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IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
ADMINISTRATIVE COURT

CO/0662/2012; CO/0656/2012

Royal Courts of Justice
The Strand
London
WC2A 2LL

Thursday, 15 March 2012

Before:
MR JUSTICE MITTING

BETWEEN:

THE QUEEN (ON THE APPLICATION OF THE MINISTER FOR ECONOMIC DEVELOPMENT OF THE STATES OF JERSEY)

Claimant

-v-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Defendants

AND BETWEEN:

THE QUEEN (ON THE APPLICATION OF THE STATES OF GUERNSEY)

Claimant

-v-

(1) HM TREASURY

(2) THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Defendants

(Transcript of WordWave International Limited
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165 Fleet Street, London EC4A 2DY
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Official Shorthand Writers to the Court)

David Vaughan CBE QC and **Conrad McDonnell** (instructed by PwC Legal) appeared on behalf of the States of Jersey.

Sam Grodzinski QC and **David Yates** (instructed by Law Offices of the Crown) appeared on behalf of the States of Guernsey.

Philippa Whipple QC, Jessica Simor and **Suzanne Lambert** (instructed by HMRC Solicitor's Office) appeared on behalf of HMRC.

Christopher Vajda QC, Valentina Sloane and **Julianne Stevenson** (instructed by Edwin Coe) appeared on behalf of RAVAS.

Judgment
As Approved by the Court

1. **MR JUSTICE MITTING:** The European Union is a complex organism. Some territories are part of the Union for some purposes, but not for others. The bailiwicks of Jersey and Guernsey (the Channel Islands) are part of the customs territory of the Union, but are not part of the territory of a member state, the United Kingdom, for the purposes of VAT; see Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the Principal VAT Directive) Article 6.1.

2. The importation of goods into the territory of member states is subject to VAT; Article 2.1(d). The entry into the territory of a member state of goods coming from the Channel Islands is to be regarded as importation of goods; Article 30, second paragraph. Accordingly, it is a taxable supply, unless exempted under Title IX.

3. Article 131 requires member states to apply the exemptions set out in Title IX, subject to conditions:

4. "The exemptions provided for in Chapters 2 to 9 shall apply without prejudice to other Community provisions and in accordance with conditions which the Member States shall lay down for the purposes of ensuring the correct and straightforward application of those exemptions and of preventing any possible evasion, avoidance or abuse."

5. Article 143 requires member states to exempt from tax the importation of goods of low value from the Channel Islands. This is achieved by Articles 143(b) and (c) and Article 23 of Council Directive 2009/132/EC of 19 October 2009 determining the scope of Article 143(b) and (c) of the Principal VAT Directive as regards exemption from VAT on the final importation of certain goods (the 2009 Directive):

> "Member States shall exempt the following transactions ...
>
> "(b) the final importation of goods governed by Council Directives ... 83/181/EEC ...
>
> (c) the final importation of goods, in free circulation from a third territory forming part of the Community customs territory, which would be entitled to exemption under point (b) if they had been imported within the meaning of the first paragraph of Article 30."

6. Article 143(b) refers to Council Directive 83/181/EEC of 28 March 1983 which was replaced with effect from 30 November 2009 by the 2009 Directive and is now to be taken to refer to the latter.

7. Articles 1 and 23 of the 2009 Directive provide:

> "Article 1. The scope of the exemptions from value added tax (hereinafter VAT) referred to in Article 143(b) and (c) of Directive 2006/112/EC and the rules for their implementation, referred to in Article 145 of that Directive, shall be defined by this Directive.
>
> In accordance with Article 131 and Article 143(b) and (c) of Directive 2006/112/EC, the Member States shall apply the exemptions laid down in

this Directive under the conditions fixed by them in order to ensure that such exemptions are correctly and simply applied and to prevent any evasion, avoidance or abuses.

Article 23. 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."

8. Thus, member states must exempt the importation from the Channel Islands of goods worth less than 10 euros and may exempt goods so imported worth less than 22 euros. The equivalent values in pounds sterling are to be fixed and may be rounded off on 1 January each year, by reference to the exchange rate obtaining on 1 October of the preceding year, Article 92. This exemption is commonly referred to as "low value consignment relief" or LVCR. The United Kingdom has not hitherto sought to exclude goods imported on mail order from LVCR. It gives effect to LVCR by Article 5.1 and item 8 of paragraph 8 of Schedule 2.2, the Value Added Tax (Imported Goods) Relief Order 1984 (SI 1984/746). As from 1 November 2011, the limit set in item 8 is £15; Section 77.1, Finance Act 2011.

