

VAT and EC Law

The Principle Of Non-Discrimination

The importance of looking to the Sixth Directive, in almost every dispute involving the interpretation of VAT law, is now widely appreciated. The Directive will, alongside the VAT Act, often be a first point of reference. The general principles of Community law, because they are not codified are, however, less fully appreciated as a source of reference. However, the general principles can have considerable impact on issues of VAT liability. Amongst the general principles is the principle of non-discrimination. It is a principle that is worthy of particular attention in the VAT field. In this piece we set out the significant, sometimes decisive, impact it can have in VAT disputes.

The principle of non-discrimination requires that similar situations should be treated equally, unless there is an objective justification for different treatment. The principle is sometimes labelled the principle of equality and, when dealing with remedies, commonly described as the principle of equivalence. The very general nature of the non-discrimination principle gives it obvious scope for application to the VAT system. It informed and has a clear fit with the harmonisation objective of the Sixth Directive; a recital even refers to 'enhancing the non-discriminatory nature of the tax'. However, because of its generality, there is little inherent clue as to its practical application in VAT law.

The principles of fiscal neutrality and of non-distortion of competition are two related principles with obvious resonance in the fiscal field. The principle of fiscal neutrality has been described as intimately bound up with the principle of non-discrimination.¹ At the core of the principle is the precept that the number of suppliers in the manufacture, distribution and marketing stages should make no difference to the VAT borne by the final consumer.² However, the principle extends to preclude treating similar goods, in competition with each other, differently for VAT purposes.³ The principle can be said to require equal treatment for similar economic activities in order to avoid distortions caused by the drawing of unimportant and unjustified

Christopher Vajda QC and Peter Mantle, Monckton Chambers, set out the significant impact that the principle of non-discrimination has on VAT disputes

distinctions, such as distinctions between forms of business entity.⁴ The principle of non-distortion of competition is to the same effect.⁵

Three important ways in which the non-discrimination principle plays a role in the VAT system are:

- (1) as a factor to be taken into account in interpreting legislation;
- (2) as a consideration when examining whether a Member State has acted properly when it has exercised a power granted by the Sixth Directive;
- (3) as a principle preventing restrictions on remedies available to taxpayers when there has been a breach of their directly effective community law rights.

Aid to interpretation

A good example of how the principle of non-distortion of competition can affect the interpretation of the Sixth Directive and UK VAT legislation is found in the ECJ's decision in *DFDS A/S*.⁶ The case concerned the identification of the place of supply of a tour operator. Was the place of supply the business establishment of the tour operator (in Denmark, where the services were exempt), or a fixed establishment (in the UK) from which the services had been provided? The interpretative exercise involved examination of (1) which of the two alternative points of reference within the Article,⁷ business establishment or fixed establishment, should prevail, and (2) whether the concept of fixed establishment was wide enough to include premises of another company, a wholly owned subsidiary in a close contractual relationship with the parent tour operator. The Court placed particular emphasis on the need to avoid distortions of competition, in coming to the conclusions that *DFDS* could be said to have a fixed establishment in the UK which was to be

taken as the place of supply in that case. The ECJ was concerned that systematic reliance on the business establishment criterion might encourage undertakings trading in one Member State to establish their businesses, in order to avoid taxation, in another Member State, hence distorting competition. That justified preferring the fixed establishment to the business establishment as the place of supply and inclining towards a broader construction of what constituted a fixed establishment.

Exercise of power by Member State

The Sixth Directive gives Member States certain options, discretions and opportunities to derogate. It also permits or requires them to lay down conditions, such as for Article 13 exemptions. When exercising such powers Member States must have regard to the principle of non-discrimination.

In the *Goldsmiths Jewellers case*⁸ the UK had legislated for a scheme of bad debt relief pursuant to a derogation permitted by Article 11, 1(C) of the Sixth Directive. The UK legislation allowed a refund of VAT if the consideration for the supply was money, but not if the consideration was in kind. The ECJ considered that such a scheme was impermissible because it led to unjustified discrimination against transactions for consideration in kind, which were not, in financial or commercial terms, in any way different from contracts involving money consideration. The Court appears to have considered that the general discrimination introduced by the scheme could never have been a proportionate response to a risk of evasion perceived by the UK.

However, where a Member State is acting outside that part of the VAT system which has been harmonised, it appears that the non-discrimination principle will not come into play. In *Ideal Tourisme SA v Belgium*⁹ the domestic court had come to

the view that international passenger air and coach transport operators were in competition and that there was discrimination. International passenger transport by coach was standard-rated, as required by the Sixth Directive, given that there was no relevant derogation. Belgium had, however, maintained an exemption for transport by air pursuant to a derogation permitted by Article 28(3)(b). The ECJ held that harmonisation had not extended to such exemptions and although the authorisation to retain national exempting legislation came from the Sixth Directive, Belgium could choose to maintain the air transport exemption without infringing the principles of Community law. Although the judgment talks of non-infringement the result appears only to be explicable in terms of the non-application of the non-discrimination principle in the non-harmonised area.

