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LOW VALUE CONSIGNMENT RELIEF: THE JUDGMENT AND ITS IMPLICATIONS

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On 16 March 2012, the High Court of England and Wales ruled that the Budget proposal ending Low Value Consignment Relief ("LVCR") for the Channel Islands was lawful. This article examines in detail that judgment and its implications in the context of the Channel Islands' unique constitutional and European relationships.

Introduction

1 The Bailiwicks of Jersey and Guernsey occupy a unique position as British Crown Dependencies. Their status and its longevity have their origins in the Norman conquest of 1066 and the constitutional privileges subsequently granted by King John when continental Normandy was lost to the English Crown.[1] Whilst never colonies, the link between the Channel Islands and the United Kingdom has been maintained via the Sovereign throughout the centuries, providing the Islands with historic rights and privileges, including, *inter alia*, the ability to determine their own taxation.[2] The background to the LVCR case highlights the modern context of such a historic relationship in an increasingly complex international arena.

2 The Channel Islands are geographically within Europe of course, but they do not form part of the territory of the European Union except in relation to the free movement of goods. The United Kingdom is formally responsible for the Islands' external relations, and accordingly there is provision for the Islands in certain of the international treaties to which the United Kingdom is signatory. Most significantly, this includes the 1972 Treaty of Accession to the European Economic Community of Denmark, Ireland and the United Kingdom. Protocol 3 to that Treaty makes special provision for the relationship between the European Community and the Crown

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[1] See Matthews, *Le Rouai, Nouot' Duc* (1999) 3 JL Rev 177.

[2] For further information concerning the constitutional status of Jersey, see *The Minquiers and Ecrehos Case* (1953) ICJ Rep 47, and Bois, *Constitutional History of Jersey*, p 84 *et seq.*

Dependencies (the Channel Islands and the Isle of Man). Broadly, Protocol 3 establishes that the Channel Islands are within the EU customs union, but apart from that, they enjoy no special rights within the EU.

3 When goods are imported into the EU, VAT is applied at the point of importation, unless specific exemptions apply. The VAT is paid by the importer, and it must be paid before the goods can be cleared through import procedures. The applicable rate of this VAT ("import VAT") is the same as would be applicable on a sale of the same goods within the territory of the Member State, and the chargeable value is the import value. If the import is linked with a sale of the goods then the import value will be the sale value (the total price of the sale, including related packing, shipping and insurance costs). If there is no linked sale—as would be the case where a person imports his or her own goods, or in the case of a gift—then the import value is, broadly, market value of the goods.

4 EU law provides a system of exemptions from import VAT. The exemptions are, essentially, the mirror image of the exemptions from customs duty which have applied under EU customs law since 1982. They cover such matters as personal luggage, gifts up to a certain value, trade samples, *etc.* Importantly for present purposes, the exemptions also include "Low Value Consignment Relief". LVCR is an exemption from import VAT for any consignment—including commercial consignments—below a specified threshold. The threshold may be either 10 euros or 22 euros: Member States have a free choice between these two value thresholds. All EU Member States apply this LVCR exemption from import VAT, and in the majority of Member States the threshold is 22 euros.

5 In November 2011, the United Kingdom announced a proposal to remove the LVCR exemption for imports into the UK by means of "distance selling transactions". The proposal was specific to imports from the Channel Islands to the UK. Imports to the UK from all other third countries and third territories will continue to benefit from LVCR. It was in response to this plainly unequal treatment that the Governments of Jersey and Guernsey undertook the unprecedented step of bringing judicial review proceedings against proposed UK primary legislation.

6 This paper aims to summarise the arguments put forward to the High Court by the Bailiwicks during this highly significant case and analyses the various aspects of the judgment delivered on 15 March 2012 by Mr Justice Mitting, with particular emphasis upon the principal finding that "fiscal neutrality" does not require equal treatment of the Channel Islands. This paper goes on to examine the possible implications of such a judgment in light of the Islands' third

territory status and challenges the strength and accuracy of the conclusions.

The judicial review challenge

7 The two sets of judicial review proceedings initiated by both governments sought to challenge the UK's decision, as reflected in the draft legislation published in December 2011, to withdraw LVCR for all consignments shipped from the Channel Islands to the United Kingdom under a "distance selling arrangement." (By virtue of a Budget Resolution and the Provisional Collection of Taxes Act 1968, this draft legislation has since taken effect as of 1 April 2012.) The Islands put forward essentially the same arguments, although by agreement between their respective counsel, certain points were developed in more detail by one or the other. The principal legal case highlighted that LVCR is a mandatory EU tax relief applicable in all Member States to imports from all third countries or third territories, apart from certain specific options permitted to Member States. The real issue in the case was whether certain permitted options and exceptions from LVCR can be applied by a Member State in a territory-specific way, in a manner which no Member State has previously attempted during the 30 years for which EU law has provided the LVCR exemption. The Islands argued that the United Kingdom's proposed measure was in excess of the powers permitted to Member States under the relevant EU legislation and thus *ultra vires*. During the course of the proceedings, the very nature of the Islands' relationship with the UK and with Europe was debated.

