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Article

VAT and Brexit: The Past, Present and Future

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1 Introduction

Exact science rarely emerges during times of febrile political discourse such as that currently revolving around the withdrawal of the UK from the EU. Woody Allen once wrote of a man named C. N. Jerome, a psychic, who claimed he could guess any card being thought of … by a squirrel.[1] Jerome may equally have professed to divine the outcome for UK VAT policy in the not-too-distant future (namely, 11 pm on 29 March 2019). Owing to this uncertainty and the possibility of up-to-date authorship becoming outdated by the time of publication, the authors have strived to cover certain topics in relation to VAT policy and Brexit with a caveated generality and occasional, hesitant prediction.

Part 1: The impact of Brexit on UK VAT

2 Background

In a referendum held on 23 June 2016, a narrow majority of UK voters[2] voted to leave the EU. On 29 March 2017, the UK invoked Article 50 of the TEU[3] by formally notifying the European Council of its intention to withdraw from the EU. Since then, the EU and the UK have been attempting to negotiate an agreement setting out the arrangements for the UK's withdrawal in accordance with Article 50(2) of the TEU (the Withdrawal Agreement). As a matter of law, regardless of whether the Withdrawal Agreement is signed and ratified, the UK will leave the EU at 11 pm on 29 March 2019 (unless both the UK and the remaining 27 Member States of the EU (the EU27) agree otherwise).

If a Withdrawal Agreement is ratified, the UK will enter into a transition arrangement under which it will effectively be treated as if it were still a member of the EU (including for VAT purposes). The latest draft of the Withdrawal Agreement shows that the transitional period and, therefore, the existing VAT rules, will apply until 31 December 2020. If a Withdrawal Agreement is not concluded, there will be no transitional period and the UK will, from the EU's perspective, immediately become a 'third country' (including for VAT purposes).

Brexit gives rise to significant challenges for the UK in relation to VAT. The UK aspires to frictionless cross-border trade with the EU after it has left, or at least borders that are as frictionless as possible, but, at least until technology has further advanced, VAT necessitates a border between those who are inside a common VAT area and those who are not.

3 The Purpose of VAT

Value Added Tax (VAT) in the United Kingdom is enacted in the Value Added Tax Act 1994 (VATA 1994) which implements Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the VAT Directive).[4]

Membership of the EU is contingent on a Member State introducing legislation to implement VAT in accordance with the VAT Directive. The VAT Directive's primary purpose is to ensure the imposition of turnover taxes that do not distort competition or hinder the free movement of goods and services. It aims to harmonise, within defined limits, VAT legislation across the EU to create, and maintain the integrity of, the internal market.[5] There is an inextricable link between the free movement of goods and services, the EU internal market and the VAT territory of the EU (the EU VAT area),

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1 W. Allen, *The Insanity Defense* 126 (Random House 2007).
2 EU Referendum Result – Leave: 51.9%, 17,410,742 votes; Remain: 48.1%, 16,141,241 votes – Majority in favour of Leave: 1,269,501 votes.
3 Treaty on European Union (Official Journal C 326, 26 Oct. 2012 P. 0001–0390).
4 Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax (OJ L 347 11.12.2006, at 1).
5 Council Directive 2006/112/EC, Recital (4).

namely, the removal of borders whether: physical; fiscal; or, administrative. Following Brexit, the UK will have to contend with the reintroduction of all three.

4 The Importance of VAT

UK VAT receipts have increased substantially since the financial year 2009–2010. In 2009–2010, total UK VAT receipts were £70.2bn. In 2017–18, the total was £125.3bn, representing a 78% increase across the eight-year period in nominal terms.[6] VAT receipts during the same period increased from 4.6% of GDP to an estimated 6.1% and from 17% of total contributions to 21%.[7]

For this reason alone, it is unlikely the UK will abolish VAT when it leaves the EU – to do so would, some argue, be an 'astonishing act of self-harm'.[8] Others, however, have made the argument that abolishing VAT is precisely what the UK should do. Some commentators[9] have even argued that the UK should replace VAT with the 'Purchase Tax' on luxury goods which operated before it joined the EU – a tax that was barely fit for purpose in the early 1970s, let alone the digital age.

5 Imports and exports, acquisitions and dispatches

It is not necessary or desirable to rehearse in detail how cross-border VAT currently operates within the EU. As far as goods are concerned, there is a clear distinction between:

- Goods moving within the single market (i.e. intra-Community 'acquisitions' or 'dispatches'), and
- Goods brought in to a Member State from (or shipped from a Member State to) a country outside the EU (i.e. third country 'imports' or 'exports').

The UK (including the Isle of Man, but excluding the Channel Islands and Gibraltar) is currently part of EU VAT area.[10]

6 Goods: acquisitions and dispatches

Intra-Community transactions carried out by taxable persons are taxable in the Member State of destination.[11] Subject to certain evidential conditions, the supplier treats its dispatch as zero-rated: it does not need to account for output VAT on the supply but can recover input VAT incurred. Again subject to certain conditions, the customer treats its acquisition as a self-supply: it accounts for the acquisition output VAT due under the reverse charge but reclaims it as input VAT incurred in its normal accounting cycle.[12] Crucially, no VAT is payable at the point that the goods cross the national border.

Subject to certain conditions, cases involving the supply of goods by a VAT registered business in one Member State to a VAT-registered business in a second Member State which supplies the same goods on to a VAT-registered business in a third Member State, may be eligible for triangulation. The first business makes a zero-rated supply of goods. The second business makes an intra-Community acquisition and a VAT-free supply to the third business. The third business accounts for the VAT due under the reverse charge.

There are some special, procedural, considerations when goods cross the Irish land border (e.g. from a UK supplier in Northern Ireland to an EU customer in the Republic of Ireland). In such cases, depending on the method of dispatch, HMRC specify the commercial evidence a UK supplier is required to obtain before it can zero-rate its supply.

Where a customer is not VAT-registered, subject to certain exceptions, the supplier will generally be required to treat the supply as a domestic supply under the distance selling rules.[13] Businesses VAT-registered in one Member State, selling goods to non-registered customers in other Member States, will need to monitor the volume of sales made in those other countries. Once the value of relevant sales in a calendar year exceeds a specified threshold, a VAT-registered supplier will be required to register for VAT in its customers' countries (and account for VAT on its supplies there).

7 Goods: Imports and Exports

Since the primary purpose of VAT is to tax the consumption of goods in the EU, any export of goods to a customer in a 'third country' is zero-rated for VAT purposes (irrespective of whether the customer is VAT-registered or not).[14] Subject to meeting certain conditions, a VAT-registered exporter will, therefore, not need to account for any output VAT on the export but will be able recover directly connected input VAT incurred in its VAT return.

Broadly speaking, subject to the availability of any relief and special rules for temporary storage and warehousing, import VAT is payable as soon as goods enter

[6] HM Revenue & Customs, Value Added Tax (VAT) Bulletin, June 2018 (20 July 2018).
[7] HM Revenue & Customs, HMRC Tax & NIC Receipts, Monthly and annual historical record (20 July 2018).
[8] Scorey QC, D., *Brexit Begins! Art. 50, the Great Reform Bill and VAT*, (1 Apr. 2017), De Voil Indirect Tax Intelligence, 251 (16).
[9] E.g. Anthony Browne, a former aide to Boris Johnson, 15 reasons why we can be cheerful about 'taking back control' after Brexit (The Sun, 9 Feb. 2018).
[10] Council Directive 2006/112/EC, Arts 5, 6(1)(e), 7; HMRC: The Single Market (VAT Notice 725), para. 2.4.
[11] Council Directive 2006/112/EC, Recital (10), Art. 40.
[12] Council Directive 2006/112/EC, Arts 2(1)(b), 20, 40, 68–69, 200; HMRC: The Single Market (VAT Notice 725), para. 7.4.
[13] HMRC: The Single Market (VAT Notice 725), para. 6.1.
[14] Council Directive 2006/112/EC, Art. 146.