The same 'non-harmonisation' reasoning may apply to all of the derogations permitted by Article 28. However, it is interesting that Article 28(2)(a) permits exemptions with refunds 'which are in accordance with Community law'. The ECJ has held that maintaining two different tax rates for what could loosely be called prescription and non-prescription medicinal products pursuant to Article 28(2)(a) was permissible only insofar as consistent with the principle of fiscal neutrality.¹⁰

Remedies

The principle of non-discrimination has particular application to remedies where there has been a breach of Community law. For example, where there has been a failure to correctly implement the Sixth Directive, giving rise to a directly enforceable right to repayment of overpaid VAT, the principle of equivalence applies, alongside the principle of effectiveness. Equivalence requires that the conditions applied to the enforcement of Community rights must be no less favourable than those governing similar domestic actions. However, it is clear from the jurisprudence of the ECJ that the principle does not oblige a Member State to extend its most favourable rules governing restitution claims to a claim to recover overpaid VAT. Indeed, in *Marks & Spencer* Mr Justice Moses held¹¹ that the comparison required by the principle of equivalence could be confined to the VAT system. It was sufficient if VAT repayment claims based on Community law were dealt with in the same way as such claims based solely on domestic law.

The principle of non-discrimination may apply to remedies in other ways. For example, in *Marks & Spencer* the taxpayer

complained of discrimination. As a payment trader,¹² its claim to recover overpaid output tax on teacakes had been subject to an unjust enrichment defence. Payments to competitor repayment traders had not been. The second Court of Appeal held that *Marks & Spencer* had no directly enforceable EC law right in respect of its teacakes claim. However, if the principle of non-discrimination had applied, the Court considered that the discrepancy in the availability of the unjust enrichment defence would have been discriminatory and incompatible with Community law.¹³

Limits on the principle

Suppose that the Commissioners have erroneously ruled that particular supplies made by A are zero-rated. A does not account for output tax. B accounts for output tax on identical supplies. The Commissioners realise their error, alter the ruling for future supplies but do not seek to re-open the past by assessing A. Or suppose that a number of taxpayers overpay VAT and that the Commissioners invoke the defence of unjust enrichment against Y, but not Z, even though it is available and the circumstances of both are similar. Does the non-discrimination principle dictate that the disadvantaged should be treated no differently from the advantaged?

The answer in the first scenario is probably the easiest. In *R(BSkyB) v CEC* [2001] STC 437, the Administrative Court rejected a claim that BSKyB had been treated unfairly compared to its competitors as a result of BSKyB receiving a ruling that its supplies of a magazine were not zero-rated a year and half before its competitors had an opposite ruling reversed. The fact that some taxpayers have received an unlawful benefit or advantage does not found a claim that it is unjustified discrimination to withhold that advantage from other persons. That is probably best seen as a limitation on the non-discrimination principle itself; the principle of non-discrimination must also live with other principles such as the principle of legality and legal certainty. The principle could otherwise become a mechanism for undermining uniform tax treatment across the Community. Were it not for this limitation, an error initially confined to one person could generate a series of claims for refund of tax which had been lawfully collected in accordance with the Sixth Directive. That would undermine the principle of legality.

The unjust enrichment defence scenario might have appeared less easy. Even though there may well not be a

Community law entitlement to restitution, if repayment would result in unjust enrichment, preventing the Commissioners from invoking an unjust enrichment defence is not obviously the same as conferring an unlawful advantage on the claimant. However, the UK courts have recently ruled decisively in just such a case.¹⁴ *National Westminster Bank* had overpaid tax and made a claim for repayment under s 80. It was met with a defence of unjust enrichment by the Commissioners. However, a number of competitor payment traders had received repayments in similar circumstances, as the Commissioners had not raised the unjust enrichment defence against them. The bank satisfied the VAT Tribunal that the refusal to repay should be set aside because of a breach of the principle of equality of treatment. On appeal Mr Justice Jacob (as he then was) held that a case of unfair treatment had not been made out. The claimants may all have been in similar situations but there was objective justification for different treatment. The objective justification was to be found in the fact that it was not appropriate that mistakes should have to be perpetuated and it was permissible to take into account that complex law and a necessarily large administrative system were involved.

Notes

¹ By AG la Pergola in *Goldsmiths Jewellers Ltd v CEC* [1997] STC 1073.

² Per Lord Walker of Gestingthorpe in *Lex Services plc v CEC* [2004] STC 73 at 81.

³ *EC Commission v France* [2001] STC 919 at 930, para 22.

⁴ *Gregg v CEC* [1999] STC 394.

⁵ See, for example, Case C-260/95 *DFDS* [1997] STC 384, para 22, discussed below.

⁶ See footnote 5 above.

⁷ The Article under consideration was Article 26(2) dealing with the special scheme for travel agents but it is derived from Article 9(1), which sets out the basic rule for the place of supply of services.

⁸ [1997] STC 1073.

⁹ [2000] ECR I-6049.

¹⁰ *EC Commission v France* [2001] STC 919, ECJ.

¹¹ [1999] STC 205 at 232.

¹² That is to say a trader whose output tax exceeded its input tax and so made payments of VAT to the Commissioners as opposed to a (repayment) trader whose input tax exceeded its output tax and who received payments from the Commissioners.

¹³ [2004] STC 1, para 103.

¹⁴ *National Westminster Bank plc v CEC* [2003] STC 1072.