9. On 9 November 2011, the Chancellor of the Exchequer announced that LVCR would be withdrawn for all goods imported on or after 1 April 2012 from the Channel Islands. The announcement somewhat overstated the position which was more precisely set out in a draft clause to be included in the Finance Bill 2012, which was published for consultation on 6 December 2011:

"Relief from VAT on low value goods: restriction relating to Channel Islands.

(1) In Schedule 2 to the Value Added Tax (Imported Goods) Relief Order 1984 (SI 1984/746) (relief for goods of certain descriptions), Group 8 (articles sent for miscellaneous purposes) is amended as follows.

(2) The existing Note becomes Note (1) (and accordingly 'note' in Group 8 becomes 'notes').

(3) After that Note, insert:

(2) Item 8 does not apply in relation to any goods sent from the Channel Islands under a distance selling arrangement.

(3) For the purposes of Note 2:

'Distance selling arrangement', in relation to any goods, means any transaction, or series of transactions, under which the person to whom the goods are sent receives them from a supplier without the simultaneous

physical presence of the person and the supplier at any time during the transaction or series of transactions, and;

'Supplier' means any person who is acting in a commercial or professional capacity."

10. The draft clause went on to provide that it would have effect in relation to goods imported on or after 1 April 2012.

11. The reference to "distance selling arrangement" echos a similar phrase by reference to which consumer protection was to be enhanced in relation to the supply of goods and services by Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, "distance contract" in Article 2(7).

12. The Channel Islands contend that the proposed clause would, if enacted, be unlawful under European Union law and invite me so to declare. If I do, it is unlikely that the draft clause will be included in the Finance Bill. If I do not, it will be; and if Parliament enacts the Bill containing the clause, it will become law with effect from 1 April 2012.

13. This claim is striking in two respects. Not so long ago, the notion that a judge might interfere in the workings of Parliament in this manner would have been considered constitutionally improper; but in areas of law within the competence of the European Union in which the law of the European Union must ultimately prevail, all sides accept that I can and should determine the issue.

14. Secondly, the issue is not acte clair. If time had permitted I would, with the assistance of the parties, have referred the issue to the Luxembourg court, but it does not, and all sides agree that it is essential that I determine it, if possible, before Budget Day next Wednesday; hence this judgment.

15. The problem which the draft clause seeks to address is the large scale importation of goods of low value from the Channel Islands to the United Kingdom. Much evidence has been filed on all sides, including evidence by the retailers against VAT avoidance schemes or RAVAS about the issue. I need set out no more than a headline summary.

16. In 2011, allowing for assumptions about importations for December of that year, statistics for which had not been collated when the table was prepared by Mr Jonas, a senior analyst with Her Majesty's Revenue & Customs, approximately £670 million of goods eligible for LVCR were imported into the United Kingdom from the Channel Islands and delivered by post. Approximately £60 million worth of goods on which VAT was paid was similarly imported and delivered. The majority of items imported with LVCR was CDs and DVDs, £378 million worth, 56 per cent by value of the total.

17. The next items by value were, in descending order: pills, electrical accessories, flowers and cards; £246 million worth, 30 per cent of the total by value. Numerous miscellaneous items accounted for £46 million, 7 per cent of the total by value.

18. The total value of goods imported with LVCR has risen from about £454 million in 2006, but has held steady for the last four years. This may be the combined result of

the recession in the United Kingdom and steps taken by the States of Jersey and Guernsey to reduce or eliminate the practice of "round tripping" by which large UK retailers took orders for goods from UK customers in the United Kingdom which they then delivered from the United Kingdom to the Channel Islands and which were then dispatched from the Channel Islands to the UK customers. This commercially pointless exercise was worthwhile because of the tax consequences. The UK retailer paid VAT on the goods when delivered to its warehouse in the United Kingdom and then exported them to the Channel Islands free of VAT. The same goods were then reexported to the United Kingdom customer, also free of VAT, due to LVCR. The UK retailer recovered the VAT which it had paid as input tax; the UK customer paid a price which was free of VAT.