EU VAT area.[15] In most cases, subject to any special duty deferral arrangements, import VAT is payable before goods can pass through border customs controls. In addition to the inevitable disruption to the movement of goods across the border, this 'hard border' creates, in the absence of any deferral arrangement, a (potentially significant) VAT cash-flow disadvantage for importers.

8 Services

The position for the supply of services is more straightforward. Where no exceptions apply, the place of supply of intra-Community services by a VAT-registered business will generally be either:

- The place of destination – where the customer is a 'relevant business person'.[16] The customer accounts for the output VAT (and reclaims its input VAT) in its home jurisdiction under the reverse charge, or
- The place of origin – where the customer is not a 'relevant business person'.[17] The supplier accounts for the output VAT liability in its home jurisdiction.

The general position for supplies of services to customers, and from suppliers, outside EU VAT area is identical because of the worldwide scope of the definition of a 'relevant business person'. However, the supply of certain services to a non-relevant business person, outside the EU VAT area, will always be treated as made where the customer belongs, and so outside the scope of VAT. Such supplies include (for example), transfers of intellectual property, advertising and the services of consultants, lawyers and accountants (unless the services relate to land).

9 The Impact of Article 50 and Brexit-day

If, at some stage, the UK ceases to be in the EU VAT area, the practical impact for the UK in relation to cross-border issues can be summarized as follows:

- A VAT border between the EU and the UK (including along the land border between Northern Ireland and the Republic of Ireland) will materialize.
- The UK (including the Isle of Man, the Channel Islands and Gibraltar) will become a 'third country' outside the EU.
- The concept of intra-Community acquisitions or dispatches will become irrelevant in the UK.
- The 'triangulation' simplification will no longer be available on transactions involving UK businesses.
- All goods moving across the UK border will be treated as imports or zero-rated exports.
- Import VAT will be payable in the UK (at 20% on goods coming from the EU) and in the EU (at the domestic rate on goods arriving from the UK) as soon as goods cross the border. Some form of border checking, categorization, tracking and processing controls would be required, on both sides of the border, immediately.[18]
- Importers may be able to make special duty and import VAT deferral arrangements (but this is far from certain).
- Services will be largely unaffected but the EU MOSS scheme for digitally supplied services will no longer be available to UK businesses operating in the EU. The scheme will need to be unwound in the UK. Unless it is able to re-register under the non-EU MOSS scheme (i.e. it is not established, does not have a fixed establishment, and is not (or required to be) VAT registered in the EU), UK businesses will need to consider the need to register for VAT in multiple EU Member States. A non-EU business that chose to register for EU MOSS in the UK will need to re-register in an EU Member State.
- The VAT-related information exchange systems and mutual administrative co-operation arrangements within the EU (established to ensure VAT is assessed correctly, monitored and applied correctly, combat VAT fraud and protect VAT revenue) will all cease to apply to the UK.[19]

10 Just what is it that you want to do?

Since the Referendum, the UK has aspired to be free of the costs of being in the EU, to have its own laws, regulations and systems (including those relating to VAT) and be subject to the jurisdiction of its own courts.

At the same time, because of the importance of UK-EU trade to the UK economy, at least in the short term, it has sought ways to retain as many of the economic and trading benefits of being a Member State of the EU as possible, including access to the single market with free movement of goods and services across frictionless (VAT) borders.

One outcome would see the UK stay in EU VAT area. That would in all likelihood require the UK to sign-up in full to the VAT Directive and to keep its VAT legislation fully aligned into the future. More fundamentally, staying in the EU VAT area would almost certainly mean accepting the ultimate jurisdiction of the CJEU over the

15 Council Directive 2006/112/EC, Arts 2(1)(d), 70.

16 Council Directive 2006/112/EC, Art. 44.

17 Council Directive 2006/112/EC, Art. 45.

18 In relation to a "no-deal" scenario, this has now been addressed by the UK government's commitment to introduce postponed accounting for import VAT on all goods, whether from the EU or elsewhere. In effect, all imports would be treated as if they were acquisitions. *See* HMRC Guidance - VAT for businesses if there's no Brexit deal, at 2.

19 E.g. Council Regulation (EU) No 904/2010 of 7 Oct. 2010 on administrative cooperation and combating fraud in the field of value added tax.

domestic operation of UK VAT. In both cases, on the face of it at least, aa 'red line' set by the UK government for the Brexit negotiations is crossed.[20] Furthermore, in being obliged to be subject to the EU VAT regime without being part of the EU, the UK would accept an unprecedented loss of tax sovereignty for a nation state. The route to this outcome, even if it were politically viable, is not straightforward.

The Isle of Man is an independent, self-governing Crown Dependency of the UK. It is outside the EEA but is within the EU VAT area. Its relationship with the EU is defined under Article 355(5)(c) TFEU and Protocol 3 to the UK's 1972 Treaty of Accession to the European Community (Protocol 3), and (despite the EU not being party), crucially for VAT purposes, the Isle of Man Act 1979. The Isle of Man Act 1979 (the Isle of Man Act), gave effect to the Customs and Excise Agreement 1979 between the UK and the Isle of Man. The Isle of Man Act provides for the sharing of 'common duties' between the Isle of Man and the UK, including VAT. Essentially, the Isle of Man is treated as UK territory for customs, VAT and excise purposes. Practically, the Isle of Man Customs and Excise has an Entry Processing Unit housed within the UK's Customs Handling of Import and Export Freight computer system. This allows for goods imported or exported to or from the UK or the Isle of Man to be declared electronically.[21]

The example of the Isle of Man demonstrates that it is technically possible for a jurisdiction to be within the EU VAT area without being part of the EU itself. It demonstrates that, in theory at least, it would be possible to amend the EU Treaties to allow for the UK to remain within the VAT rules. The rules, and indeed the principles of the EU are capable of being applied with some flexibility. One interesting effect of the Isle of Man's arrangements with the UK and EU is that inhabitants of the Isle of Man are British Citizens[22] and therefore EU Citizens, by virtue of the UK's membership of the EU, and yet do not benefit from the freedom of movement that citizens of EU Member States ordinarily do. Protocol 3 expressly provides that the free movement of persons or of services does not apply to Manxmen (or Channel Islanders).[23] Of the four freedoms, the Isle of Man benefits only from the freedom of goods. In principle, therefore, the UK *could* 'cherry-pick' those elements of the EU it wished to benefit from, whilst walking away from the rest.

This is of course to over-simplify the matter to an enormous degree. The practical obstacles preventing the UK from achieving a similar arrangement to that of the Isle of Man are immense. Politically, for example, the UK government has made it clear that it would not be prepared to remain subject to the jurisdiction of the CJEU. The political and economic implications for the EU of the inclusion of the Isle of Man within the EU VAT area are significantly less than the implications of the inclusion of the UK. Such an arrangement is fitting for the Isle of Man, whose governance is, as a Crown Dependency, the ultimate responsibility of the Crown. The same does not work for the UK and the EU.

A consideration of the microstate of Monaco highlights these points further. Relations between Monaco and the EU are conducted through France, and it is through agreements with France that Monaco is within the EU VAT area. Geographically, it would be impractical for there to be customs borders between Monaco and France, and Monaco is deemed too small in size to become a member of the EU in its own right. Whilst the Isle of Man has never expressed an interest in becoming closer to the EU, Monaco is in the process of negotiating an Association Agreement with the EU, for as full as possible participation. This brings us back in full circle to political considerations – the EU is highly unlikely to be willing to make complicated amendments in order to accommodate the UK's wishes, when the UK has chosen to leave the union, and there is no obvious 'sponsor' Member State to keep a watchful eye on the UK.

