

VAT focus

The post-Brexit interpretation of UK VAT law

Speed read

Whilst the effect of Brexit on the UK VAT system cannot yet be fully known, what is certain is that the UK courts will be required to interpret the UK's VAT legislation consistently with EU law until the UK formally leaves the EU. After formal Brexit, it is likely that the decisions of the CJEU on the VAT directives will remain of persuasive authority in interpreting the UK VAT Act, save in areas where Parliament has amended the Act after Brexit. Widespread amendment of the Act is unlikely, save for some modifications to take account of specific UK interests and to reflect the fact that supplies to and from the EU will no longer be intra-Community supplies.



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The UK has formally voted to leave the EU, and the government has since confirmed that 'Brexit means Brexit'. However, there remains significant uncertainty regarding what the UK's relationship with the EU will look like after formal withdrawal takes place.

Whilst nobody has a crystal ball and the consequences of Brexit are not yet clear, there will no doubt be political considerations that will drive the negotiations. The UK government's objective must be to ensure that the UK remains competitive (or indeed becomes more competitive) in a post-Brexit world, with VAT being only one of a number of considerations. Taxation is clearly a key differentiator for countries but there are a raft of other fundamental issues, such as ensuring that the UK financial services sector is not handicapped by not being able to passport through Europe and the obvious issues around international trade.

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The UK VAT strategy cannot be decided until the Brexit model is known. For instance, it is possible that there could be an agreement with the EU for single market access, whereby certain EU laws such as VAT remain in force or are tinkered with to a minimal extent. This article assumes that there is no such agreement reached in respect of VAT. On that basis, we consider what changes Brexit may or may not bring to the interpretation of the UK's VAT legislation; what will happen to preliminary references to the CJEU up until the point at which the UK formally leaves the EU; and specific VAT issues we would expect the UK to address post Brexit.

CJEU case law

A good starting point is to briefly recap on the current system. As a member state of the EU, the UK courts and tribunals are required to ensure the full effectiveness of EU law. That stems from the general duty of sincere cooperation laid down in article 4(3) of the Treaty on European Union (TEU), which requires the member states to take 'any appropriate measure ... to ensure fulfilment of the obligations arising out of the Treaties', as well as EU secondary legislation. In the context of directives, the UK courts are also subject to the particular obligation under the article 288 of the Treaty on the Functioning of the European Union (TFEU) that directives are binding upon each member state (subject to national implementation).

In interpreting the UK's VAT legislation, the UK courts are therefore under an obligation to construe the UK legal provisions as far as possible in accordance with the wording and purpose of the directives (see *Marleasing* (Case C-106/89) para 8). One aspect of the obligation of the UK courts to ensure the full effectiveness of the VAT directives in the UK is that they are bound to apply judgments of the CJEU interpreting those directives. Indeed, the UK taxpayer is entitled to rely on both UK law and directly effective EU law which has not been implemented into UK VAT law, whilst the UK government can only rely on UK law as construed in the light of EU law.

Until the UK invokes TEU article 50, the obligation on the UK courts to interpret the UK's VAT legislation consistently with judgments of the CJEU will remain unchanged. The same will be true once the UK invokes article 50, but before Brexit formally takes place. Formal Brexit will only occur either once a withdrawal agreement enters into force or the two year withdrawal period expires without an extension; and article 50(3) makes clear that it is only when one of those dates is reached that the treaties cease to apply in the UK.

Once the UK has formally left the EU, does that mean that the UK courts can safely ignore decisions of the CJEU interpreting the VAT directives? In most cases, the answer is no.

The CJEU's judgments will remain persuasive authority, even if they are no longer binding. Although the EU law duty of sincere cooperation will have ended, the UK courts will have to interpret the UK VAT legislation in accordance with UK principles of statutory construction – which require the courts to ascertain the legislative intention of Parliament. Since the intention of parliament (when enacting the majority of the current UK VAT legislation), was to ensure a harmonised VAT system with the rest of the EU, the UK courts will still have to construe the current UK legislation consistently with the directives, as well as the existing and future case law of the CJEU interpreting their provisions.

Furthermore, as a matter of logic, an unamended provision of UK law cannot change in its meaning from one day to the next. So, if a particular supply would be exempt before Brexit, it is difficult to see how the meaning of the same provision could change overnight on Brexit, so as to render the supply in question taxable.

The only circumstances in which the UK courts will not have to take the CJEU's case law into account after Brexit is where Parliament deliberately amends the UK's VAT legislation after Brexit, so as to change the prevailing VAT law.

But all of this is not to say that problems will not occur after the UK formally withdraws from the EU. The major difficulty will be that the UK courts will not be able to seek preliminary references to the CJEU under TFEU article 267 after Brexit. So, on cases falling within parts of the VAT system which have not been amended by the UK Parliament after Brexit, the UK courts will simply have to make their own judgments without having regard to the CJEU. That leaves open the possibility that the CJEU will interpret a similar provision in a different way at a later date and that the two systems will start to diverge.

That would leave the UK courts in the invidious position of recognising in principle that the unamended parts of the UK VAT legislation should be construed consistently with the VAT directives and CJEU case law, but in fact applying different interpretations to those ultimately reached by the CJEU on the same or similar situations. Clearly, the UK VAT law would gradually get more complex going against the desired objective of simplicity. One potential result of such complexity is a rewrite of UK VAT law across the board.