19. There is evidence from members of RAVAS that this practice has not stopped. It is unnecessary for me to determine the extent to which it continues, if at all. It was, and if it continues is, clearly an abusive practice. I accept, as RAVAS members and HMRC witnesses assert, that it has had a significant adverse impact on the turnover and profitability of some UK retailers in the affected sectors.

20. What can properly be categorised as legitimate export activity has also been conducted by Channel Island-based companies, of which Play.com and Indigo Lighthouse are exemplars. Both have established a warehousing and distribution centre in Jersey, from which orders placed by the internet from the United Kingdom are supplied. The business of Play.com is the supply of digital media, principally CDs and DVDs. That of Indigo Lighthouse is more diversified. Both have invested significantly in establishing and developing their facilities and operations in Jersey, and both are substantial employers of local labour.

21. A third category of Channel Island business which would be affected by the withdrawal of LVCR is horticulture and flower selling, both indigenous to the Channel Islands. The withdrawal of LVCR would have a significant adverse impact on all of these categories of business. It would also substantially reduce the number of large letters and postal packets handled by the post offices of the Channel Islands.

22. The overall impact of withdrawal is summarised by two officials of the States' governments, Mr King and Mr Buckland respectively. Approximately 700 directly employed workers would lose their jobs in Jersey, and up to a further 800 indirectly affected would also do so. Approximately 600 would lose their jobs in Guernsey; and the export trade would shrink from, it is estimated, £265 million to £30 million.

23. It is not necessary for me to subject these statements to rigorous scrutiny. I accept their general thrust and am satisfied that the withdrawal of LVCR would have a severe adverse impact on employment and business, including that of the postal services, in the Channel Islands. Estimates have been made by HMRC of the VAT loss in the last six years, resulting from the application of LVCR to goods imported from the Channel Islands and of the gain in VAT revenues which might be anticipated from its withdrawal.

24. These estimates have been the subject of detailed and trenchant criticism; principally for two reasons. The sale of CDs and DVDs, the majority of items by value subject to LVCR, is in seminal decline because of alternative technology, downloading music and films from the internet, and the supply of these and other items from the Channel Islands may be replaced by supplies of the same goods, also free of VAT, from other countries outside the European Union, such as Switzerland.

25. There is force in these criticisms. I decline to speculate on the economic and fiscal impact of the proposed measures in the United Kingdom, save that I am satisfied that it will 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.

26. Her Majesty's Treasury now identifies the proviso to Article 23 of the 2009 Directive as the source of the power to enact the proposed measure. For that to be right, two conditions must be satisfied. The goods which will be subjected to VAT must be supplied on "mail order" and the proviso must permit a selective removal of LVCR on mail order imports.

27. According to Wikipedia, the sale of goods by mail order originated in the United States, possibly devised by Benjamin Franklin in 1744; certainly in existence by 1848 when the earliest surviving mail order business was founded in New York. The essential features of mail order business then, and for many decades after, was the placing of an order for goods by a retail customer by post for delivery by the retailer to the customer's home, without the need for the retailer to maintain or the customer to visit a shop.

28. In 1872, Aaron Montgomery Ward developed the concept by producing and distributing a catalogue of goods offered for sale by mail order to his customers. Catalogue selling spread to the United Kingdom in the first decade of the 20th century and to France in the 1920s.

29. Until, at the earliest, the early 20th century, the only means by which a customer could order goods remotely for delivery to his home was by post; but the advent of the telephone, and for business customers the fax machine, provided alternative methods of ordering. By 1988, when the predecessor to the proviso to Article 23 was first introduced by Council Directive 88/331/EEC of 13 June 1988, all three methods would have been in regular use. Since then, the internet has added two more: e-mail and online ordering via a website maintained by the retailer.

30. Mr Grodzinski QC and Mr Vaughan QC originally submitted that the definition of "mail order" in Article 23 did not encompass all of those methods of placing an order, but now accept that it does. They are right to do so. The common understanding of the phrase is that it describes the ordering of goods by a customer from a retailer by remote means, for dispatch to the home or place of business of the customer by the retailer.

31. The Wine Society is a typical mail order business. Although it is possible for members to buy wine from two shops in Stevenage and Montreuil, the bulk of its business is done remotely. Members can place orders by post, telephone, fax, e-mail or online.