The backstop solution for Northern Ireland does not look dissimilar to the arrangement between the UK and the Isle of Man, in respect of the relationship between Northern Ireland and the Republic of Ireland. Certainly some of the practical elements are similar. Northern Ireland could remain within the EU VAT area by virtue of arrangements with the Republic of Ireland. This would avoid a hard land border, but it would inevitably necessitate a border down the Irish Sea that the UK government has adamantly ruled out. It would also be politically and constitutionally challenging, segregating Northern Ireland from the rest of the UK. For Northern Ireland, whilst it would benefit from a lack of trade barriers with the rest of the EU, the Parliament of Northern Ireland would likely have little to no say on the EU VAT rules to which it was subject. The imposition of a border down the Irish Sea is, of course, a major stumbling block for Northern Irish politicians as well as those in Westminster.

The Protocol on Ireland/Northern Ireland[24] (the Protocol) will apply from the end of the transition period (i.e. from 1 January 2021), and forms part of the draft Withdrawal Agreement. As a result, unlike the rest of the

[20] HM Government, The United Kingdom's exit from and new partnership with the European Union (2 Feb. 2017).

[21] *See* https://www.gov.im/categories/tax-vat-and-your-money/customs-and-excise/international-trade-and-the-isle-of-man-requirements-and-standards/ (accessed July 2018).

[22] The British Nationality Act 1981 confers British Citizenship on 'all those with close connections with the UK, the Channel Islands and the Isle of Man'.

[23] Art. 2, Protocol 3.

[24] Draft Withdrawal Agreement, Protocol on Ireland/Northern Ireland, at 108.

draft Withdrawal Agreement, it specifically relates to the future relationship between the UK (at least so far as Northern Ireland is concerned) and the EU. The Protocol (agreed by both the UK and the EU as a policy objective) illustrates the lack of progress in cutting the Irish border Gordian knot. While negotiations reportedly continue to find an operable alternative solution, the current version of the Protocol still sets out the EU's original 'backstop' solution included in the first draft of the Withdrawal Agreement. The EU 'backstop' comprises a 'common regulatory area' for the whole of the island of Ireland (to ensure the free movement of goods),[25] but necessitates bespoke customs,[26] VAT[27] and excise[28] regimes for Northern Ireland (aligned with the EU law) separate to whatever is adopted by the rest of the UK.

11 Breaking Up Is Hard To Do

The only outcome, the authors opine, is for the UK to leave the EU VAT area after transition. In the short-term, this leads to the import VAT cash-flow problems for UK and EU businesses but postponed accounting or deferral arrangements should (conceivably at least) manage the worst effect while the UK's Making VAT Digital project,[29] the EU's Action Plan on VAT and a form of administrative co-operation along the lines of the 2018 EU-Norway VAT Agreement[30] ought to be capable of easing matters in the medium term.

The bigger problem is that a hard border is essential to the proper operation of VAT. Import VAT forms a central base upon which VAT operates throughout the remainder of the value chain in that VAT area, ensuring tax neutrality, the recovery of the correct amount of input VAT, and that the ultimate consumer bears the correct amount VAT on the final purchase. The border also allows a tax authority to collect the VAT at the point of entry. A VAT border is intended to create friction but in normal circumstances, VAT borders are manageable. The abnormal characteristic of Brexit, however, is the commitment to avoid a hard border on the island of Ireland.

There has been remarkably little detail on how the UK envisages the new VAT border would operate, whether on the island of Ireland or between the UK and the rest of the EU. There was, in the original White Paper for the Customs Bill, a suggestion that in order to ensure UK-EU trade remained as frictionless as possible, no UK VAT would arise on any items of any value imported from the EU for personal use.[31] This gives rise to some planning opportunities (e.g. a retailer could set up an outlet just south of the Irish border allowing UK tourists to buy goods free of tax). More importantly, without some form of controls and checks, compounded with the loss of information exchange and administrative cooperation, the opportunities for smuggling and evasion grow exponentially.

Finally, from the EU perspective, if the UK leaves the EU VAT area there is a danger it would use its VAT regime to gain a competitive advantage. Such action might include reducing the headline rate below 15% (the minimum allowed by the EU) expanding the scope of zero-rating and altering the scope of certain exemptions (e.g. for financial services) allowing business to recover input VAT for the first time.[32] It is, therefore, unsurprising that the European Council's own guidelines for negotiating the framework for the future relationship make specific reference to preventing the *'unfair competitive advantage that the UK could enjoy through undercutting levels of protection with respect to*, inter alia*, … state aid, tax … and regulatory measures and practices'*.[33]

Finding the 'landing zone' where these political and economic imperatives find balance has become the defining characteristic of the negotiations for the Withdrawal Agreement, and helps explain the evolution in UK government thinking since the end of March 2017.

12 The Framework for the Future Relationship

With the UK unable to agree to the current version of the Protocol, and keen to avoid it being triggered on 1 January 2021, the resolution (or not) of the Irish border is key not only to the Withdrawal Agreement but also the parameters within which the UK will be able to design and implement its post-Brexit VAT regime. In short, the UK hopes its expectations for its future relationship with the EU could resolve the Irish question, and avoid the 'backstop' being triggered, but they will also dictate how far it is happy to go to preserve its economic trading links with the EU single market at the expense of taking back control of its laws.

Beset by internal party divisions and hobbled by its fragile Parliamentary arithmetic, the UK government's

[25] Draft Withdrawal Agreement, Protocol on Ireland/Northern Ireland, Arts 3 and 4.

[26] Draft Withdrawal Agreement, Protocol on Ireland/Northern Ireland, Art. 4(2)–(7).

[27] Draft Withdrawal Agreement, Protocol on Ireland/Northern Ireland, Art. 4(8).

[28] Draft Withdrawal Agreement, Protocol on Ireland/Northern Ireland, Art. 4(9).

[29] Assuming its smooth initiation from 1 Apr. 2019 – only 2 days after the Brexit day.

[30] http://www.consilium.europa.eu/en/press/press-releases/2018/02/06/eu-norway-agreement-signed-strengthening-the-prevention-of-vat-fraud/ (accessed July 2018).

[31] HM Government, Customs Bill: legislating for the UK's future customs, VAT and excise regimes (9 Oct. 2017), para. 5.41.

[32] It should be noted that UK banks lending to EU borrowers will, in principle, now be able to claim credit for attributable input tax in the way they currently can for non-EU borrowers.

[33] European Council, Art. 50 guidelines on the framework for the future EU–UK relationship (23 Mar. 2018).

vision of the future relationship after the transition period has evolved over the past 18 months and climaxed when the Cabinet met at Chequers in early July 2018 and agreed the Chequers Statement.[34] A government White Paper, The future relationship between the United Kingdom and the European Union[35] (the White Paper), followed on 12 July 2018.

In brief, the White Paper comprises several elements, including (so far as relevant to VAT):

- **A common rulebook for goods** – the UK is committing itself to ongoing harmonization of UK laws with the relevant EU rules to maintain frictionless UK-EU trade
- **A Facilitated Customs Arrangement** – in effect, the UK is proposing a new quasi-combined customs territory to remove customs checks and controls between the UK and the EU
- **Common cross-border processes and procedures for VAT and Excise for goods** – in effect, ensuring that new VAT declarations and border checks will not be needed. New administrative cooperation and information exchange will support the new procedures[36]
- **New arrangements on services, financial services and digital** – ensuring UK regulatory freedom from the EU while accepting increased barriers on access to the EU market
- **A common rulebook for state aid** – including cooperative arrangements on competition, and
- **CJEU** – the UK will recognize the CJEU as the sole arbiter of EU law.

Putting to one side the practical difficulties of implementing the proposals as well as the deep political divisions they have exposed at the heart of UK politics and the fact the EU has rejected them, from a VAT (and customs and excise) perspective, the White Paper suggests the UK is willing to accept severe limitations on its freedom to remake (radically or not) its VAT regime. Suggestions of 'common rulebooks' (especially in relation to state aid) and common cross-border procedures, hint at a post-Brexit UK VAT regime that is not only closely aligned with the VAT Directive but one that is tied to the EU in the longer term. The acceptance of the CJEU as sole arbiter of EU law (and, by extension, EU derived law), is especially telling. All in all, one may get the sense that the UK is preparing to maintain close alignment with the EU and to cede control over its future VAT laws to retain the economic benefits of frictionless trade with the EU. The one exception is the position taken on services and financial services in particular where the UK appears to be trying to reclaim greater self-determination (although even here, state aid will limit the government's ability to do anything truly dramatic).