8 The judicial review proceedings were brought purely on the grounds of EU law. That is a valid legal basis on which prospective UK primary legislation can be challenged in the courts, and a small number of precedents exists in which the courts have declared proposed primary legislation to be not in conformity with EU law (in which case, either the courts will determine a conforming construction, or the relevant government department must simply disapply the UK legislation). Indeed, so compelling was the strength of the respective *prima facie* cases (which included accompanying written evidence from commercial parties, in Jersey's case), that in an early success, the High Court granted permission for judicial review within two days of Jersey's application being issued, and ordered expedition so that the case could be heard before Budget Day, 21 March 2012. Guernsey's application was not so immediately fortunate but the UK government (represented by HM Revenue & Customs—"HMRC"—and HM Treasury) and the parties agreed that both Islands' applications should be heard together in a joint judicial review, expedited as requested by Jersey.

9 Mr Justice Mitting accordingly heard the case from 13–15 March, and delivered his oral judgment on 15 March, with the written version of his judgment becoming available in approved form by 21 March 2012.[3]

The Channel Islands' relationship with the EU

10 The Channel Islands are not part of the EU, but they enjoy a relationship with the EU governed by Protocol 3 to the 1972 UK Treaty of Accession.[4] In essence, art 1 of Protocol 3 provides that the Bailiwicks of Jersey and Guernsey are a part of the EU customs union and that the abolition of customs duties and quantitative restrictions (and charges having equivalent effect)[5] will apply to trade between the Channel Islands and the EU Member States in the same way as they apply to trade between Member States. Additionally, EU "free movement of goods" rules apply to agricultural products moving between the EU and the Channel Islands or vice versa (but not to other types of goods).

11 By art 2 of Protocol 3, Channel Islanders[6] shall not benefit from EU provisions relating to the free movement of persons and services. Therefore as a matter of EU law, Channel Islanders do not enjoy any particular rights to enter or reside in Member States, other than the UK, or to provide services in those Member States, but equally the Channel Islands are not obliged to open their borders to immigration from the EU. (In practice, Channel Islanders may move freely between Member States simply because Channel Islanders carry UK passports.) Article 2 of Protocol 3 requires the Channel Islands to treat the citizens of all EU Member States equally: this is in effect a non-discrimination

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[3] *R (Minister for Economic Development of Jersey) v HMRC* [2012] EWHC 718 (Admin).

[4] Treaty concerning the Accession to the European Economic Community and to the European Atomic Energy Community of Denmark, Ireland, and the United Kingdom, signed on 22 January 1972.

[5] The prohibition on charges having equivalent effect to customs duties does not, however, prevent "internal taxation" which is not the same thing: see Case C-28/96 *Fricarnes*, para 19: "provisions relating to charges having equivalent effect and those relating to discriminatory internal taxation cannot be applied concurrently, so that under the system of the Treaty the same taxation cannot belong to both categories at the same time" and case-law there cited.

[6] See art 6 of Protocol 3 which defines what is meant for these purposes by a "Channel Islander."

requirement and was subject to detailed analysis in Case C-171/96, *Rui Roque* [1998] ECR I-4607.[7]

12 The Treaty on the Functioning of the European Union ("TFEU"), which updated the Treaty of Rome in 2009 as a result of the Lisbon Treaty and which represents the modern definition of the fundamental principles of EU law, reflects Protocol 3. Article 355.5(c) of TFEU provides—

> "(c) the Treaties shall apply to the Channel Islands and the Isle of Man only to the extent necessary to ensure the implementation of the arrangements for those islands set out in the Treaty concerning the accession of new Member States to the European Economic Community and to the European Atomic Energy Community signed on 22 January 1972."

13 That is an express exception from the default provision in art 355.3, namely that "The provisions of the Treaties shall apply to the European territories for whose external relations a Member State is responsible." It follows that the Channel Islands are not obliged to apply EU law within their territory, save to the extent required for the purposes of the customs union as set out in Protocol 3. But equally, for most purposes of EU law, the Channel Islands are "third territories", that is to say, territories outside the European Union, with no more rights than third countries.[8] Indeed, EU VAT legislation[9] expressly defines the Channel Islands as "third territories" in which VAT does not apply. Goods imported from third territories are treated, for VAT purposes, in the same way as goods imported from outside the customs union altogether.

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[7] See Plender, *The Rights of European Citizens in Jersey* (1998) JL Rev 220.

[8] In accordance with the decision of the European Court of Justice in C-384/09, *Prunus SARL v Directeur des services fiscaux*, regarding the status of the BVI, overseas territories which are not countries as such may nevertheless be regarded as "third countries" for relevant EU law purposes such as the free movement of capital provisions. The BVI are an Overseas Country or Territory ("OCT") enjoying a special associated status with the EU, like all the British Overseas Territories other than Gibraltar, by virtue of inclusion in Annex II to TFEU colonies and see art 198 of TFEU. In *Prunus*, the ECJ decided that the OCTs are to be classed as "third countries" for the purposes of EU law generally where there is no special provision for OCTs, in particular for the purposes of free movement of capital rules.

[9] Articles 5 and 6 of Council Directive 2006/112/EC, "the Principal VAT Directive".