Wine is delivered by the Society's own delivery fleet. It is conducting a mail order business, however the orders are placed. Any other conclusion would lead to absurdity and unjustifiable and impractical distinctions. Is a fax mail? Why is e-mail mail, but not an online order? Why should telephone ordering be distinguished? The fact that these distinctions cannot rationally be drawn suggests that it is no more appropriate now to hark back to the 19th century model of mail order, apart from its essential features, than it would be to look to the original meaning of "mail", a packet of letters bundled together for ease of carriage and delivery.

32. The description in the draft clause is no more and no less than a modern synonym and a description of "mail order" in Article 23. It is entirely compatible with it.

33. Is the United Kingdom entitled selectively to disapply LVCR? This is the nub of the case. Mr Vaughan and Mr Grodzinski submit that the answer is no, for two basic reasons:

> (1) As a matter of language, the proviso to Article 23 does not permit selective disapplication, either by reference to categories of goods or territories. In Mr Grodzinski's words, the United Kingdom has a "binary" choice, to apply or not to apply the proviso across the board.
>
> (2) Selective disapplication of the proviso offends against the principles of fiscal neutrality and non-discrimination and of proportionality.

34. Ms Whipple QC, for the Treasury and HMRC, submits that the answer is yes, for four reasons:

> (1) Selective disapplication is permitted by the language of the proviso; a power to disapply LVCR across the board includes a power to disapply it to a lesser extent.
>
> (2) The principles of fiscal neutrality, non-discrimination and proportionality have no part to play in assessing the lawfulness of a measure which targets imports from a territory outside the EU.
>
> (3) The United Kingdom is entitled to take measures to limit avoidance or abuse or distortion of competition and the draft clause is such a measure.
>
> (4) Properly understood, the draft clause will enhance, not diminish, fiscal neutrality.

35. Mr Vajda QC, for RAVAS, additionally submits that Article 1 of the 2009 Directive requires the United Kingdom to take measures to combat avoidance or abuse and the draft clause fulfils that obligation.

36. Mr Vaughan and Mr Grodzinski submit in response that the legislative history and wording of Articles 1 and 23 of the 2009 directive exclude Ms Whipple's third and fourth propositions and Mr Vajda's additional proposition.

37. I will deal with the latter submissions first.

38. Article 95 of the Treaty of Rome, now Article 110 of the Treaty on the Functioning of the European Union, and Article 99 of the Treaty of Rome, provided:

> "Article 95. 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 products. Furthermore, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products ...
>
> Article 99. The Commission shall consider how the legislation of the various Member States concerning turnover taxes, excise duties and other forms of indirect taxation, including countervailing measures applicable to trade between Member States, can be harmonised in the interest of the common market."

39. The sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the member states relating to turnover taxes -- Common system of VAT: uniform basis of assessment, was an important milestone on the way to harmonisation; a process begun by the first and second Council Directives of 11 April 1967. It included a provision for exemptions of importation in Article 14:

> "1. Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of such exemption and of preventing any possible evasion, avoidance or abuse ...
>
> (d) final importation of goods qualifying for exemption from customs duties other than as provided for in the Common Customs Tariff or which would qualify therefore if they were imported from a third country. However, Member States shall have the option of not granting exemption where this would be liable to have a serious effect on conditions of competition on the home market ...
>
> 2. The Commission shall submit to the Council at the earliest opportunity proposals designed to lay down Community tax rules clarifying the scope of the exemptions referred to in paragraph 1 and detailed rules for their implementation. Until the entry into force of these rules, Member States may:
>
> -- maintain their national provisions in force on matters related to the above provisions.
>
> -- adapt their national provisions to minimise distortion of competition and in particular the non-imposition or double imposition of value added tax within the Community."

40. Thus what the sixth Directive envisaged was at an interim stage, during which member states would, by their own laws, minimise avoidance, abuse and the distortion of competition, followed by the submission of detailed proposals by the Commission to the Council, for detailed rules to clarify and implement the scope of exemptions on importation. This was achieved by Council Directive 83/181/EEC of 28 March 1983, determining the scope of Article 14(1)(d) of the sixth Directive. The fourth recital stated:

> "Whereas arrangements for value added tax should be introduced that differ according to whether goods are imported from third countries or from other Member States and to the extent necessary to comply with the objectives of tax harmonisation; whereas the exemptions on importation can be granted only on condition that they are not liable to affect the conditions of competition on the home market."

