Tax Representation

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

Tax Faculty

TAXREP 41/04

VAT: DOUBLE TAXATION

Memorandum submitted in August 2004 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in July 2004 by Customs

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VAT: DOUBLE TAXATION

INTRODUCTION

1. We welcome the opportunity to comment on JVCC paper 01/04 issued on 1 July by Customs and published on the web at http://www.hmce.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_PublicNoticesAndInfoSheets&propertyType=document&columns=1&id=HMCE_PROD_010223.

KEY POINT SUMMARY

2. There is an urgent need to ensure that differences between the VAT regimes of Member States do not give rise to double tax charges. A mechanism similar to the direct tax side, namely bilateral treaties and an arbitration process, would enable differences to be resolved quickly and simply without the need for court proceedings.

WHO WE ARE

3. The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

4. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

5. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

COMMENTS

6. Customs are seeking views on whether a process is needed to eliminate double taxation for VAT within the European Union. Customs' JVCC paper cites the European Commission as saying that this arises owing to the tax authorities of one Member State interpreting the facts differently from another even though the legislation of both Member States is in accordance with the Sixth VAT Directive. This is one of the causes: another is that two Member States may choose to interpret the law differently, each arguing that its interpretation is in accordance with the Sixth Directive.

7. The scenarios cited in Customs' JVCC paper are valid examples of where differences between the VAT regimes of Member States cause difficulties, and if they are not based on cases heard before the European Court of Justice (such as *Aro Lease BV*, Case C-190/95), they have presumably been brought to the attention of the European Commission in representations by businesses or advisers who have faced these situations.

8. One example given by the Commission concerns the proof required for intra-EC supplies of goods where they are directly transported by the purchaser. The approach of Customs in the recent High Court case of *Teleos plc and 13 others*, [2004] EWHC 1035 (Admin) (Judgment of 6 May 2004) (see http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWHC/Admin/2004/1035.html&query=teleos&method=all) exemplifies the problem. In referring the case to the European Court of Justice, the judge stated (at para 72):

> 'I am persuaded that it is not merely necessary but essential that the correct interpretation of the provisions of the Sixth VAT Directive in relation to exemption in respect of intra-community acquisitions should be determined by the European Court of Justice. This case affords a primary example of the necessity for a uniform interpretation application to all Member States and all the authentic texts providing for the exemption contained in Article 28cA(a)'.

9. The judge also stated that the companies had done everything reasonable within their power to obtain the required proof, even though it appeared subsequently following Customs' investigations to have been falsified (see in particular paras 147-152 of the judgment). The judge also recorded (see para 120) that Customs had retrospectively registered the Spanish customer for UK VAT, and appeared to have allowed them to deduct as input tax the VAT which had not been charged by Teleos and the others (since the appellants considered they had made intra-EC supplies).

10. The Commission are clearly correct to identify a general difficulty here. Leaving aside the specific case (of which we have no knowledge other than the published judgment), if a prudent business carries out all reasonable checks and controls within its power, but Member States can later seek to change the liability of a supply following an investigation which only they have the power or authority to carry out, then the logical and rational decision for a business is not to make such supplies. That must act as a barrier to cross-border trade.

11. However, the number of cases heard and pending before the European Court of Justice can only be the tip of the iceberg. The experiences of our members indicate to us that businesses doing business cross-border in the European Community do face double taxation problems. In most cases the rational answer for them in economic terms is simply to pay the VAT twice, since the amount of VAT involved does not warrant the time, cost and inconvenience of taking legal action. As Customs are aware, it is likely to cost a minimum of £100,000 to take a case through the UK courts to the ECJ. It may also be necessary to take legal action in the other Member State. Many businesses, particularly SMEs, simply do not have the resources to do this.

12. A classic example concerns Eighth Directive refunds, which has been the source of double taxation problems ever since its introduction in 1981. Some Member States make the administrative process deliberately difficult with a view to discouraging claims. Others consistently fail to respect the repayment time limit: the Commission's Press release of 19 July 2004 states that they have started infringement proceedings against Luxembourg on this latter point, but Customs will know that Luxembourg are by no means the only offender. Since the amounts involved with Eighth Directive refunds are often small, many businesses do not consider it worthwhile to make a claim.

