevent tax avoidance and *Vodafone 2* explained as a rescue exercise on non-compliant legislation, it is concerning that in *Rapid Sequence* the issue was a straightforward one of interpretation. As such, it now appears that neither HMRC nor the courts consider the extreme approach restricted to exceptional circumstances.

Although most obviously an issue with VAT, this is not a problem restricted to that sphere. There are a series of EU directives in the tax sphere relating to parent-subsidiary, merger, mutual assistance and recovery. The possibility of extreme conforming interpretations and the erosion of the safeguards which the restrictions on direct effect allow inevitably causes significant uncertainty where an overlap occurs.

the solution

The use of an extreme conforming interpretation is objectionable in such circumstances, particularly where it gives rise to a tax charge. In those cases, it is suggested that other EU law principles come to the fore and require consideration, namely that of legal certainty and the protection of legitimate expectations.

The principle of legal certainty is an EU equivalent of the common law maxim

(*Halifax Plc and Others v CCE* [2006] STC 919 at para 43, case C-255/02).

The principle concerning protection of legitimate expectations (not to be confused with the similar UK principle of the same name) should be available to be relied upon where a conforming interpretation would otherwise operate in a manner which frustrates those expectations (see for example *Marks & Spencers Plc v CCE* [2002] ECR I-6325 paras 44 to 46, case C-62/00). Apparently clear words of UK legislation would seem capable of giving rise to such a legitimate expectation.

These principles appear to have been overlooked in the rush to expand the scope of conforming interpretation. Legal certainty was cursorily dismissed in *IDT* (para 111) on the basis that the issues were apparently well known and the width of those comments were badly misconstrued by the First-tier Tribunal in *Rapid Sequence* (para 52). Neither considered whether legitimate expectations were in point.

Where UK legislation applies in an apparently clear manner and a taxpayer relies on that legislation in the understandable belief that it represents the law, he should be entitled to rely on the words of the UK legislation. This is nothing more than an application of the principle that there should be no taxation without clear words. To date the UK courts have given insufficient regard to these principles. It is to be hoped that they will be less dismissive in the future.

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Read Richard Wild's article 'When is the law not the law?' published in the January issue of *Tax Adviser* online at: www.taxadvisermagazine.com/ta/article/when-law-not-law-1011751

to ensure Convention compliance to the Sixth Directive. Subsequently, the same approach was adopted in *Vodafone 2 v HMRC (No 2)* [2009] EWCA Civ 446 to even more eye-catching effect, importing a new subsection to rescue the controlled foreign companies legislation.

Given the express words of HRA 1998 s 3 covering the importance of rights under the convention, the desirability that legislation should be compatible with such rights and

that there should be no taxation without clear words. It requires that rules involving negative consequences for individuals should be clear and precise and that their application should be predictable for those subject to them. Although it is a general principle of EU law, the requirement of legal certainty is to be observed all the more strictly in the case of rules liable to entail financial consequences, in order that those concerned may know precisely the extent of the obligations which they impose on them