13 The Taxation (Cross-border Trade) Act

Whatever the outcome of negotiations with the EU, the UK will need new domestic legislation for its post-Brexit customs, VAT (and customs and excise) regime. The Taxation (Cross-border Trade) Act (the TCTA), previously The Taxation (Cross-border Trade) Bill (the TCT Bill), will ensure the regime works appropriately with effect from the time EU law ceases to have effect in the UK. That could be either on 29 March 2019 (under the 'no-deal' scenario) or, in the absence of an extension of the transition period, another agreement or arrangement, 1 January 2021 (after the expiry of the transition period in the draft Withdrawal Agreement).

In broad outline, as far as VAT is concerned, the TCTA ensures a UK VAT regime will continue to function whatever the outcome of the Brexit negotiations. Among other things, the TCTA gives the UK government flexibility to:

- give effect to any Withdrawal Agreement
- deal with VAT on supplies of goods and services between the UK and EU, and
- vary UK information sharing obligations to give effect to any new agreement for the continued exchange of information with EU Member States.

The TCTA also confirms how EU law, converted into domestic law by the EU (Withdrawal) Act 2018, will apply in relation to VAT as discussed in Part 2, below.

More specifically, the TCTA amends the existing UK VAT regime by abolishing the EU concept of acquisitions and dispatches (for business-to-business intra-EU movements).[37] This confirms that the UK will charge import VAT on all imports, including those brought in from the EU. In addition, Schedule 8 of the TCTA makes a series of complex amendments to UK VAT legislation. These include:

- the omission of registration provisions in relation to distance selling and acquisitions (as they will no longer have relevance)
- the withdrawal of provisions that establish the VAT Mini One Stop Shop (MOSS) system in the UK meaning the UK will no longer be able to collect and pass on VAT due in EU Member States
- the removal of provisions allowing relief goods to be supplied VAT free if transferred between fiscal warehouses in the UK and those in the Member States
- withdrawing the legal obligation for HMRC to make arrangements to forward applications made by UK

[34] Chequers Statement from HM Government (6 July 2018); n.b. two Cabinet Ministers subsequently unagreed and resigned.

[35] The future relationship between the United Kingdom and the European Union (12 July 2018).

[36] It is possible the UK is thinking about something akin to the Agreement between the EU and Norway on administrative cooperation, combating fraud and recovery of claims in the field of VAT, approved by the Council of the EU on 22 June 2018.

[37] Taxation (Cross-border Trade) Act, section 41.

registered taxpayers for VAT refunds on supplies or importations made in another Member State to the tax authorities of that Member State, and
– amendments to ensure the VAT zero-rate continues to apply to supplies of work on goods that are in the UK and subsequently exported and on the handling and storage of goods in the UK.

One last-minute amendment to Schedule 8 of the TCT Bill, proposed during its Report stage by the European Research Group of Eurosceptic Conservative MPs, removed the intended insertion of a new section into the Value Added Tax Act 1994 (VATA 1994) that would have provided some flexibility in relation to a post-Brexit VAT policy by envisaging the charging of acquisition VAT on cross-border movements of goods within a customs union. The intervention essentially commits the UK to leaving the EU VAT area which, the authors consider, is inevitable in all but the softest of soft Brexits. The House of Commons approved the amendment by 303 votes to 300.

14 Post-Brexit UK VAT

It is possible to see a Brexit accorded by a Withdrawal Agreement and an Agreement on the Future Relationship under which, although it leaves the EU VAT area, the UK remains broadly aligned with it and, while not removing a hard border, reduces the infrastructure needed for it. A harder, no-deal, VAT Brexit liberates the government from the constraints imposed by the EU and accepted by the UK (primarily because of the inevitable border friction and impact on UK-EU trade) and could ultimately lead to more radical action on VAT (and other taxes).

On 23 August 2018, the UK government published its guidance notice *VAT for businesses if there's no Brexit deal*.[38] The consistent impression one has had since the referendum is that the current government is *'minded to pursue continued "alignment" with the UK on matters of [VAT] in the long-term, effectively staying in the single EU VAT area'*[39] and the `no-deal´ guidance notice does little to disabuse that impression confirming "the government's aim will be to keep VAT procedures as close as possible to what they are now".[40] The headline announcement was that the UK government would "introduce postponed accounting for import VAT on goods brought into the UK"[41], both from the EU and non-EU countries, relieving (at least) the cashflow disadvantage for businesses occasioned by having to pay import VAT. The move would actually put businesses importing into the UK from outside the EU into a better position than that in which they currently find themselves. This would appear to be a magnanimous position for the UK government to have taken as it surrenders the cashflow advantage import VAT undoubtedly provides the Treasury's purse and potentially opens up the possibility for more VAT fraud on cross-border trade. It is currently unclear whether this will be a general feature of future UK policy if there is a Brexit deal. It is possible that the government's hand had been forced (or it perceived that it had) to remove the distinction between imports and acquisitions in order to be compliant with World Trade Organization (WTO) rules. So far as the key issue of a hard border on the island of Ireland is concerned, the notice is depressingly vague, promising merely that the government "will provide more information in due course".[42]

Of course, governments and Prime Ministers can change. Undoubtedly, the 'no-deal' guidance notice and (in respect of a future relationship following a deal) the White Paper, with their commitments to common cross-border processes and procedures for VAT, a Facilitated Customs Agreement, recognition of the CJEU as sole arbiter of EU law and a common rulebook on State Aid, represent a major step towards a system that is at least broadly aligned with that of the EU. That outcome would also be largely consistent with the government's position that *'the administration of the VAT and excise regimes will remain largely the same as today'*.[43] However, this is hard to square with the way in which the EU conceives the Single VAT area will work and, at best, it appears to leave the UK close to the position of Norway, with which the EU has a hard VAT border.

Part 2: VAT rate flexibility – the EU and the independent UK

'*Value added tax is essentially an EU tax, imposed by Member Stats in compliance with EU legislation*'.[44]

Like all Members States, the UK is constrained by the VAT Directive in its application of different VAT rates to different products. The background to the rate structures available is long and convoluted, an exegesis of which is not relevant here. Simply put,

[38] HMRC Guidance - VAT for businesses if there's no Brexit deal, https://www.gov.uk/government/publications/vat-for-businesses-if-theres-no-brexit-deal (accessed 23 Aug. 2018).
[39] House of Commons European Scrutiny Committee, Value Added Tax: EU proposals for reform and the implications of Brexit, Twenty-third Report of Session 2017–19 (3 Apr. 2018), at 5.
[40] HMRC Guidance - VAT for businesses if there's no Brexit deal, at 2.
[41] HMRC Guidance - VAT for businesses if there's no Brexit deal, at 2.
[42] HMRC Guidance - VAT for businesses if there's no Brexit deal, at 6.
[43] H.M. Treasury, Customs Bill: legislating for the UK's future customs, VAT and excise regimes (Oct. 2017).
[44] *Royal and Sun Alliance Insurance Group plc v. HMRC* [2003] UKHL 29.

the Commission has consistently, in line with their treaty competence, pushed for harmonization and rationalization of rates for the benefit of the internal market as well as to avoid targeted benefits both within Member States and across the EU, whilst Member States – the UK being a prime example – have fought to maintain their derogations. This was until recently when the Commission decided to afford Member States flexibility to apply reduced rates almost without constraint. With these new proposals, which would seem to placate some of the UK's purported policy issues on VAT (too late, sorry!), the question to be asked is: if the UK is to leave the EU VAT area and tread a new path, what is it leaving behind in the EU and what lies ahead?