14 Under art 355.5(c) TFEU, the EU Treaties therefore apply to the Channel Islands to the extent necessary to implement Protocol 3. This includes the provisions regarding customs duties and charges having equivalent effect[10] and quantitative restrictions and charges having equivalent effect,[11] it also includes free movement of goods rules for agricultural products, and consequently it also includes—at least so far as relevant to the interpretation and application of Protocol 3—the provisions permitting domestic courts to refer questions of EU law to the European Court of Justice: Case C-171/96, *Rui Roque* and Case C-293/02, *Jersey Produce Marketing Organisation Ltd* were examples of such a reference.

15 However, for all other purposes of EU law, the Channel Islands remain in the same position as any third country with no special relationship with the EU, and one which does not have preferential access to EU markets. EU tax law (direct or indirect) sits firmly outside the remit of Protocol 3 and therefore does not apply, and, crucially for the purposes of the present case, that means that the Channel Islands are outside the territory of the EU for VAT purposes.

16 In principle, import VAT therefore applies to goods shipped from the Channel Islands into EU territory. Technically, such goods might not be considered to be "imported" since the Channel Islands are within the customs union and therefore part of the customs territory of the EU, and accordingly goods in the Channel Islands are already considered to be in free circulation. However art 30 of the Principal VAT Directive provides expressly that for VAT purposes, "the entry into the Community of goods which are in free circulation, coming from a third territory forming part of the customs territory of the Community, shall be regarded as importation of goods." Therefore import VAT applies. And the prohibition in Protocol 3 of customs duties and charges having equivalent effect does not protect Channel Islands goods from import VAT, since VAT is neither a customs duty nor a charge having equivalent effect.[12]

17 In summary therefore, for EU VAT purposes, the Channel Islands fit within a select group of "third territories"[13] which exist within the EU customs union, but outside the territory of the EU for VAT purposes. The other territories with a similar status are the Åland

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[10] Article 30, TFEU, and see Case C-293/02 *Jersey Produce Marketing Organisation Ltd v States of Jersey*.
[11] Article 34, TFEU.
[12] See Case 15/81 *Schul v Inspecteur der Invoerrechten en Accijnzen* [1982] ECR 1409, para 21.
[13] As defined in arts 5 and 6 of the Principal VAT Directive.

Islands, the Canary Islands, Mount Athos, and the French overseas departments. The Channel Islands are unique even within this select group as being the only territories which are not part of the territory of a Member State and not part of the EU for any other purpose other than customs union: in contrast, the Åland Islands are an autonomous region of Finland, the Canary Islands are an autonomous region of Spain, Mount Athos is an autonomous region of Greece, and the French overseas departments are administratively part of France. It is perhaps also worth noting in contrast that the Isle of Man and Monaco are part of EU territory for VAT purposes (being deemed part of the United Kingdom and of France, respectively, for that purpose), so that VAT applies in both of those territories. The status of the Channel Islands in EU VAT law is therefore *sui generis*, although perhaps most similar to Andorra which is, likewise, under special arrangements, a non-EU territory which is within the customs union although VAT does not apply there.

EU VAT law: the debate

18 Article 143.1(c) of the Principal VAT Directive provides for exemptions from import VAT to apply to goods shipped to the EU from third territories which are within the customs union, such as the Channel Islands, in the same way as exemptions from import VAT would apply to imports from third countries outside the EU. Imports from third countries are, under art 143.1(b), subject to a system of exemptions from import VAT which is a close parallel to the system of exemptions from customs duties, including for example the well-known "duty free" allowances for international travellers.

19 The system of exemptions from import VAT is definitively laid down by Directive 2009/132/EC ("the 2009 Directive"). As noted, there are many categories of exemption from import VAT, but for the present purposes the provision of interest is art 23—

> "IMPORTS OF NEGLIGIBLE VALUE
>
> Article 23
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> Goods of a total value not exceeding EUR 10 shall be exempt on admission. Member States may grant exemption for imported goods of a total value of more than EUR 10, but not exceeding EUR 22.
>
> However, Member States may exclude goods which have been imported on mail order from the exemption provided for in the first sentence of the first subparagraph."

20 This is the exemption known as LVCR. During the proceedings before the High Court, Jersey and Guernsey argued that art 23 of the

2009 Directive imposes LVCR mandatorily for at least the 10 euro level, unless a Member State exercises the option contained in the second paragraph (above) to exclude goods imported on mail order. However, should a Member State choose to make use of that option—the "mail order option"—it is an option which must be exercised globally in relation to all imports into the Member State; in other words the mail order option cannot be implemented selectively for goods coming only from certain territories (or indeed selectively for only certain categories of goods).

21 This argument was based on essentially three grounds—

(i) as a matter of construction, there was no power in art 23 of the 2009 Directive to apply the mail order option selectively unless the Directive made express provision for that, which it did not: the Member States only had the powers expressly conferred;

(ii) any use of the mail order option to disapply LVCR to goods from the Channel Islands purportedly justified on the grounds of eliminating "distortion of competition" was disproportionate to that objective, first since the United Kingdom's proposed measure applied to all goods from the Channel Islands including goods which on any view were not distorting competition, and second since any alleged "distortion of competition" would still exist in as much as LVCR would still apply to imports from third countries other than the Channel Islands;

(iii) the over-arching EU VAT law principles of fiscal neutrality and non-discrimination—that is to say equal treatment of the same situations—prohibited a use of the mail order option which was selective for some territories and not others.