Referrals to the CJEU pre Brexit

In the meantime, what will happen to preliminary references to the CJEU up until the point at which the UK formally leaves the EU? The CJEU is currently continuing to hear UK VAT cases which were referred prior to the referendum – and new VAT cases are still being sent to Luxembourg from the UK. For example, in August 2016, the UT decided to refer the *DPAS* case ([2016] UKUT 0373) on the scope of the exemption for payments and transfers in PVD article 135(1)(d) to the CJEU.

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A particular problem will be what to do with UK references as the date for the UK's final exit from the EU comes closer. References can take several years to resolve, so this is a looming issue. One possibility would be for the CJEU to decide that a judgment is no longer required and decline to answer the UK court's questions. However, the purpose of references is often just as much to resolve disputes as to the VAT treatment of past transactions as to determine VAT liabilities in the future. It is arguable that the CJEU should answer references made before Brexit, in order that the national courts can fulfil their role of providing 'the legal protection which individuals derive from the rules of EU law and to ensure that those rules are fully effective' (see *Küçükdeveci* (Case C-555/07) para 45).

Indeed, we consider that European law should be construed in a way that ensures that all Europeans (noting that the issues at stake would have arisen whilst the taxpayers were in the EU) are able to benefit from their European rights for the entire period that they remain EU citizens. These rights should not be denied for such periods simply because it is known that a member state will be leaving the Union.

Specific issues post-Brexit

There are situations where the UK view of how VAT law should be interpreted is clearly at odds with that of Europe. A typical example would be both the cases of *Andersens* (Case C-472/03) and *Aspiro* (Case C-40/15), which have not been implemented into UK law. As a matter of policy, we would expect the UK to disregard these cases in a post-Brexit world and to clarify their position by a change of law.

The UK has often been challenged about the zero rating available under the Terminal Markets Order 1973, which is of great benefit to the City. In the context of the UK's objective to remain and potentially become more competitive, this regime is likely to be left in place with no

basis for challenge by Europe in the future.

Another area which currently creates extensive issues, both in terms of liability of services and VAT recovery, is the VAT treatment of pension schemes. Businesses, as well as HMRC, agree that the current situation is too complex and simplification is needed. Following Brexit, these issues may be easier to overcome, as the UK government could simply introduce a new and simpler VAT regime for pension funds. This would be welcome news for many pension funds, which are currently spending inordinate amounts of time and money trying to manage their VAT affairs and understand how best to optimise their VAT position. This is truly a ridiculous position to be in and simplifying this area would be a major step forward in the simplification of the tax regime.

Of course, the big issue for financial institutions would be whether they become entitled to VAT recovery for supplies made to member states of the EU under the Input VAT (Specified Supplies) Order, SI 1999/3121. This will clearly raise a number of issues, given that blocking input VAT relating to supplies to EU counterparts is an important source of revenue for the Exchequer. However, this is not the only consideration. Given that tax is an important consideration in determining where investments are made, the UK would have to also consider that locating significant IT investments in Europe to support UK businesses would become potentially more attractive, given they would get VAT recovery when the UK leaves the EU.

In any event, any decision on this matter would certainly need to be taken on a holistic basis, taking account of the entire tax regime for financial institutions to minimise revenue leakage, whilst also making the UK an attractive location for the financial services sector.

Furthermore, the EU is a customs union which allows freedom of movement of goods between member states without any customs formalities or duties/tariffs. Leaving the EU customs union will almost certainly mean that customs formalities and duties/tariffs will by default

be imposed on trade in goods between the UK and the remaining EU member states.

The administrative costs of trading with the EU will increase due to the re-imposition of customs formalities (i.e. real time preparation and submission of customs declarations, having to determine the origin of goods, delays due to customs clearance, providing financial securities to the authorities, possible registration requirements for customs (EORI) and VAT purposes, and import VAT cash flow).

Customs duties may be imposed on UK exports to EU countries and the UK may impose customs duties on imports from other EU countries. In addition to this, the UK will no longer be able to take advantage of the EU's free trade agreements (FTAs) with third countries such as Mexico, South Africa, Chile, Switzerland and South Korea (as well as those in the pipeline, e.g. USA, Canada, Japan). In a post-Brexit world, the UK must negotiate its own FTAs.

Finally, abuse of law is an issue where we can reasonably expect changes by the UK post Brexit. The UK's referral in *Halifax & Others* (Case C-255/02) has been much relied on by HMRC to protect the revenue and abusive practices. Clearly, the test is premised on achieving a result contrary to the purpose of the directive and the national rules transposing it. The tax authorities will no doubt wish to retain the spirit of the *Halifax* principles but perhaps tailored to suit a post-Brexit world. It would not be surprising for the GAAR regime to be extended to include VAT.

Final thoughts

Whilst the effect of Brexit on the UK VAT system is not yet entirely clear, what is certain is that the UK's exit from the EU will be a big issue. Businesses have started to and should continue to consider their strategic options, including the potential VAT consequences and appropriate strategies to mitigate any potential VAT leakage. ■

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