Analysis

How has the EU shaped the UK's tax landscape?

Speed read

In 1973, when the UK acceded to the EU, the new legal order profoundly affected the interpretation of UK statutes, including tax statues. The infringement procedure has often led to changes in UK law, although not always to the extent initially requested. Corporation tax has become the best-known area of EU influence, with litigation over dividends, tax credits, cross-border tax relief and controlled foreign companies. EU law necessarily governs VAT, although member states are given considerable discretion both by the legislator and the courts. The doctrine of abuse of right derives from the EU legal order but the UK has played a major role in developing it. EU law has affected the activity of tax authorities, the structure of the system of appeals and the permitted structure of taxes, as well as substantive tax law. HMRC has become used to cooperation between tax authorities in the single market, and a role for EU law may arise through the terms of the EU/UK trade agreement, as well as through domestic legislation.

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If, as Kierkegaard said, 'life must be understood backwards; but ... it must be lived forwards' then, perhaps, by looking back we can usefully understand something about how the EU has shaped the UK's tax landscape.

Of course, the contributions of the UK in the Council and the submissions of the UK government in Luxembourg have been far from insignificant. The EU, for its part, may want to ask how the UK has shaped the EU's tax landscape.

EU law as thunderbolt

Asking how EU law has shaped UK tax law may suggest the UK has been entirely passive. In *Pirelli Cable Holding* [2006] UKHL 4, Lord Walker, referring to the group income election provisions, said that the 'thunderbolt from Luxembourg, in the form of the decision in *Hoechst*, has shown that under EU law the statutory scheme was flawed, and has been flawed since its inception in 1973' (para 104).

The phraseology is attractive but one should keep in mind that Sir David Edwards, the UK's judge in the CJEU, was one of the five judges who threw the thunderbolt at the invitation of the High Court under the preliminary reference procedure (see the joined cases of *Metallgellschaft* (Case C-397/98) and *Hoechst* (Case C-410/98)). The thunderbolt was delivered from Luxembourg but the supply chain which manufactured it contained a significant UK element. So too has much of the EU's activity in relation to tax.

Literal and purposive interpretation

In 1973, when the UK acceded to the EEC, UK tax statutes were interpreted strictly, following the case of *Duke of Westminster* [1936] AC 1. As Lord Steyn put it in *McGuckian* [1997] STC 908: 'Tax law was by and large left behind as some island of literal interpretation.' Tax rates were high – the main rate of corporation tax in 1973 was 52% – and 1973/74 was 'the first really big year' for Roy Tucker's tax schemes (see *The History of Tax Avoidance*, N Tutt (1989) p 20).

Into a world largely governed by the application of specific rules to specific situations, the EEC Treaty inserted the principles of 'a new legal order which governs the ... different natural and legal persons to whom it is applicable' (see *Commission v Luxembourg and Belgium* [1964] ECR 625).

The new legal order profoundly affected the interpretation of UK statutes, including the Human Rights Act 1998, which drew on an analogy with the EU law obligation of conforming interpretation. That obligation was articulated in *Marleasing SA v La Comercial Internacional de Alimentación SA* (Case C-106/89. (For a recent example of *Marleasing* being used in VAT, see *Loughborough Students Union* [2018] UKFTT 357.) Lord Sumption called it 'a highly muscular approach to the construction of national legislation so as to bring it into conformity with the directly effective Treaty obligations of the United Kingdom' (see *FII Group Litigation* [2012] UKSC 19).

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Tax statutes were subjected to the highly muscular approach as much as any others. Beginning with the *Ramsay* doctrine, UK domestic law may have evicted tax statutes from the island of literal interpretation, but EU law considerably reinforced the landing party. In the tax case *Vodafone 2 v HMRC* [2009] EWCA Civ 446, the judge noted that 'it is not a requirement of a conforming interpretation that it should be capable of precise formulation'. Purposive interpretation of tax statutes domestically was hardly revolutionary in such an environment.

Principles versus rules

The new legal order, based upon broad principles, was bound to clash with the detailed rules which are a hallmark of the UK tax system.

The clash took some time to develop. The relevance to tax matters of treaties establishing the European Communities had been apparent since 1960 in a case concerning Belgian income tax and the ECSC Treaty (*Humblet v Etat Belge* (Case C-6/60). The special commissioners had referred a case to the ECJ in 1979 (*Donington v Aspden* [1981] ECR 2205); however, only after *Commission v France* (1986] ECR 273 was the power of the fundamental freedoms to reshape aspects of tax widely acknowledged.

Infringement actions

It took the infringement action in *Commission v France* to lay the foundations. After that, preliminary rulings became more significant. Nevertheless, the infringement procedure has remained important.

It has been used, for example, in relation to the UK's implementation of preliminary rulings in *Philips Electronics* (Case C-18/11) (infringement number (IN 2015/4206), *Marks & Spencer* (Case C-446/03) (IN 2009/4462) and *Cadbury Schweppes* (Case C-196/04) (IN 2009/4105). Some would say that indicated considerable UK resistance to EU influence.