22 Conversely, HMRC and HM Treasury argued that Member States were free to use the mail order option selectively since a selective use of the mail order option would depart from the basic LVCR exemption to a lesser extent than a global use of the mail order option. HMRC and HM Treasury argued that where they exercised the mail order option, there was no obligation on them to exercise it in a fiscally neutral manner since nothing in EU law required the equal treatment of different third countries or third territories, and there was no obligation on them to exercise it in a proportionate manner since they had absolute discretion within the powers conferred by art 23. HMRC and HM Treasury also argued that the public policy purpose underlying LVCR was "administrative simplification" and accordingly it was up to them to determine how best to implement LVCR.

23 The pressure-group known as RAVAS ("Retailers Against VAT Avoidance") also submitted arguments to the High Court, arguing that since they could provide evidence that, in certain cases at least (though

they sought to embellish that into a more generalised pattern of behaviour) fulfilment companies located in the Channel Islands could be said to be engaging in VAT avoidance or abuse of the VAT relief, it followed that Member States (the UK) had a consequent duty to act and stop all LVCR for shipments from the Channel Islands. (It is possible that this argument was intended to assist RAVAS' longer-running campaign that their members are entitled to compensation from the United Kingdom government for not taking action to close the LVCR "loophole" at an earlier date.)

The judgment

24 On factual issues, the Channel Islands largely prevailed, and in particular Mitting, J held that there was no tax avoidance or abuse by the major fulfilment operations located in the Channel Islands—Play.com and Indigo Lighthouse group were expressly named as "exemplars" of businesses carrying on a legitimate export activity.[14] (The judge also commented that it was unnecessary for him to determine the extent to which the abusive practices alleged by RAVAS continued, if at all.[15])

25 The United Kingdom had set out estimates of the amount of VAT losses which would allegedly be stemmed, in future, by disapplying LVCR to the Channel Islands. The Channel Islands challenged these estimates, first on the basis that the predominant category of goods imported from the Channel Islands, CDs and DVDs, was a market which had peaked and was in decline (in both volume and unit value terms), and secondly on the basis that the likely response of certain commercial operators would be to rearrange their businesses so as to ship goods from a different jurisdiction such as Switzerland, or otherwise to arrange matters so that their sales into the UK continued to be subject to LVCR. The judge held[16] that there was force in these criticisms. He declined to speculate on the economic and fiscal impact in the United Kingdom of the withdrawal of LVCR, save to say that he was satisfied that it would have some impact: "probably not commensurate with the harm caused to the economy of the Channel Islands, but of some value to the United Kingdom Exchequer and to UK-based traders." During oral argument, counsel for HM Treasury and HMRC submitted that it was no concern of the government of the United Kingdom if a measure to protect the UK tax base caused economic damage in the Channel Islands: the judge commented orally

[14] See paras 20 and 62 of the judgment.
[15] See para 19 of the judgment.
[16] See para 25 of the judgment.

that given the close historic ties between the Channel Islands and the United Kingdom and their unique link through the Crown, that was a startling proposition.

26 On points of law, Mitting, J essentially found in favour of the United Kingdom. In particular, he determined that a Member State could apply the mail order option (contained in the second paragraph of art 23 of the 2009 Directive) selectively to imports from some third countries or third territories but not others, and he determined that the EU VAT law principles of fiscal neutrality and non-discrimination did not prohibit a Member State from applying the VAT system differently in the case of different third countries and third territories.

27 The basis of the judge's reasoning was a surprising and, we consider, controversial interpretation of art 95 of the Treaty of Rome (now art 110 TFEU)—formed on the basis of two decisions of the ECJ in a different field, Case 52/81, *Faust v Commission* and Case C-130/92, *OTO Spa v Ministero delle Finanze*—that nothing in EU law required equal treatment of different third countries. See further analysis below.

28 The precedent value of the judgment on these points of law is limited, however, since at para 14 of the judgment the judge also stated that in his view, the position in EU law is not "*acte clair*" and that ideally the points of EU law would have been referred to the ECJ—however time did not permit that since the parties were seeking the court's ruling before 21 March 2012.

29 Significantly, the judge also granted the Islands immediate permission to appeal to the Court of Appeal—an unusual step for a judge at first instance, which tends to be reserved for cases of great public importance or where the judge is in significant doubt as to the conclusions he has reached.

Analysis of the judge's reasoning on key points

30 The judge considered that nothing at the EU level obliges Community institutions or Member States to treat third countries equally, citing Case 52/81, *Faust* (relying in particular on the Opinion of Advocate General Jacobs) and Case C-130/92, *OTO Spa*. Thus, as a matter of EU law, Community institutions and Member States can be as arbitrary as they like in their dealings with third countries and third territories, including the Channel Islands[17]—

[17] See para 75 of the judgment.