13. For direct tax purposes the United Kingdom has probably the largest number of bilateral tax treaties in the world. The Inland Revenue actively keep the treaties up to date and negotiate new ones with emerging countries. Whilst not perfect, this procedure minimises the likelihood of taxpayers suffering double taxation and also clarifies for tax authorities who is entitled to collect what tax. The treaties and a process of arbitration in case of dispute obviates the need for expensive and time-consuming litigation, which is of enormous benefit to taxpayers and tax authorities alike, and for self-assessed taxes means that the majority of taxpayers with international tax obligations can finalise their tax liabilities within the normal deadlines without recourse to the courts.

14. Where the process works properly, it also means that taxpayers pay tax in only one country, which is not only correct but self-evidently fair. We have heard a great deal in recent months about abuses by taxpayers, but little where it is the state itself which is the abuser.

15. The lack of any proper procedure to resolve double taxation issues for VAT means therefore that:
- only large businesses are able to challenge double taxation in the courts, and will only do so when the amounts involved merit it in economic terms;
- SMEs largely have to accept double taxation as a cost of doing business cross-border (and may decide not to trade cross border as a result);
- unless either taxpayers or the Commission take legal action, Member States have no incentive to resolve double taxation issues; and
- other than taking infringement proceedings themselves (which has never been done) Member States have no mechanism to resolve double taxation issues.

16. We see a further advantage for tax administrations in the Commission's proposal. Both Customs and the Inland Revenue (particularly the latter) have been critical in recent months of the effect of ECJ judgments on UK domestic tax law. But the 'system' that we have at the moment inevitably produces that result, since the only recourse of business is to the courts, and national courts are likely to refer to the ECJ where double taxation (ie the tax law of another Member State) is involved. We see it as being in the interest of Member States and good administration more generally for double taxation disputes to be resolved without the necessity for legal action.

17. We therefore do see a need to introduce mechanisms to ensure that differences between the VAT regimes of Member States do not give rise to double taxation. Double taxation is a real disincentive to cross-border trade, and whilst tax

administrations might dislike the prospect of forgoing revenue, double taxation thwarts the objectives of the European Community, which is to have a Single Market, ie one in which trading in one's home state and with customers in other Member States is fiscally neutral.

18. A mechanism similar to the direct tax side would enable differences to be resolved quickly and simply without the need for court proceedings. This would bring VAT on cross border trade more into line with our Ten Tenets for a Better Tax System (see Annex) as it would inter alia make the application of the rules more **certain**, VAT more **easy to calculate** and help make the European Community and the UK in particular more **competitive**.

19. Given the obvious advantages for UK plc of businesses being able to trade without impediment with other Member States, especially in the light of the emerging markets of the ten countries that have just joined the EU, we would have thought that the UK government would want to ensure that its tax authorities encourage international trade. We are therefore surprised that Customs are questioning the need for action to eliminate the VAT difficulties that arise for cross-border traders.

20. The Commission's proposals can be seen as a litmus test showing whether Member States are genuinely interested in facilitating cross-border trade within the EU, particularly by SMEs. If no progress is made, that will indicate that, for all their public statements, Member States prefer simply to collect the maximum revenue possible. In our view that would be a damaging and short-sighted approach. It could also be costly in economic terms – as we have said, the barriers to cross-border trade, including double taxation, mean that many SMEs are discouraged from trading cross-border. Member States are now forgoing the tax revenue that such trade would have generated.

21. We do not believe that the Commission's proposals would solve every double taxation dispute between Member States. But we do consider that a proper mechanism, operated in good faith, would represent significant progress, and would in particular encourage SMEs to trade cross-border.

22. As to the numbers of cases and amounts of VAT involved, as a representative body we do not have access to such information. However, as mentioned above, ECJ cases which by definition are in the public arena and for which the VAT at stake will be known are the small minority of instances where businesses are suffering double taxation.

23. We are sending a copy of this submission to the European Commission for their information.

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PCB
20.8.04

ANNEX

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory**: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. **Certain**: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. **Simple**: the tax rules should aim to be simple, understandable and clear in their objectives.

4. **Easy to collect and to calculate**: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. **Properly targeted**: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. **Constant**: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. **Subject to proper consultation**: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. **Regularly reviewed**: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. **Fair and reasonable**: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. **Competitive**: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99; see http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160.