It has also been used in other contexts such as exit taxes for companies (IN 2008/4923) and limitation periods (IN 2009/4462). As recently as July 2018, an infringement procedure was opened in relation to the UK provisions on share loss relief and loans to traders (IN 2018/4046 and 2018/4047) (see *Tax Journal,* 7 September 2018, p 12).

Infringement cases were also opened in the private client field; for example, in relation to the discriminatory tax treatment of gifts and transfers to charities (IN 2005/2281), inheritance tax relief for agricultural property only in the UK, the Channel Islands or the Isle of Man (IN 2007/2433), the taxation of transfer of assets abroad (IN 2009/4130), and rules on non-domiciled spouses (IN 2010/2111).

The procedure often led to changes in UK law, though not always to the extent initially requested. Sometimes it was not successful at all, as in the VAT cases concerning refunds of VAT to persons not established in the EC (*Commission v UK* (Case C-582/08)) and membership of VAT groups (*Commission v UK* (Case C-86/11)). It was, though, the preliminary ruling procedure that generated the most excitement.

Direct taxation: corporations and others

Corporation tax has become the best known area of EU influence, following litigation over the taxation of dividends (*FII Group Litigation* (Case C-35/11 and Case C-446/04)); tax credits (*Class 4 of the ACT Group Litigation* (Case C-374/04); cross-border loss relief in various forms (for example, *Marks and Spencer* (Case C-446/03) and the taxation of controlled foreign companies (*Cadbury Schweppes*). This partly reflects the fact that national taxpayers were engaging in national litigation to shape UK tax law and corporations had the necessary resources. Legislation affecting private clients has nevertheless been successfully challenged (see *Trustees of P. Panayi Accumulation and Maintenance Settlements* (Case C-646/15, concerning the trustees' exit tax).

When the CJEU makes a ruling it does not shape a replacement provision. That is left to member states, which may make different choices. In *ICI Plc v Colmer* (Case C-264/96), for example, the requirement that 'companies' in the relevant legislation be 'companies resident in the United Kingdom' was held to be inconsistent with the freedom of establishment (ICTA 1988 s 258(7)). The UK removed the requirement of residence from its legislation (ICTA 1988 s 413). Ireland, which had similar legislation, inserted a requirement that companies must be resident in a member state of the EC by virtue of that state's law (Taxes Consolidation Act 1997 s 411(1)(c)).

In a number of areas, the UK has made the same choice as Ireland and has conferred advantages on residents within the single market. After Brexit, countries outside the EU may view the UK's EU-centric tax provisions with interest.

VAT and customs law

EU law necessarily governs VAT, although member states are given considerable discretion both by the legislator and the courts. The recent decision of the UK Supreme Court in *Littlewoods* [2017] UKSC 70 permitting simple interest on VAT repayments shows that.

The exemptions in respect of insurance and financial transactions have been a significant area of activity and may be so after Brexit, given that 'input VAT deduction rules for financial services supplied to the EU may be changed' (see HMRC's *VAT for businesses if there's no Brexit deal*, 23 August 2018). In its submissions to various courts and tribunals, the UK has played an important role in ensuring that EU law does not give taxpayers exemptions which are as wide as they would like. (See, for example, *Minister Finansów v Aspiro SA* (Case C-40/15) in relation to the exemption for insurance transactions; and *Bookit Ltd* (Case C-607/14) *v HMRC* and *DPAS* (Case C-5/17) *Ltd*, amongst others, in relation to the exemption for payments and transfers.)

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Perhaps one of the most broadly influential areas of EU law, used in VAT cases, is the doctrine of abuse of right as explained in *Halifax* (Case C-255/02). The questions the CJEU answered in *Halifax* were asked by a VAT and Duties Tribunal. The UK considered that the general principle of EU law preventing abuse of right operated to prevent deduction in certain circumstances and where 'a taxable person is artificially creating conditions to justify the application for deduction'.

The CJEU concluded that 'the Sixth Directive must be interpreted as precluding any right of a taxable person to deduct input VAT where the transactions from which that right derives constitute an abusive practice'. The UK will, no doubt, want some credit for its input into that conclusion.

Subsequently, the UK Supreme Court refused to render abuse of right inapplicable because the situation in question was governed by a UK statutory instrument. In *Pendragon and others* [2015] UKSC 37, having referred to general principles of EU law, Lord Sumption said: 'Their application is not excluded because some particular feature of the national legal regime applying an EU tax has its origin in a domestic legislative choice rather than in a member state's obligation to implement a Directive.'

The doctrine of abuse of right derives from the EU legal order but the UK has played a major role in developing it and the UK Supreme Court may have somewhat domesticated it.