> "These two cases, taken together, demonstrate that the European Union and, by necessary extension, member states, when permitted to do so or not prohibited from doing so by Union legislation, may, for any reason or none, discriminate against non-EU states in relation to the import of goods from them; even in the field of indirect taxation. The principle of fiscal neutrality is not, therefore, engaged in that context. There is no requirement that the United Kingdom should treat one non-EU territory in the same manner for the purposes of LVCR as any other, or as every other. For the same reasons, the principle of proportionality is also not engaged."

31 The judge also indicated that in his view, the origin of "fiscal neutrality" in EU VAT law is art 95 of the EC Treaty (now art 110 TFEU) which prohibits Member States from applying "internal taxation" to goods imported from other Member States in excess of the tax applicable to domestic goods. Accordingly, he reasoned, the VAT law requirement for equal treatment applies only to intra-Community trade and there is no legal requirement for "fiscal neutrality" and/or "equal treatment" as regards import VAT levied on products imported from third countries[18]—

> "Fiscal neutrality in that sense does not assist the Channel Islands. Both sides rely on the differences in taxation treatment of the same goods. But their comparators are different. The Channel Islands compare goods imported from their territory with goods imported from other non-EU territories and contend that they should be treated with fiscal equality. Her Majesty's Treasury and RAVAS say that the comparison is with goods sold by UK VAT-registered traders. If the Channel Islands are right, the principle of fiscal neutrality, and so of equal treatment, would be breached by the draft clause. If Her Majesty's Treasury and RAVAS are right, it would not be . . ."

32 Stating the principle does not, however, provide a useful guide to the answer. That can only be discerned from the principles which underlie the European Union VAT regime, stemming ultimately from art 95 of the Treaty of Rome or now art 110 of the Treaty on the Functioning of the European Union—

> "No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products."

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[18] See paras 67–68 of the judgment.

33 It follows, he reasoned, that that the second paragraph of art 23 of the 2009 Directive should be construed so as to permit Member States to use the mail order option selectively for some third countries or third territories but not for others. This is based on the perception that nothing in EU law would prevent unequal treatment of these third countries, and therefore art 23 should be construed so as to permit unequal treatment[19]—

> "These considerations provide most of the answer to the question which is at the heart of this case. There is no principle of EU law which requires the United Kingdom to treat the importation of low value goods on mail order from the Channel Islands in the same manner as similar goods from any other non-EU territory. They also assist in construing the language of Article 23. There is nothing in the words to prohibit a selective disapplication of the proviso. If there is nothing in the basis of EU law to prohibit a selective disapplication, there is no reason to construe the words narrowly so as to achieve that result, and I decline to do so."

34 It will be noted that the judge decided that there is no requirement for proportionality when a Member State uses the mail order option, because it is an unfettered option: a Member State may discriminate against a third country or a third territory "for any reason or for none", and if no reason is required, then there is no reference in relation to which the discrimination is required to be proportionate.

35 The judge also commented[20] that the United Kingdom's proposal if anything increases fiscal neutrality by applying VAT to goods in the UK which have been imported from the Channel Islands as well as to domestic goods.

36 The judge accordingly found that the proposed measure would be lawful as a matter of EU law since the second paragraph of art 23 to the 2009 Directive permits a Member State to act in this way.

Significance of the judgment to the Islands

37 Further scrutiny supports the view that even apart from his overriding comment that the relevant EU law is not *acte clair*, there is a considerable case that Mitting, J adopted an overly simplistic and inaccurate analysis. This is discussed in more detail below.

38 Leaving aside such arguments, the Islands should be aware, on the one hand, of the possible consequences of the judgment itself and, on

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[19] See para 67 of the judgment.
[20] See paras 67–68 of the judgment.

the other, of the implications of the judgment being inaccurate and how this might require attention in the future. Either way, it is important at legal and policy levels that the nuances of the judgment are understood so that effective strategies for the Islands' future planning, including protection for other industries, may take place.

39 Of course, such protection concerns the Islands' relations with the EU outside the context of Protocol 3 relations, however, this could be materially wide-ranging. For example, within the VAT system in particular, the Islands should be mindful of any risk of discriminatory action being taken against them by Member States in future and what might be done should such a position arise. On a more general basis, to the extent that the Islands are properly considered to fall outside EU law principles of proportionality and fiscal neutrality, the potential ramifications for various service industries will need to be carefully monitored if and when relevant issues arise.

Judgment: further discussion

40 In order to provide critical scrutiny of Mitting, J's analysis, three aspects of his reasoning will benefit from re-examination to expose the core reasons why the relevant EU law is indeed not *acte clair*. The three aspects are the fundamental principles of proportionality, fiscal neutrality and the effect of international legal obligations in their wider context. Each of these three aspects is examined below.

Proportionality

41 Contrary to the judge's view, it is fundamental that there is a general requirement for proportionality in any discretion conferred on Member States in a field governed by EU law. In other words, while it may sometimes be difficult to identify the true policy objective underlying a discretion conferred on Member States, there always is an objective in play, and the exercise of the discretion must be proportionate to that objective.

