13th Directive refunds

EC v UK (C-582/08)

The European Commission has brought infringement proceedings against the United Kingdom having taken the view that the UK decision to remove entitlement to Directive claims in respect of inputs used to make financial supplies outside the EU breached Community law. This article reports on developments to date – we await a final decision.

Background

In December 2004, and in the wake of the Court of Appeal's interim judgment in the *WHA* case (*WHA Ltd v Commissioners of Customs and Excise* [2004] STC 1081, the UK amended reg 190 VAT (General) Regulations 1995 (SI 1995/2518), with the effect that non-EU taxable persons were unable to claim 13th Directive refunds in respect of the provision of financial services to non-EU customers. Following a complaint, the Commission commenced infringement proceedings against the UK.

The Commission contends that arts 169 to 171 Principal VAT Directive (2006/112/EC) and art 2 13th Directive require Member States to repay to 13th Directive claimants VAT that they have used in making financial supplies to customers outside of the EU. The Commission considers that the legislative history of the 13th Directive and the purpose underpinning the refund arrangements demonstrate that VAT used by non-EU based businesses to provide financial services to non-EU customers is refundable. The Commission also notes that there is no difference as between the 8th and 13th Directives with regard to refunding of VAT incurred on making financial supplies to non-EU customers. The Commission considers that, as a general principle, VAT which is used to provide goods or services which are exported from the EU is refundable. The Commission also submitted that the interest in combating abuse and avoidance does not justify the removal of the right to refund of such claimants.

The UK contends that the legislative wording of the 13th Directive and art 169(c) Principal VAT Directive is precise and does not allow an interpretation which affords refunds to 13th Directive claimants who make claims relating to VAT used in making financial supplies to non-EU recipients. The UK further submitted that the 13th Directive differs from the 8th Directive and that the objective of the free movement of goods and service is not applicable in the context of 13th Directive claims.

Implications

The case is of interest not only in relation to 13th Directive claimants or potential claimants who had their access to refunds removed by the 2004 changes in the UK, but also as to how EU law is to be properly interpreted. The UK has taken an almost literal linguistic approach as a starting point, and has then developed its arguments by reference to certain principles (such as that the general scheme of VAT requires output tax to be charged in order for VAT to be reclaimed and thus any radical departure from the principle requires express provision). In contrast, the Commission had adopted a purposive approach and does not rely (and indeed may not be able to rely upon) a linguistic analysis. One key difficulty it is alleged that there was an historic misconception as to whether the right to refund in relation to financial supplies made outside of the EU was already covered by what is now art 169(a) Principal VAT Directive such that references to the actual provision providing entitlement to deduction in refund in what is now art 169(c) Principal VAT Directive was believed to be unnecessary.

The outcome is that this case may be as much a battle as between the purposive approach to construction of EU law and a literal approach as the subject of the infringement itself. The Advocate General will have an interesting challenge in unraveling the competing contentions of the Commission and the UK.

Businesses which have not already done so should seek advice as to how to protect their position pending the outcome of this case.