

ECJ finds against UK government in politically-motivated VAT case

*The European Court of Justice has once again demonstrated its politicised nature, by finding the UK government guilty of a supposed infraction that is DECADES old. The European Commission only brought the case AFTER the UK had voted to leave the EU. Civil servant **Caroline Bell** explores the consequences of the judgement, which has not even been reported by the British media, and explains why it could blow up the Withdrawal Agreement.*

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The European Court of Justice (ECJ) yesterday found against the UK government, in a case brought against it by the European Commission for failing to impose VAT on transactions in the City's multi-trillion-dollar derivatives markets.

The background to case C-276/19 dates back to March 2018, when the Commission sent a formal letter to the UK government, warning that it was investigating a misapplication of the Terminal Markets Order 1973, which zero-rates derivatives trades for VAT. The UK's alleged 'illegal' extension of zero-rating, according to the Commission, dates back to 1977 (i.e. before some current derivatives markets were even in existence).

The timing of this notice of infringement, for a supposed infraction dating back *four decades* (i.e. giving the Commission plenty of time to request that the UK amend its legislation), and coming after we had voted to leave the EU,

could not be more political. All subsequent stages of the proceedings need to be viewed as political moves on the Brexit negotiations chessboard.

The original notice ordering the UK to impose VAT on the derivatives markets was designed to put pressure on the May government to surrender ground on the draft Withdrawal Agreement, and came after another failure to muster enough support for an EU Financial Transactions Tax (FTT). Reinterpreting this old VAT law offered the EU a way of raising money and denting the City's global dominance.

The UK disputed the Commission's claim and left its VAT law unchanged. The Commission followed its initial notice with a 'reasoned opinion' – or final warning – in July 2018, around the time of the infamous Chequers summit. UK VAT law still remained unchanged, and the Commission duly referred the UK to the ECJ in January 2019.

Consequences of the judgement

Legal

Now that the ECJ has ruled that the UK breached the Terminal Markets Order 1973, the layperson might conclude that under the Withdrawal Agreement, the British government is obliged to change its domestic law forthwith to impose VAT on its derivatives markets. However, this is most unlikely to happen, not least because once the transition period ends on 31 December, we are free to set our own VAT law and zero-rate anything we choose. And changing the law in the time available is simply not feasible with all the other EU Exit legislation still to be made.

But by not imposing VAT on derivatives between now and the end of the transition period, we would be in breach of the ECJ

ruling and also in breach of our undertakings under the Withdrawal Agreement to apply such rulings within the UK. It is here that the greatest risk of C-276/19 blowing up the whole Brexit settlement lies.

The likely short-term outcome is a refusal by the British government to change its VAT law (since there is no right of appeal at the ECJ), with the Commission lining up further proceedings for failure to implement the judgment.

The City

Given that the UK government is unlikely to change the VAT law, the effect on the City will probably be neutral. Imposing VAT on the City's terminal markets would see them offshored to other global jurisdictions in a nanosecond. It would be inconceivable for a government committed to restoring our sovereignty and expanding our trade globally to collude in such a blatant attack on the City's dominance in financial services, and so one would not expect the situation to change. Despite the EU's claim that the Terminal Markets Order has been misapplied since 1977, there is no retrospective aspect to this case and no market actors can be forced to collect back VAT – the Commission simply wants VAT applied now.

In terms of trade talks, Brussels was never willing to grant any sort of enhanced equivalence to the City anyway. Even basic equivalence for financial services could now be an issue.

But for every blow the EU tries to strike here, the UK is in a position to retaliate much harder against EU financial institutions, so the outcome is again likely to be neutral. Does anyone even expect there to be a financial service agreement with the EU anymore? The EU's action against the Swiss in this area to try to bring them to heel has badly backfired, and would do so if they applied the same tactics on

the UK.

This brings us to the possible financial and political consequences, and here it gets more interesting.

Financial

Potentially, yesterday's adverse judgment will have the hardest financial impact on the British government (just as it was designed to do). I say potentially since, with the current unhappy state of FTA talks and the end of the transition period fast approaching, there is no way the EU can be sure that we will obey its diktats and pay whatever fine it chooses to impose, despite what the Withdrawal Treaty says.

Since the infraction is alleged to have taken place over a period of 47 years, one would expect any fine the Commission decides to issue to be well north of the €15 billion it ordered in the case against Ireland for illegal state aid to Apple. But it will not be an American digital behemoth which will be expected to pay, but the already much put-upon British taxpayer. One cannot see a Johnson government selling that lemon to a population already hard pressed by the Covid-19 lockdown.

However, C-276/19 carries a nasty sting in its tail. The EU is struggling to find the funds to prop up EU27 economies hit by the coronavirus and has ruled out 'coronabonds'. A Financial Transactions Tax, a Common Corporation Tax and a Digital Services Tax have already been mooted. But getting a slice of a humongous putative VAT take from the UK, and bopping BoJo in the eye at the same time, will be almost irresistible. We can expect the Commission to play hardball because they are in a filthy mood over our refusal to surrender our Fisheries in the trade negotiations.

It therefore seems very probable that yesterday's judgment

will see the immediate launch by the Commission of a claim for underpaid UK contributions to the EU budget, money it will claim should have been owed had we charged VAT on our derivatives markets. How far will they backdate the demand – to March 2018, when they notified us of the infringement, or for forty-seven years? It is immaterial – the London derivatives market is so huge that even a claim for the period from March 2018 to 31 December 2020 would be eye-watering.

Of course, that doesn't mean the UK will pay it. Nor should we. And here we get to the most political part of this very political case.

Could C-276/19 blow the Withdrawal Treaty sky high?

One thing EU officials still seem to have difficulty understanding is that the UK is no longer a member state, but an independent sovereign nation. This is clearly evident from statements made during trade talks and even more so as regards the Northern Ireland Protocol.

Legally, we have left the EU. We can make our own laws, set our own taxes, negotiate our own trade agreements, control our own waters and form our own alliances. We are not asking for any favours from the EU – no complex bespoke 'relationship' but a quick off-the-peg model just a short way up from WTO rules. They don't like it, and with reason, because this independence means our room for political manoeuvre is large. The Withdrawal Treaty is an international agreement, and international agreements – as President Trump likes to demonstrate – can be torn up by a sovereign state.

The British government can leave the transition period at the end of this year, ignore all and any summons it receives to the ECJ and demands for money, and let the EU seek remedies under the Vienna Convention on the Law of Treaties at the International Court, under international law. Even were a

judgment there to go against us, forcing us to pay any unreasonable demands for money would be another battle entirely. The cost of giving in, when we have to reboot our own economy from the coronavirus pandemic, would be too great, both economically and politically.

Therefore, yesterday's ECJ judgement, if correctly handled by the government, could be the secret weapon which blows the whole disastrous Withdrawal Agreement sky high.

Caroline Bell is the nom de plume of a civil servant who needs to remain anonymous.