42 In particular, this applies to the discretions conferred on Member States in the field of VAT law: such discretions are always subject to this general requirement in their exercise, and in particular a proportionate measure adopted by a Member State must be effective to achieve its purpose.[21] In Case C-334/02, *Commission v France*,[22] it

[21] see Joined cases C-177 and 181/99 *Ampafrance SA*, and Case C-334/02 *Commission v France* [2004] ECR I-2229. There is also a detailed and learned analysis of the origins of the proportionality concept in the opinion of

was established that if it is to be proportionate, the provisions of a measure must be "necessary for the attainment of the specific objective which it pursues" (para 28).

43 The need for proportionality, in relation to the discretions which Member States have in the field of VAT law, is essentially because the VAT directives lay down the "common system of VAT" to be applied in all Member States and there is an overall policy objective in favour of harmonization, while recognising that complete harmonization is yet to be achieved (and indeed the discretions allowed to individual Member States are what currently prevents complete harmonization from being achieved). This progressive trend in favour of harmonization is made express in art 403 of the Principal VAT Directive which provides—

> "The Council shall, acting in accordance with Article 93 of the Treaty, adopt Directives appropriate for the purpose of supplementing the common system of VAT and, in particular, for the progressive restriction or the abolition of derogations from that system."

44 In relation to art 23 of the 2009 Directive, there is a good case that LVCR—the first paragraph of art 23—is the basic rule and therefore a part of the common system of VAT (notwithstanding the fact that it provides for an exemption from import VAT: the whole of the 2009 Directive provides for exemptions from import VAT and it can sensibly be said that provision for such exemptions, reflecting the customs duty exemptions, is the essential purpose of the 2009 Directive), whereas the mail order option—the second paragraph of art 23—is the derogation from that system, and therefore the mail order option is to be construed restrictively.

45 In other cases relating to VAT exemptions, there are indications that Member States' powers must be exercised in an objective manner using "appropriate criteria" so as to remain consistent with the objects of the exemption in question.[23]

Lord Hoffmann in *CR Smith Glaziers (Dunfermline) Ltd v HMRC* [2003] UKHL 7.

[22] [2004] ECR I-2229.

[23] Case C-346/95 *Blasi*, paras 21–23. A requirement for objective justification and proportionality can be seen in particular in two cases regarding exceptions from the duty free exemption—which is a close analogy with the exemptions from import VAT conferred by the 2009 Directive. These cases are Case C-140/05 *Valeško*, judgment para 65 referring to the

46 With this premise in mind, a UK proposal which aims to single out the Channel Islands specifically cannot possibly be proportionate, first because the stated reason for singling out the Channel Islands is alleged distortions of competition but the measure applies to all mail order transactions[24] without identifying whether they are likely to distort competition or not and, secondly, because the UK proposal applies only to these two territories and most surely must encourage increased transactions from other jurisdictions and therefore the perpetuation of territorial anomalies in what is intended to be an internationally unified system.

47 The need for proportionality is also particularly keen given the judge's finding that in the case of the businesses operating in the Channel Islands, in particular the major Jersey-based businesses to which the judge made express reference, there was no avoidance or abuse. Therefore (contrary to the case advanced by RAVAS), any requirement in EU VAT law for Member States to introduce conditions to prevent avoidance or abuse cannot possibly be held to justify exemption from LVCR.

48 With such a model in mind therefore, Mitting, J's analysis of proportionality can be regarded as incomplete, and in particular his conclusion that there is no need for Member States to respect any requirement for proportionality when exercising the mail order option selectively for some territories and not others, appears questionable.

Fiscal neutrality

49 In his judgment, it is arguable that Mitting, J underestimated the fundamental relationship between fiscal neutrality and the framework of EU VAT law. Although there is no authoritative case law from the ECJ to determine whether "fiscal neutrality" extends to requiring equal VAT treatment of goods imported from different third countries (at least in cases where there are not objective differences between the different countries), equally this is a point which certainly cannot be said to be *acte clair*. Furthermore, Mitting, J arguably failed to address crucial elements from which it may be said that fiscal neutrality must arise.

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need "strike a reasonable balance" and para 40 of the Advocate General's opinion, and also Case C-394/97 *Heinonen.*

[24] In the course of oral argument, the Islands accepted that, in modern circumstances, the expression "mail order" must extend to goods ordered by means of the internet or email and delivered to the customer by post, since there is no objective difference between that and goods ordered by traditional postal methods.

50 First, far from being a principle based upon art 95 of the Treaty of Rome, the concept of fiscal neutrality in VAT law should more appropriately be said to derive from the terms of the EU VAT Directives, beginning with the First Directive[25] and the Sixth Directive[26]. Fiscal neutrality is fundamentally the reason for the imposition of import VAT, that is to say import VAT is designed to ensure that goods imported from third countries (in particular, goods imported by final consumers) bear a broadly similar burden of VAT to domestic goods, bearing in mind that no VAT will have been imposed in the third country. Among others, the case of *Drexl*[27] at para 9 makes this position very clear—

> "The imposition of value-added tax on importation is designed in order to ensure the neutrality of the common system with regard to the origin of goods."