15 The European Union

The flexibility announced EU-wide (due to a volte-face from the Commission) would have been welcomed by the UK had it been remaining in the EU. Instead of a blanket application of a standard rate save for a list of permitted derogations, in effect the reverse would be implemented with freedom to apply rates save as for any good or service specifically standard-rated in the 'negative list'.[45]

The Commission Memo states that the move to the destination-based system renders 'a restrictive approach' to VAT rates unnecessary.[46] There is some truth that without the end-goal of an origin-based system, harmonization is no longer critical.[47] However, even if not *entirely* necessary, there are serious ramifications to deregulation, and the lack of positive harmonization means the proposal is probably unlawful under Art.113 TFEU.[48] Despite this, the proposals are puzzlingly referred to as the 'new Harmonised rules'.[49] If harmonization is being sought for the EU – it was specified as a requirement by the Council – it can be achieved by the removal of derogations and the approximation of rates.[50] To label the flexibility proposal as harmonizing is sophistry.

There should be no doubt that this is a disharmonization measure which, if adopted, will increase complexity. Without controls, flexibility can allow for well-resourced or well-represented industries to lobby for beneficial VAT liabilities, contrary to fair competition – a fact recognized by the Commission and bizarrely proffered as a justification for allowing flexibility.[51] Even the press release (which one would think should proselytize the benefits) stated 'EU countries consider VAT rates as a useful instrument to pursue their political objectives'. The EU are essentially moving VAT further into the political sphere such that products' VAT liabilities will be subject to change from lobbying, trends, political allegiances and fleeting economic concerns. As a result, legal certainty will reduce and administrative and compliance costs (the former for the state revenue collectors and the latter for taxable persons) will increase.[52] Furthermore, varied rates can create market distortions between borderless states and erode the base, reducing the budgetary pot which can have a knock-on effect on redistribution. Domestically, the tax loses neutrality as products might be altered to fit a certain rate or litigated to be reclassified either to compete against rival products or to gain competitive advantage. One might think that VAT rate litigation on the CJEU docket would reduce as interpretations as to what qualifies under EU law will no longer be called for;[53] however, the safeguards discussed below will almost certainly call for clarification.

The flexibility is accompanied by caveats: it calls for Member States to ensure any new reduced rates benefit the final consumer[54] and are applied in a consistent manner to pursue an objective of general interest,[55] there must also be a weighted average rate of 12%. These are described as 'safeguards' to avoid potential risks like revenue erosion, distortion of competition, unnecessary complexity and legal uncertainty.

The 12% weighted average, intended to protect revenues, is largely superfluous due to the need for revenue from taxation and the average actual VAT rates being substantially higher.[56] Regarding the 'consistent application', this could be a nod to existing principles of certainty and legitimate expectation but does little to solve the tension between the strict interpretation of derogations and the principle of fiscal neutrality.[57] There is no explanation of how the reduced rating should pursue an

[45] This list would be reviewed every 5 years by the Commission and indications are that it would be somewhat Pigouvian in ideology, dealing with unfavourable goods such as weapons, tobacco, alcohol and gambling.

[46] MEMO/18/186, Questions and Answers on the VAT package, Brussels (18 Jan. 2018).

[47] The origin system as envisaged required harmonisation to avoid incentivising lower rating for a competitive advantage and to avoid disparities that promote market distortion between net-dispatching and net-acquisition states.

[48] R. De La Feria & M. Schofield, *Towards and [Unlawful] Modernized EU VAT Rate Policy*, EC Tax Rev. 89 (2017).

[49] COM(2018) 20 final, Proposal for a Council Directive amending Directive 2006/112/EC as regards rates of value added tax, Brussels 18 Jan. 2018, 4; although one notes that the word 'harmonised' does not appear once in the accompanying Press Release.

[50] I. Lejeune & C. Herbain, *A revamped flexibility on VAT rates for Member States*, 2 B.T.R, 162 (2018).

[51] MEMO/18/186, Questions and Answers on the VAT package, Brussels, 18 Jan. 2018 – 'Member States have come under increasing pressure to favour certain sectors when it comes to VAT rates but they can't easily do so'.

[52] For more, *see* R. De La Feria, *VAT and in EC Internal Market: The Shortcomings of Harmonisation*, (2009), OUCBT WP 09/29, 28.

[53] I. Lejeune & C. Herbain, *supra* n. 45.

[54] COM(2018) 20 final, Proposal for a Council Directive amending Directive 2006/112/EC as regards rates of value added tax, 4, 11 (Brussels 18 Jan. 2018).

[55] Per the new Art. 98, COM(2018) 20 final, Proposal for a Council Directive amending Directive 2006/112/EC as regards rates of value added tax, 11 (Brussels 18 Jan. 2018).

[56] I. Lejeune & C. Herbain, *supra* n. 45.

[57] And therefore a tension between certainty, fairness, neutrality and base erosion, *See* R. De la Feria, *EU VAT Principles as Interpretative Aids to EU VAT Rules: The Inherent Paradox*, in *Recent VAT Case Law of the CJEU*, 1–17 (M. Lang, et al. eds, Vienna: Linde 2016).

objective of general interest. There has been litigation concerning the requirement for 'clearly defined social reasons' which is narrower than the requirement in the Proposal's new Art.98.[58] It is easy to envisage a new wave of litigation to assess, inter alia, whether (1) the pursuit is met by lip service alone i.e. even if the results differ; (2) whether specific interests can have generality; (3) whether an objective has a general interest; (4) what happens if there are multiple or competing interests and neutrality problems; and (5) what the threshold is in light of other EU legal principles (proportionality etc.).

Regarding beneficial incidence, although this is included in the wording of Article 110 of the VAT Directive, it is unclear how Member States are to ensure and prove such a consumer benefit ex ante so as to permit the reduced rating.[59] It is a task which is both difficult to assess over time and across market places. The test is unlikely to be met in light of the literature on incidence which, even putting it at its highest, says that the evidence is variable and inconclusive.[60] The Commission's own publications[61] have said that reductions in VAT are 'never passed on in full' to consumers and are 'very often it is negligible and temporary'.

If lower rates are not reflected in prices, they will increase margins leading to an effective state subsidy affording an advantage to businesses over similar competitors domestically and in other Member States. When coupled with the complexity and compliance costs which can dissuade businesses expanding into markets across the EU-28 (27-to-be), the purported safeguard although well-intentioned, comes up short.

Alternatively, it might be a somewhat toothless provision to ensure the VAT advantage is merely capable of being passed on down a supply chain and any benefit in the supply chain is sufficiently close to the consumer,[62] an issue which has not been sufficiently dealt with in EU jurisprudence. Essentially, the flexibility proposal lacks a foundation in traditional VAT economics and is peppered with ambiguities and misunderstandings, both of which will necessitate litigation for clarification.

One cannot hope to divine the inner workings of the Commission's VAT policy unit from the outside looking in; however, the threat of Brexit may have played a part in the new flexibility proposal. For example, in 2015 (and since[63]), the application of 5% VAT to women's sanitary products became a political cause célèbre with mentions in parliament, protests, and a petition with over 320,000 signatories; the EU's restrictions were always to blame. The Treasury wrote to the Commission requesting discretion for the VAT-rating and the Commission, contrary to the legal position, replied in agreement. As VAT purists, the authors hoped that with the announcement of Brexit, the Commission would in fact abandon the flexibility and rebound to strive for an ever closer union. It seems however that as things stand, the proposal will be coming into force in 2022. Whether a vote by unanimity for traditional harmonization and rate approximation is more achievable for the EU without the UK's veto appears to be a question of only academic relevance now.

The conclusion of these authors is that the EU VAT system is structurally worse off for the flexibility proposals. To some extent, therefore, the UK as a member of the EU would have been negatively affected by the changes even if, ironically, it was the EU ceding control for Member State autonomy as was so passionately desired by many Brexiteers.

16 The Independent UK

In the opinion of the authors, it is fair to say that tax has been afforded very few Brexit column-inches.[64] There has been considerable discussion of customs issues; however, in the recent White Paper, VAT is barely mentioned. One throwaway line reads:

The UK's proposal for its future economic partnership with the EU would not fetter its sovereign discretion on tax, including to set direct or indirect tax rates, and to set its own minimum tax rates.