41. Article 1 provided:

> "1. The scope of the exemptions from value added tax referred to in Article 14(1)(d) of Directive 77/388/EEC and the rules for their implementation referred to in Article 14(2) of that Directive shall be defined by this Directive. In accordance with the aforesaid Article, the Member States shall apply the exemptions laid down in this Directive under the conditions fixed by them in order to ensure that such exemptions are correctly and simply applied and to prevent any evasion, avoidance or abuses."

42. Article 22 provided:

> "Member States may allow exemptions on imports of goods of a total value not exceeding 22 ECU."

43. On the same day, by Article 22 of Council Regulation number 918/83 of 28 March 1983, setting up a Community system of reliefs from customs duty, certain low value imports were exempted from customs duty:

> "Subject to Article 28, any consignment dispatched to its consignee by letter or parcel post containing goods of a total value not exceeding 10 ECU shall be admitted free of import duties."

44. Both the Directive and the Regulation came into force on 1 July 1984. Thus from that date, member states were obliged to exempt consignments of goods worth less than 10 ECU dispatched by letter or parcel post from customs duty and permitted to exempt goods worth less than 22 ECU from VAT on importation. I do not know what the reason for the difference in the limits was.

45. They were partly aligned by Article 1.2 of Council Directive 88/331/EEC of 13 June 1988, which amended Directive 83/181/EEC by replacing Article 22 with the following:

> "Goods of a total value not exceeding 10 ECU shall be exempt on admission. Member States may grant exemption for imported goods of a total value of more than 10 ECU but not exceeding 22 ECU. 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."

46. The Principal VAT Directive consolidated and built on these foundations. Its principal objectives are set out in recitals 4 and 7:

> "(4) The attainment of the objective of establishing an internal market pre-supposes the application in Member States of legislation on turnover taxes that does not distort conditions of competition or hinder the free movement of goods and services. It is therefore necessary to achieve such harmonisation of legislation on turnover taxes by means of a system of value added tax (VAT) such as will eliminate, as far as possible, factors which may distort conditions of competition, whether at national or Community level.
>
> (7) The common system of VAT should, even if rates and exemptions are not fully harmonised, result in neutrality in competition, such that within the territory of each Member State similar goods and services bear the same tax burden, whatever the length of the production and distribution chain."

47. Article 131, already cited, set out provision for exemptions, including Article 143(b) and (c), also already cited. Article 145 repeated the legislative technique used in the sixth Directive of permitting member states to maintain national provisions in force, pending the adoption of detailed rules proposed by the Commission:

> "1. The Commission shall, where appropriate, as soon as possible, present to the Council proposals designed to delimit the scope of the exemptions provided for in Articles 143 and 144 and to lay down the detailed rules for their implementation.
>
> 2. Pending the entry into force of the rules referred to in paragraph 1, Member States may maintain their national provisions in force."

48. Article 395 contained a longstop provision to facilitate simplification and to prevent evasion and avoidance by derogation by a member state authorised by the Council acting unanimously. The 2009 directive implemented the detailed proposals presented to the Council by the Commission under Article 145 of the Principal VAT Directive, as recital 3 makes clear:

> "3. Pursuant to Article 145 of Directive 2006/112/EC, the Commission is required to submit to the Council proposals designed to lay down Community tax rules clarifying the scope of the exemptions referred to in Articles 143 and 144 of that Directive and detailed rules for their implementation."

49. Recital 5 echos in slightly different words the fourth recital of Council Directive 83/181:

> "5. Separate arrangements for value added tax should be laid down for imported goods to the extent necessary, to comply with the objectives of tax harmonisation. The exemptions on importation can be granted only on condition that they are not liable to affect the conditions of competition on the market."

50. Recital 5 does not state that member states may make arrangements for or lay down conditions to minimise distortions in competition, as in Article 14.2 of the sixth directive.

51. The legislative technique in the 2009 Directive was to lay down mandatory rules for exemption, see Article 1 already cited, and then to provide limited discretions to member states to limit or revoke them.

52. An example of a discretion to limit is contained in Article 42 which permits member states to impose a limit on the quantity or value of goods imported for charitable or philanthropic organisations "in order to remedy any abuse and to combat major distortions of competition".