51 Moreover, fiscal neutrality requires equal treatment of the same type of goods within the territory of a Member State, and requires equal treatment of traders in the face of merely technical differences in their circumstances. All these aspects of fiscal neutrality show that it is a far more fundamental concept than indicated by art 95 of the Treaty of Rome, which is purely concerned with the non-imposition of discriminatory VAT (and other internal taxation) on goods moving between Member States. It follows therefore, that there must be a universal requirement for equal VAT treatment of the same situations, that is to say, situations which are not objectively different. The essential reasons for this are to enable the tax to be applied objectively and rationally, and to avoid anomalies and distortions of competition. Thus, "fiscal neutrality" arises out of the conceptual design of VAT as a harmonised, neutral, system of taxation which applies equally to all goods and services.

52 Accordingly, it is no surprise that there are numerous indications in the VAT directives that a harmonised approach should be adopted and that discretions conferred on Member States should be progressively limited and that measures derogating from the common system of VAT require a narrow interpretation (see references above to art 403 of the Principal VAT Directive), as wide and unfettered discretions could not lead to the desired comparable results across all the Member States. There are also indications that this neutral approach should be extended to dealings between Member States and third countries, see

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[25] Directive 67/227/EEC on the harmonisation of legislation of Member States concerning turnover taxes.
[26] Council Directive 77/388/EC.
[27] Case 299/86.

in particular Case C-111/92 *Lange* in which unlawful exports of restricted technological goods to Bulgaria and USSR had to be treated in the same way, for VAT purposes, as lawful exports to other countries which were not subject to the relevant embargo.

53 Therefore, contrary to the judge's reasoning, there are arguments that the principle of fiscal neutrality in EU VAT law is not derived simply from art 95 of the Treaty of Rome but instead is a concept of a far more fundamental character, and, consequently, that neutrality requires goods imported from the Channel Islands to be treated—for VAT purposes—in the same way as similar goods imported from any other third territory or third country.

54 Finally it is worth noting that art 95 of the Treaty of Rome operates only to protect intra-Community trade from discriminatory taxation or multiple layers of taxation. Article 95 is not therefore the basis of the concept that VAT exemptions must be applied in the same way to objectively comparable situations, since a transaction which is exempt from VAT could never in any event give rise to internal taxation contrary to art 95. Although fiscal neutrality in VAT—and the requirement for equal treatment of comparable situations, which is an aspect of fiscal neutrality—is certainly consistent with art 95, it is a concept that can only derive from the terms of the Directives themselves and from the jurisprudence of the ECJ in VAT cases. Moreover, the concept of equal treatment would certainly have had application to the exemptions from import VAT conferred by the 2009 Directive (or by its precursor, Directive 83/181/EEC) prior to the commencement of the Single Market in 1992. The Single European Act in 1992 resulted in import VAT ceasing to apply to the movement of goods between Member States, but until then, goods moving between Member States were in general subject to import controls and import VAT in the same way as goods imported from third countries. It is clear that, prior to 1992, a Member State could not have selectively applied the mail order option to goods coming from another named Member State only. Although it could be argued that other fundamental provisions in the Treaty of Rome would have prevented such specific discrimination, nevertheless the inherent wrongness of such an approach is an indication that the mail order option for LVCR was never intended to operate in a selective manner.

Legal position for third countries under international law (the WTO)

55 A core part of the reasoning of Mitting, J, as analysed above, was his view (based on *Faust* and on *OTO SpA*) that nothing in EU law requires Member States to treat third countries in the same way. However there *is* a general principle of EU law to the effect that all provisions of EU law should be interpreted, so far as possible, in

conformity with the international obligations of the EU and the Member States. For many third countries, an important principle of equal treatment is actually enshrined in their relations with the EU, as defined at art I of the General Agreement on Tariffs and Trades ("GATT"), a multilateral treaty which is in effect in order to implement the objectives of the World Trade Organisation ("WTO"). All individual EU Member States are contracting parties to GATT, as well as a large number of third countries. Article I is known as the "most-favoured nation" rule and requires that any favourable rule, concession or exemption applied by a contracting party to its trade with one nation must be extended in the same way to all WTO members.

56 It follows that any EU Member State which applies LVCR to goods imported from Japan, say, would therefore equally have to apply LVCR to its imports from every other WTO member. The relevant law is art I of GATT, and only the WTO procedures can enforce that. However, EU law would require all EU legislation to be construed in a manner consistent with that international obligation.

57 For the Channel Islands, the context is more complex because the Channel Islands are not themselves members of the WTO, and the United Kingdom's membership of the WTO does not currently confer rights on the Channel Islands. Nonetheless the influence of the Channel Islands' previous relationship under GATT (prior to 1993) remains relevant when analysing how the 2009 Directive should be read and its scope assessed. For the avoidance of doubt, the reason the Channel Islands currently do not have rights and obligations at the WTO is that the Channel Islands were expressly not included within GATT when it was re-ratified by the UK in 1994. At present, they therefore cannot claim to benefit directly from requirements for equal treatment under the most-favoured nation rule.