As mentioned above, the authors consider that the UK will almost certainly leave the EU VAT area. Upon leaving, as expounded below, the constraints of EU treaties and directives will fall away as will the primacy of CJEU

58 The VAT Directive does not define what qualifies as a social objective, *see* M. Schofield, *VAT Reduced Rates? Save your energy*, (11 June 2015), Bloomberg BNA International Tax Law Blog; and, C-108/11, *Commission v. Ireland*, 14 Mar. 2013.

59 The House of Commons European Scrutiny Committee in its Twenty-third Report of Session 2017–2019 (HC301) asks the Minister to clarify how these tests will be applied in practice.

60 *See* M. Schofield, *GCC VAT: Rates Roadmap*, in *VAT in the Gulf Region*, MENA Bus. L. Rev. 39–48 (Mar. 2017); R. De La Feria, *Blueprint for Reform of VAT Rates in Europe*, 43(2) Intertax 155 (2015); and I. Gaarder, *Incidence and Distributional Effects of Value Added Tax* (2016), presented at a Stanford Economics Seminar, available on SSRN.

61 *See* European Commission, Reduced Rates of VAT: Frequently Asked Questions, Press Release, Brussels: MEMO/03/149 (16 July 2003).

62 Case C-108/11, *Commission v. Ireland*, 14 Mar. 2013; Case C-416/85, *Commission v. United Kingdom*, 21 June 1988.

63 *See* e.g. this blog from the prominent Brexiteer and former Conservative Cabinet Minister John Redwood MP http://johnredwoodsdiary.com/2018/08/07/spending-the-39-bn-cutting-vat/ (accessed July 2018).

64 This has been mentioned by other authors too, e.g. E. Wong, *Doing Business After Brexit: Tax (including VAT)*, in *Doing Business After Brexit: A Practical Guide To The Legal Changes* Ch. 4 (H. Tse ed., Bloomsbury Professional 2017); and on the other side of the coin, when discussing VAT, Brexit has not been raised. The House of Commons European Scrutiny Committee in its Twenty-third Report of Session 2017–2019 (HC301) found it 'curious' that the Financial Secretary to the Treasury (Mel Stride) did not refer to Brexit and the effects on the UK's domestic VAT regime 'in any substantive way'. The FT's Economics Correspondent, Chris Giles, is an honourable exception to the rule https://www.ft.com/content/7ff44a0c-59e2-11e8-b8b2-d6ceb45fa9d0.

rulings.[65] This legislative freedom could have profound economic effects and yet taxpayers, voters, the general public, even tax lawyers have no indication as to how this power will be wielded. The answer will lie somewhere on a scale with profligate rate reductions and base erosion at one end, and a broad-based, single-rated, neutral VAT at the other. The corpus of evidence should take us to the latter[66]; the worry is that the political pressures and UK's track record lean towards the former.

In the real world of legislating, there is a balance to be struck with VAT policy. The primary aim of taxation will always be revenue raising, then comes a list of secondary factors the hierarchy of which will depend on subjective preference.[67] A lower standard rate is generally preferable as it avoids the dissuasion of consumption and reduces the incentive for fraud but, to raise money, a low rate must be applied across as many products as possible. Without varying the taxable base, the aforementioned primary aim will mean that the standard rate is not cut to an inefficient level of revenue raising. Therefore, despite the quote above which specifically clarifies the discretion to set the UK's own minimum rates, it is not expected the UK will reduce the standard rate below the Directive minimum of 15%. On the contrary, if revenue is required due to any low growth following no-deal Brexit economy, the standard rate might be subject to an increase[68] even though this was ruled out by the Conservative Party in its manifesto before the 2017 General Election.[69]

Importantly, 'the revenue yielded by any sales tax is the product of its base and rate'.[70] Evidence suggests that changes in the standard rate account for a relatively small part of the development in VAT revenues. Instead, the focus for a prosperous UK indirect tax system should be to reduce rate differentiation.

Much has been written to dispel the traditional arguments for reduced rates. The contention that reduced rates lower regressivity (the 'vertical equity' argument), encourage consumption of merit goods (the 'positive externalities' argument) and increase employment (the 'labour intensive industries' argument) has been shown to be false. All justifications assume reductions are passed on in the consumer price; this is rarely the case. Many are based on arbitrary categorization with blurred lines, often functioning contrary to traditional inverse elasticity.[71] Furthermore, the regressivity is not so clear when looking at income and expenditure over time; instead the reduced rates unwittingly lead to public subsidisation of the leisure time of the wealthy and the encouragement of leisure over productivity.[72]

Not only do the reduced rates fail to meet their purported aims, they actually harm revenue collection and the market. It is anti-competitive, high cost, and low return. Even if some justifications *did* hold true, the complexity alone should bar rate differentiation. Having more than one rate increases compliance costs for firms who must account for different rates with regard to their inputs and outputs. It also increases administrative costs for HMRC who must police the correct application of rates (including complex rules on composite/mixed supplies). The greater the rate differentiation, the higher the compliance costs. This contravenes the neutrality of the VAT as firms may choose to alter their production to avoid having to account for multiple rates. Smaller taxpayers are also at a disadvantage if they do not have the money for accountants and lawyers to assess the rates applicable to them. The categorization necessitates delineation which often requires expensive litigation to obtain a judicial ruling or expensive tax planning advice, on topics which most of the public would find laughable – from asking whether Jaffa Cakes are biscuits or cakes to whether Bridge has a sufficient promotion of physical and mental health to be classified as a sport.[73] By way of a non-UK example, a bizarre quirk has arisen under Dutch law where sunscreen and fluoride toothpaste are reduced-rated pharmaceuticals and, simultaneously, expressly removed from the reduced rate such that either reduced or standard rating could amount to a breach of the Directive.[74] Furthermore, the complexity and compliance costs may deter incoming investment or domestic start-ups – which is not ideal when the UK will be losing all its worldwide Free Trade Agreements overnight. Reduced rates are a significant revenue cost to the government

[65] This refers more to the precedents to which the UK courts must follow, as to a system of stare decisis in the CJEU context *see* K. McAuliffe, *Precedent at the Court of Justice of the European Union: The Linguistic Aspect*, Current Legal Issues 15, 483 (2013).

[66] *See* R. De La Feria, *supra* n. 55; and Copenhagen Economics, Study on Reduced VAT Applied to Goods and Services in the Member States of the European Union: Final Report (2007), 6503 DG TAXUD.

[67] These other factors include, inter alia: compliance costs, administrative costs, market efficiency and tax neutrality, social policy including redistribution, welfare funding, the encouragement of positive externalities alongside disincentivising negative behaviour, industry subsidisation, avoiding fraud or abuse, and appeasing voters (i.e. public relations).

[68] An optimum revenue-raising rate, if it exists, can be higher in low growth periods *see* R. De La Feria, *supra* n. 55, at 167, although this will vary depending on compliance and enforcement as well as divergence from reduced rates, K. Matthews, *VAT Evasion and VAT Avoidance: is there a European Laffer Curve for VAT?* 17(1) Int'l Rev. Applied Econ. (2003).

[69] H. Verma, General Election 2017: Tory plans for income tax and corporation tax cuts confirmed and an end to 'triple lock, 18 May 2017, available here: https://www.tax.org.uk/media-centre/blog/media-and-politics/general-election-2017-tory-plans-income-tax-and-corporation-tax (accessed Aug. 18).

[70] R. Bird & P. Gendron, *The VAT in Developing and Transitional Countries* 39 (CUP 2011).

[71] If Brexit does lead to economic downturn, the expenditure on (basic/non-luxury) inelastic goods will increase and yet these are often afforded lower VAT rates under the vertical equity justification such that revenue loss will be exacerbated.

[72] For a full critique *see* M. Schofield, *supra* n. 55; and I. Crawford, M. Keen, S. Smith, *Value Added Taxes and Excises*, in *Dimensions of Tax Design: The Mirrlees Review* 286 (J. Mirrless ed., IFS 2010).