53. Article 23 confers a discretion on member states unfettered by any express words. Mr Vaughan and Mr Grodzinski submit that the legislative history demonstrates a progressive narrowing of the general right of member states to enact national measures to prevent avoidance and abuse or the distortion of competition which are replaced by a detailed scheme laid down by the Union legislature. Member states only have a discretion to enact national measures for those purposes when expressly authorised to do so by the Union legislation.

54. I accept that submission. The wording of the operative provisions of the Union legislation leaves no room for any other interpretation. It is the detailed rules adopted by the Union legislature which now determine how and to what extent harmonisation, the minimisation of avoidance and abuse and of distortion of competition are to be achieved, not the separately determined legislative and administrative acts of the member states.

55. It follows that subject to Article 1, the extent to which the importation of goods of low value may give rise to avoidance or abuse or to distortion of the market is conclusively determined by Article 23. None of the following will do so: the blanket exemption of goods of a value not exceeding 10 euros, the blanket exemption of goods of a value not exceeding 22 euros, or of neither, if imported on mail order.

56. I do not accept the further submission made jointly by Mr Vaughan and Mr Grodzinski that member states can only invoke the mail order proviso if they have first confined the exemption to goods worth less than 10 euros. Member states may achieve the removal of the exemption by not allowing it for mail order goods between 10 and 22 euros and by removing the exemption for mail order goods below 10 euros.

57. Although Her Majesty's Treasury initially claimed to be entitled to rely on the power contained in Article 1 to fix conditions to prevent avoidance or abuses, Ms Whipple no longer does so, on instructions. She contends that it can nevertheless be relied on as an interpretive aid when considering the scope and nature of the proviso to Article 23.

58. Mr Vajda submits that Article 1 imposes a freestanding obligation on the United Kingdom to act to eliminate avoidance and abuse by the imposition of a condition which excludes goods imported from the Channel Islands from LVCR.

59. I will deal with Mr Vajda's submission first. I do not accept it. It requires a construction to be placed on the words of Article 1 which they do not bear. Member states are required to apply the exemptions laid down in the 2009 Directive; the words "shall apply" leave them no choice. They may impose conditions, but only for the purposes identified in Article 1; correct and simple application and to prevent evasion, avoidance or abuse. A "condition" which has the effect of disapplying the exemptions altogether would frustrate, not fulfil, the primary task of applying the exemptions.

60. Thus, if there are importations of small value items which are not on mail order, which may be open to doubt, a member state would not be entitled to revoke the exemption which requires that importation to be permitted under Article 23.

61. Mr Vajda submits that that is too literal an interpretation for a European Union instrument. I disagree. Only an approach to the construction of Article 23, of the kind identified by Lord Atkin in Liversidge v Anderson [1942] AC 206 at page 245, would permit it.

62. Ms Whipple's submission is more persuasive in principle; but because, for reasons which I will briefly explain, I am not satisfied that, round tripping apart, there is avoidance or abuse, it is of no assistance to her. What Channel Island traders are doing is no more and no less than exploiting a fiscal advantage established by clear words of general application in European Union legislation for their own profit. They have not, as in Direct Cosmetics Ltd and Laughtons Ltd v the Commission (Case C-138/86), conducted what is objectively a single economic activity in a manner which breaks it down artificially into a series of smaller transactions, so as to take illegitimate advantage of a fiscal opportunity. They are doing nothing beyond accepting orders from customers and supplying them, in the ordinary course of their trade. The fiscal advantage afforded by LVCR gives them an economic incentive to conduct that trade from the Channel Islands, but it is not abusive for them to do so; and, because VAT on importation is payable by the consignee, they, as opposed perhaps to their customers, have not avoided VAT by so doing.

63. It is settled law and common ground that fiscal neutrality, non-discrimination or equal treatment and proportionality are basic principles of European Union law. As to fiscal neutrality and equal treatment, see the observations of the court in Marks & Spencer Plc v Revenue and Customs Commissioners (Case C-309/06), paragraph 47:

> "The principle of fiscal neutrality ... in particular precludes treating similar goods which are thus in open competition with each other differently for VAT purposes."

64. And paragraph 51:

> "The general principle of equal treatment requires that similar situations are not treated differently, unless differentiation is objectively justified."

65. In relation to the tax treatment of goods and services, the decisive consideration is whether:

> "They have similar characteristics and meet the same needs from the point of view of consumers, the test being whether their use is comparable ..."