58 The position of the Channel Islands might be contrasted with that of the Åland Islands and the other third territories to which the Principal VAT Directive extends the 2009 Directive import exemptions by virtue of art 143.1(c). All of the other such "third territories" are, as noted above, autonomous regions of a Member State and as such they possess the express right to equal treatment under art I of GATT simply by virtue of the respective Member State's membership of the WTO; they may also possess rights to non-discrimination under EU law itself, for example art 18 of TFEU. Equally, the British Overseas Territories other than Gibraltar, and all other "OCTs" listed in Annex II to TFEU, are not within the EU for

VAT purposes[28] but benefit from the equivalent of GATT most-favoured nation protection expressly as a matter of EU law, that is to say by virtue of rights under art 199.1 of TFEU.

59 Crucially, the question of whether to pursue full WTO membership now may therefore be key for the Channel Islands from the perspective of future protection of their position in EU law. (WTO membership protects both trade in goods under GATT, and provision of services under GATS, the General Agreement on Trade in Services.) As can be seen, it is relevant in the context not only of their protection at a global level but also of their emerging personalities within the EU.

60 For present purposes, the previous status of the Channel Islands under GATT may still be of importance. From 1947 to 1993, the Channel Islands were represented by the UK as a contracting party to GATT. Although ironically this membership would not have protected the Channel Islands against discrimination by their own representative contracting party, the United Kingdom, they were nevertheless shielded from unequal treatment by the other contracting parties, and that would have prevented them from being singled out for unequal treatment by any another Member State. This protection would have therefore been assumed to cover the Channel Islands at the time that LVCR was first introduced under Directive 83/181/EEC, and at the time of Directive 88/331/EEC[29] which introduced the mail order option. By extension, this would have therefore affected how a Directive such as 88/331/EEC would have been construed and applied, with the mail order option arguably for this reason not being capable of being construed in such a way so as to permit geographic selectivity against the Channel Islands. In other words, selectivity against the Channel Islands would have been contrary to international law at the time the directive was enacted, and on an *ex tunc* basis it could be argued that even though the position of the Channel Islands in international law has changed, the meaning of the directive cannot have changed. More generally, cases such as *Valeško*[30] have

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[28] Case C-181/97 *van der Kooy*.

[29] A Directive amending Directive 83/181/EEC determining the scope of art 14(1)(d) of Directive 77/388/EEC, the Sixth VAT Directive.

[30] In Case C-140/05 *Valeško*, the ECJ decided that the power in Directive 69/169/EEC to reduce the duty-free threshold for tobacco products could be applied selectively to different third countries, but only where that was *objectively justified*, and only where that was proportionate with the public health objective (which would also be a ground for departure from the GATT principle of non-discrimination, pursuant to art XX of GATT). In particular, in para 29 of the Advocate General's opinion, he indicated with reference to

demonstrated such a generalised approach to the construction of directives by reference to the GATT most-favoured nation principle.

61 In this regard, it can be noted that at the time of the *Faust* case (so heavily relied upon by both HMRC and the judge in their comparative analysis), neither China nor Taiwan as "third countries" were members of the WTO. Thus, the equal treatment requirements under art I of GATT would not have applied to them, unlike the Channel Islands (at that time). However, we would also comment that the measures of EU law in question in *Faust* were in a field where different rules for different countries are expressly contemplated, whereas the position in relation to the 2009 Directive would seem to be fundamentally different: there is no express provision in the 2009 Directive for different VAT treatment of imports from different third countries, and since most countries in the world are now WTO members it is accordingly highly unlikely that the debated mail order option was ever intended to be used in a geographically selective manner. Given that such a power of selectivity would have been wholly contrary to the rights of large numbers of third countries, third territories and OCTs as a matter of either international law or EU law, it would not have been possible even had there been express wording to that effect, and so it is unlikely to be the correct construction of the mail order option.

62 In summary, although the Channel Islands are not now protected by GATT, the proper construction of the mail order option relied upon by the UK cannot have changed in scope since it was introduced in 1988 (the recent 2009 Directive therefore merely codifies the earlier legislation). At that time all Member States other than the UK, would have had an international treaty obligation not to apply the mail order option selectively to the Channel Islands. More generally, that is the current position for a large number of third countries and third territories. Thus, the judge's reading of the Directive is provided with a potentially major challenge. Following *Valeško*, there is a strong basis for arguing that the 1988 Directive, in introducing the mail order option, did not intend to confer any discretion on Member States involving geographical selectivity which would amount to discrimination against specific third countries or third territories, at least unless it could be objectively justified.

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art I of GATT: "There is in international trade law a principle of non-discrimination between third countries by reference to which art 5(8) of Directive 69/169 must be interpreted", while also reasoning that some differentiating treatment can be justified on objective grounds which preclude the existence of genuine discrimination.

Conclusion

63 With the above reasoning in mind, it is clear that there are significant aspects of Mitting, J's reasoning which would benefit from reconsideration when the situation requires it. Having regard, in particular, to the judge's stated view that the relevant EU law is not *acte clair*, the Channel Islands might be able to develop these lines of analysis should this be a necessary legal or political step in future.

64 In any case, the principles of proportionality and fiscal neutrality, and overarching international law in particular in the WTO context, clearly merit continued close scrutiny from the Channel Islands having regard to the international perspective and protection of the existing freedoms of the Channel Islands into the future.

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