[73] Case C-90/16, *The English Bridge Union v. HMRC*, 26 Oct. 2017.

[74] House of Commons European Scrutiny Committee in its Twenty-third Report of Session 2017–2019 (HC301), 27.

before any of the further costs are even considered: it is compounded loss.

In conclusion, the UK has an opportunity for a new start (symbolically even if not legally).[75] Ideally, efficiency would be improved by broadening the base and levying the standard rate without exception. This will foster a competitive business landscape and save costs of administration. Unfortunately, the reality might not meet the hopes and expectations of academics. The UK has historically been unwilling to cede the application of reduced rates found in Schedules 7A and 8 of the VAT Act 1994. As a result, the UK has a large untaxed base with estimates in 2000–2001 putting 20% of all supplies as subject to the zero-rate (equivalent to 35% of supplies to final consumers).[76] Furthermore, rate flexibility (from the EU's recent proposal) has received support from the Treasury.[77] All of this is indicative of the UK Government's approach to rate rationalization.

Although VAT raised approximately £125 billion for the Treasury in 2017–2018 , that figure has the potential to be much higher depending on whether the Government adopt 'strong and stable' VAT policies or succumb to 'the will of the people'.[78]

17 The role of the CJEU after Brexit

VAT is one of the most heavily litigated areas of EU law and the Commission have reported that reduced rates and complexity were the primary cause of requests and questions received.[79] Following Brexit, the UK will no longer have the primacy/supremacy of, or future recourse to preliminary rulings of, the CJEU.[80] This means that the direct jurisdiction of the CJEU is lost, however, there could be scope for an indirect role.[81] In fact, the European Union (Withdrawal) Act 2018 specifically permits domestic courts and tribunals to have regard to anything done on or after exit day by the CJEU or other EU entity, although decisions and, interestingly, principles are not binding.[82]

The question of principles for VAT purposes is interesting as one would hope that fundamental tenets such as the right to deduction are maintained as integral to the functioning of the VAT system despite its foundation in EU jurisprudence.[83] Other principles include:

- The strict interpretation of derogations from the general rules (i.e. reduced rates)[84];
- Linguistic differences between the different versions are to be solved according to the purpose and context of the rules, without any linguistic version having pre-eminence over the others, and interpreted uniformly;[85]
- Economic reality prevails over purely artificial constructions;[86]
- Abuse of rights;[87]
- Fiscal neutrality;[88]
- Other EU principles such as legal certainty, legitimate expectation, proportionality etc.[89]

The UK is expected to want to retain some of these principles, such as abuse in *Halifax* which has been much relied upon by HMRC to protect revenue.[90] Indeed, in the TCTA, section 42 specifically refers to the applicability of *Halifax* and *Kittel* in retaining the principle of abuse of law. However, the schemes will no longer be contrary to the provisions of the VAT Directive and as such may need to be clarified and evolve post-Brexit.[91] It is unclear how *Kittel*-style due diligence will be applied with UK-EU MTEC fraud. There is an overlap with the principle of economic reality which already has a place in domestic law.[92] Neutrality is also fundamental for the proper functioning of the UK VAT system,

[75] Due to the proposed flexibility from the EU proposals.

[76] An increase from the zero-rate to a 10% rate could raise approximately £18 billion per annum, *see* SWD(2018) 7 final, Impact Assessment, European Commission, Brussels, 18 Jan. 2018; and A. Mathis, *VAT Indicators* (2004), Taxation Papers, European Commission, Working Paper Feb. 2004.

[77] Mel Stride's Explanatory Memorandum submitted by HM Treasury dated 8 Feb. 2018, COM (2018) 20.

[78] This does not mean the UK would have to take a greater proportion of GDP in tax: it could decide to cut other, less efficient, taxes.

[79] House of Commons European Scrutiny Committee in its Twenty-third Report of Session 2017–2019 (HC301); and European Commission, Proposal for a Council Directive Amending Directive 77/388/EEC as Regards Reduced Rates of Value Added Tax, COM(2003) 397 final, 23 July 2003.

[80] Although strictly speaking s. 19 of the European Union (Withdrawal) Act 2018 states that nothing in the act prevents participation in or a relationship with the agencies of the EU after exit day.

[81] A. Howard, *Status of EU law and ongoing role for the Court of Justice?,* 24 Aug. 2017, Monckton Chambers, Brexit Blog, available here: https://www.monckton.com/status-and-ongoing-role-for-the-court-of-justice (accessed Aug. 18).

[82] S. 6, European Union (Withdrawal) Act 2018.

[83] E.g. in MTIC frauds, *see* the judgment of the court and the opinion of AG Maduro in joined cases C-354/03, C-355/03 and C-484/03, *Optigen, Fulcrum and Bond House v. CCE* (2006).

[84] Case 348/87, *Stichting Uitvoering Financiële Acties v. Staatssecretaris van Financiën*, 15 June 1989.

[85] Case C-169/04, *Abbey National plc and Inscape Investment Fund v. CCE*, 4 May 2006; Case C-141/00 *Ambulanter Pflegedienst Kügler GmbH v. Finanzamt für Körperschaften I*, 10 Sept. 2002; and, Case C-161/14 *Commission v. United Kingdom*, 7 June 2015.

[86] Which overlaps with case law on abuse, *see* Case C-653/11, *HMRC v. Newey*, 20 June 2013.

[87] Case C-255/02, *Halifax Plc v. CCE*, 21 Feb. 2006.

[88] Case 89/81, *Staatssecretaris van Financiën v. Hong-Kong Trade Development Council*, 1 Apr. 1982; and, Case C-481/98, *Commission v. France*, 3 May 2001. For more discussion *see* R. De la Feria, *EU VAT Principles as Interpretative Aids to EU VAT Rules: The Inherent Paradox*, in *Recent VAT Case Law of the CJEU* 1–17 (M. Lang, et al. eds, Vienna: Linde 2016).

[89] Joined Cases C-177/99 and C-181/99, *Ampafrance SA v. Directeur des Services Fiscaux de Maine-et-Loire*, 19 Sept. 2000.

[90] R. Iferenta, R. Hill, *The post-Brexit interpretation of UK VAT law*, Tax J., 17 (14 Oct. 2016).

[91] Although the VAT Directive remains relevant for interpreting the law under s. 42 of the TCTA.

although any maintaining of rate differentiation is by its very nature contrary to neutrality, as discussed above. On the other hand, inherently EU principles such as effectiveness and equivalence would almost certainly be abandoned.

In terms of retained case law made before Brexit day, when deciding whether to depart from extant CJEU judgments, the courts are to apply the same approach as to the departing from their own domestic precedent.[93] This is a little unclear as the 2018 Act says the Supreme Court can overturn existing retained case law as they are explicitly not bound by it. However, despite not being bound, they must still follow the same test as domestic Supreme Court precedent in deciding whether to depart from it: if they have to depart from it, at least conceptually, there is some degree of extant precedent.[94] The UK will wish to depart from some CJEU rulings and will no doubt want to maintain others. Some (non-exhaustive) examples of CJEU encroachment into UK VAT law includes:

– **Construction**: Construction services for any new buildings were zero-rated even if for wholly commercial or industrial use until the CJEU ruled that it was a breach of EU law.[95] After Brexit, it will be possible for the UK to reinstate the original provisions which would likely be sought by charities who have to pay VAT on construction services for buildings which are not used for non-business purposes.[96]
– **Energy Saving Materials:**[97] The CJEU found that the reduced rating of energy-saving materials and their installation irrespective of the housing concerned or the levels of income, age or other criteria of the occupants, failed the test of an exclusively social or principally social interest.[98] The UK might believe that environmental objectives should be pursued and therefore warrant a reduced rate.
– **E-Books and Digital Newspapers**: the UK may wish to apply the reduced rate to E-Books and to electronic newspapers in the aim of fiscal neutrality (with the hard copy versions) rather than defining them as electronically supplied services. The recent case of *News Corp v. HMRC* [2018][99] concluded that digital newspapers were not zero-rated like their physical counterparts. This was decided with reference to *Commission v. Luxembourg*[100] on E-Books as well as principles of interpretation and the restriction of 'stand-still' derogations under EU law.
– **Littlewoods:**[101] the UK will surely want to continue to apply simple rather than compound interest which was permitted by the CJEU as long as the national law determination of interest complied with the principles of equivalence and effectiveness. Although, this is slightly different as the provision is contained in the VAT Act and post-Brexit there would be no recourse to the CJEU on issues of compatibility, which may come as some relief to the Government.[102]
– **English Bridge Union:**[103] the UK could extend the definitions of sports to include those without a considerable degree of physical activity if there is lobbying or some sentimental reason, although this is doubtful as it would erode the base more than it already is by the sports and culture derogation.
– **Payment mechanisms**: Although HMRC has been broadly successful in this regard, the UK may wish to simplify the treatment of payment facilitation such as card handling services following *Everything Everywhere*[104] and *Bookit*,[105] or online auction credits.[106]
– **Brockenhurst catering:**[107] The UK could pursue revenue by overturning the CJEU's decree that allows restaurant services as part of catering and hospitality courses to be exempt as closely related to the provision of education.
– **Management Services**: The UK formerly exempted management services supplied to open-ended investment companies but not to closed-ended investment trust companies. The CJEU ruled that this was incompatible with EU VAT law and the exemption had to extend to management services provided to investment trust companies.[108] The UK might wish to reverse this treatment thereby broadening the base. There have also been cases on fund management services provided by insurers in relation to pension funds which afforded an exemption to investments from defined contribution

[92] E.g. *Airtours Holiday Transport Limited v. HMRC* [2016] UKSC 21.
[93] I.e. senior courts can overrule or reverse earlier decisions if there can be distinguishing facts or legal principles or if there are conflicting decisions, e.g.
[94] Previous supreme court decisions are treated as normally binding from which the court could depart if it appears right to do so, *see* Practice Statement (Judicial Precedent) [1966] 1 WLR 1234; and *Austin (FC) v. Mayor and Burgesses of the London Borough of Southwark* [2010] UKSC 28.
[95] Case C-416/85, *Commission v. United Kingdom*, 21 June 1988.
[96] E. Wong, *Doing Business After Brexit: Tax (including VAT)*, in *Doing Business After Brexit: A Practical Guide To The Legal Changes* Ch. 4 (H. Tse ed., Bloomsbury Professional 2017).
[97] Case C-161/14 *Commission v. United Kingdom*, 7 June 2015.
[98] M. Schofield, *VAT Reduced Rates? Save your energy*, (11 June 2015), Bloomberg BNA International Tax Law Blog, https://www.bna.com/vat-reduced-rates-b17179927590 (accessed Aug. 18).
[99] *News Corp UK & Ireland Limited v. HMRC* [2018] UKFTT 129.
[100] Case C-502/13.
[101] Case C-591/10, *Littlewoods Retail Ltd v. HMRC*, 19 July 2012.
[102] For a case comment *see* D. Visser, *Littlewoods Ltd v. HMRC: compound interest – not so simple in unjust enrichment cases?*, B.T.R. 2, 184 (2018).
[103] C-90/16, *The English Bridge Union v. HMRC*, 26 Oct. 2017.
[104] Case C-276/09, *Everything Everywhere Ltd v. HMRC*, 2 Dec. 2010.
[105] Case C-607/14, *Bookit Ltd v. HMRC*, 26 May 2016.
[106] Case C-544/16, *Marcandi Ltd (t/a MadBid) v. HMRC*, 5 July 2018.
[107] Case C-699/15, *HMRC v. Brockenhurst College*, 4 May 2017.
[108] C-363/05, *JP Morgan Fleming Claverhouse Investment Trust plc and The Association of Investment Trust Companies v. HMRC*, 28 June 2007.

schemes qualifying as a Special Investment Fund but not defined benefit schemes and not to fund supervisory services which, although recently implemented, the UK may wish to revisit.[109]

- **Differential rates.** The UK is not allowed to apply a lower rate of VAT in a different region. In the 2018 Spring Statement, it announced a consultation[110] as to whether the rate of VAT in Northern Ireland on tourism-related services should be cut to allow it to compete with Ireland's 9% rate.

There are also current indications of infringements as raised by the Commission which, following Brexit, will likely go unrectified and also unpunished without the jurisdiction of the CJEU, for example:

- **MOSS**: The Commission alleges that the UK has been failing to collect and transmit to other Member States the bank account details for each taxable person registered under the Mini One-Stop Shop. On 19 July 2018, the Commission threatened proceedings before the CJEU within two months[111] – this would fall before Brexit day but it would be inconceivable for the case to be heard within the next 10 months and even if they were, the UK could feasibly ignore the ruling.
- **TMO**: On 9 March 2018, the Treasury released a statement regarding the Commission's notification of infraction proceedings in respect of VAT treatment of certain commodity derivatives, trading under the Terminal Markets Order (TMO).[112] This TMO allows the zero rating of specific derivative transactions when traded on an exchange. The Commission contends that the UK has considerably extended the scope of a 1977 standstill derogation and it is no longer limited to trading in the commodities originally covered.[113] There is sparse information available at the time of writing but, as above, it will be interesting to see whether the UK engages in any dialogue (outside of the ongoing negotiations) let alone legal proceedings.[114]

18 Conclusion

CJEU jurisprudence will continue to influence the UK VAT system after Brexit. Some judgments will be incorporated into UK jurisprudence, others will have a persuasive effect. Although similarity with the EU VAT system would make the UK more attractive for EU commerce, the likelihood is that there will be gradual divergence over time. The question is how long? The EU currently has large-scale reform in the pipeline (destination-based VAT, One Stop Shop, Digital Single Market package, Certified Taxable Persons, changes for SMEs, possibly split payment mechanisms etc.) which will coincide with the post-Brexit evolution of the UK VAT. Differences in the systems and principles therefore, may emerge sooner than first envisaged.

The authors hope that post Brexit, the UK courts do not take the option, when faced with what would have been a referable issue, of ignoring the EU's approach simply because of complexity or the political landscape.[115] The Brexit process will already entail considerable legal uncertainty. With the abrogation of precedents and principles and the prospect of a wave of test cases, the provision of legal advice regarding VAT will provide a challenge. On the other hand, the authors consider that the UK could, through careful and considered reform, become a beacon on how the EU VAT system could be improved.

Who knows whether VAT as 'essentially an EU tax' will continue to hold true in the UK? Maybe we should ask Jerome's squirrel.

[109] Case C-464/12, *ATP PensionService A/S v. Skatteministeriet*, 13 Mar. 2014; Case C-424/11, *Wheels Common Investment Fund Trustees Ltd and Others v. HMRC*, 7 Mar. 2013; and Case C-169/04, *Abbey National plc and Inscape Investment Fund v. HMRC*, 4 May 2006.

[110] https://www.gov.uk/government/consultations/vat-air-passenger-duty-and-tourism-in-northern-ireland (accessed Aug. 18).

[111] European Commission – Fact Sheet, July infringements package: key decisions, Brussels, 19 July 2018.

[112] Available on the Gov website here, https://www.gov.uk/government/news/statement-on-infraction-proceedings-on-vat-treatment-of-certain-commodity-derivatives-trading (accessed Aug. 18).

[113] https://ec.europa.eu/taxation_customs/node/1066_en (accessed Aug. 18).

[114] For comment, *see* Cape and Beetham, *Terminal Markets Order: Please Terminate*, Tax J., 14 Mar. 2018 https://www.taxjournal.com/articles/terminal-markets-order-please-terminate-14032018.

[115] Even if done implicitly or unconsciously which is not impossible where judges have been the focus of attack by Brexiteers as 'enemies of the people', noted by A. Hofmann, *Resistance against the Court of Justice of the European Union*, 14(2) Int. J. L. C. 271 (2018).