Principles such as those applied in *Halifax* will survive in the UK's tax system after Brexit. The Withdrawal Act 2018 provides for the supremacy of EU law after Brexit in relation to prior enactments or rules of law, and what the European Court of Justice does after exit day may be taken into account so far as relevant. (See the Withdrawal Act 2018 ss 5(3) and 6(2). Section 19 provides that nothing in the Act is to prevent the UK from replicating in UK law any EU law made on or after exit day.) The Tax

(Trade and Customs) Act 2018 s 42(4) makes clear what the Withdrawal Act 2018 implies, namely, that:

> 'the principle of EU law preventing the abuse of the VAT system (see, for example, the cases of *Halifax* and *Kittel*) continues to be relevant, in accordance with that Act, for the purposes of the law relating to value added tax.'

EU law will shape UK VAT law for a long time to come.

So far as concerns customs law, the Union Customs Code (UCC) Reg (EU) No. 952/2013 article 22.6 and secondary legislation contain provisions which facilitate the exercise of the trader's right to be heard in compliance with the Charter of Fundamental Rights of the EU. The provisions governing notification of import duty liabilities in the Taxation (Cross-Border Trade) Act 2018 Sch 6 appear to be strongly influenced by the UCC. The effects of the charter in UK law are being felt, therefore, even as the UK leaves the EU.

Institutional and structural issues

EU law has affected the activity of tax authorities, the structure of the system of appeals and the permitted structure of taxes, as well as substantive tax law.

HMRC has become used to cooperation between tax authorities in the single market. (See, for example, Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures; and Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing directive 77/799/EEC.) Just as EU law has reinforced a trend towards purposive interpretation that existed independently of the EU so, in relation to institutional matters, the EU has reinforced a trend towards international cooperation that has existed independently of the EU. No doubt, HMRC will continue to give international cooperation a high priority after exit day.

So far as the structure of the appeals system is concerned, EU influence has been significant and will endure. The Community Customs Code Title VIII ('Appeals') applied to the UK from 1 January 1995, one year later than for other member states. The delay allowed the UK to set up a tribunal system to handle customs duty previously outside the civil appeals process. By virtue of FA 1994 s 7, the UK's VAT Tribunals became VAT and Duties Tribunals and now customs matters go to the First-tier Tribunal. (FA 1994 continues to apply after Brexit subject to certain amendments: see the Taxation (Cross-Border Trade) Act 2018 Sch 7.)

EU state aid law has become significant in relation to the structure of tax systems. The fact that it encompasses the tax law of member states was clear from 1974 onwards if not before (see *Italy v Commission* (Case C-173/73). That it encompasses the design of a tax system was made clear in the litigation over Gibraltar's tax system (*Commission and Spain v Gibraltar and the United Kingdom*: joined Cases C-106/09 and C-107/09).

The future

A role for EU law may arise through the terms of the EU/UK trade agreement, as well as through domestic legislation. The UK will, no doubt, avoid entering into an obligation like the one the Ukraine undertook when it agreed, in its association agreement, gradually to approximate its VAT legislation to Council Directive 2006/112/EC (see *Official Journal of the EU* [2014] L161/1945 Chapter 4 Annex XXVIII). The UK, though, will want more than that.

The UK has made clear in its white paper, *The future relationship between the UK and the EU* (July 2018) (at para 110), that it is committed to the continued control of anti-competitive subsidies. Its partnership proposal, though, 'would not fetter its sovereign discretion on tax'. This suggests an approach which differs from that of the EU, which considered the Swiss tax regime was caught by the provisions on public aid in the Swiss/EEC trade agreement (the Commission Decision of 13 February 2007 on the incompatibility of certain Swiss company tax regimes with the Agreement between the EEC and the Swiss Confederation of 22 July 1972). In January 2016, the Commission made clear in a Communication on an External Strategy for Effective Taxation ('External Strategy') (COM (2016) 24) that it:

> 'will ... work to include state aid provisions in negotiating proposals for agreements with third countries, with a view to ensuring fair tax competition with its international partners'.

> The challenge for the UK is to limit the EU's future influence and to maximise its own

Difficult negotiations are likely to lie ahead if the UK wishes to avoid its tax system being shaped by EU state aid law.

The EU's decision to include good tax governance clauses encompassing commitments to fair tax competition may also be troublesome. The Commission has said it has 'set out core elements for a renewed good governance clause, which should be included in all negotiating proposals for relevant agreements' (External Strategy section 3.1).

Furthermore, the Commission sees agreements with third countries as vehicles which 'allow the EU to ensure that its tax policy priorities vis-à-vis third countries are appropriately integrated into its wider external relations' (External Strategy section 3). The UK may not take the same view.

Conclusion

The EU has certainly helped to shape the UK's tax system and legal system generally. In return, the UK has helped to shape the EU, its laws and tax policies. After Brexit, as UK statutes facilitating withdrawal from the EU make clear, and as any trade future agreement may confirm, the EU is likely to maintain a significant influence over UK tax matters. The challenge for the UK is to limit the EU's future influence and to maximise its own. ■

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