66. See Rank Group Plc v Revenue & Customs Commissioners, joined cases C-259/10 and C-260/10, paragraph 44.

67. 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. Indeed as Ms Whipple contends, the draft clause will tend to enhance, rather than to diminish, fiscal neutrality and equality of treatment.

68. 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 Article 95 of the Treaty of Rome or now 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." --

69. Now expanded, since at least the sixth Directive, to include all goods in free circulation within the European Union; in other words, those on which VAT, if payable, has already been paid on importation.

70. The principle is therefore limited. It is never applied and does not apply to the treatment of goods and services produced in non-member states, until they have entered into free circulation in the European Union, as two cases read together make clear.

71. In OTO SpA v Ministero delle Finanze (C-130/92), the difference in the tax treatment of goods entering Italy direct from a non-EU state and goods produced in Italy or in other member states, or which had entered into free circulation within the European

Union, was at issue. Directly imported goods enjoyed a modest and probably unintended fiscal advantage. OTO SpA complained that it offended against the principle of fiscal neutrality. The court ruled that it did not, for the reasons explained in paragraphs 16, 18 and 19 of its judgment:

> "16. According to a consistent line of cases, the aim of Article 95 of the Treaty is to ensure free movement of goods between the Member States in normal conditions of competition by the elimination of all forms of protection which result from the application of internal taxation which discriminates against products from other Member States. The Court has made it clear, as regards the free movement of goods within the Community, that products which are in free circulation are definitively and wholly assimilated to products originating in Member States. It follows that Article 95 covers all products from Member States, including products originating in non-member countries which are in free circulation in the Member States ...
>
> 18. The Court has also consistently held that Article 95 applies only to products from the Member States and, where appropriate, to goods originating in non-member countries which are in free circulation in the Member States. It follows that the provision is not applicable to products imported directly from non-member countries ...
>
> 19. Accordingly, a tax such as that which is the subject matter of the main proceedings does not come within the scope of Article 95 of the Treaty, insofar as it is applicable to goods imported directly from non-member countries."

72. Mr Grodzinski submits that OTO SpA is not in point, because it did not concern VAT; but it did concern a consumption, i.e. point of sale tax, and has at least persuasive force.

73. The second case is Offene Handelsgesellschaft in Firma Werner Faust v the Commission (Case 52/81) on the importation of preserved mushrooms from Taiwan. As a result of a specifically targeted Community measure, the importation of preserved mushrooms from Taiwan shrank drastically in 1979 and 1980; while those from the People's Republic of China remained at a high level. Faust complained that the measure discriminated against Taiwan and so infringed the principles of non-discrimination and equal treatment. The Advocate General, Sir Gordon Slynn, disagreed. He made the following submission:

> "In the ordinary way, the respective positions of importers who have dealings with third countries which accept a limitation on their exports and those who do not, are not the same or comparable. Any different treatment is objectively justifiable by reason of the threat to the market from third countries which have not agreed to limit their exports. Even where the failure to agree a limitation of exports is the result of arbitrary discrimination on the part of the Commission, it still does not constitute unlawful discrimination as between importers, because the Commission is

> under no legal duty to accord equal treatment to third countries. There are, of course, many cases where the court has held that the rules regarding equality of treatment also apply to covert or indirect discrimination. These have, in general, concerned acts whose effects are felt solely within the Community. The result of transposing these cases to the different situation of the Community's trade relations with third countries would be to bind the Community to give equal treatment to third countries as a general rule because the effects of any different treatment would, in the nature of things, be felt by some class of persons within the Community, whether importers, other operators or consumers, and could always be said on this hypothesis to constitute covert or indirect discrimination between them. None of the authorities cited supports the view that the mere effect on operators of treatment meted out to third countries which is different but not unlawful itself constitutes without more unlawful discrimination."

74. The court accepted the Advocate General's opinion in paragraph 25:

> "Although Taiwan certainly appears to have been treated by the Commission less favourably than certain non-member countries, it should be remembered that there exists in the Treaty no general provision obliging the Community, in its external relations, to accord to non-member countries equal treatment in all respects. It is thus not necessary to examine on what basis Faust might seek to rely upon the prohibition of discrimination between producers or consumers within the Community contained in Article 40 of the treaty. It need merely be observed that if different treatment of non-member countries is compatible with Community law, different treatment accorded to traders within the Community must also be regarded as compatible with Community law, where that different treatment is merely an automatic consequence of the different treatment accorded to non-member countries with which such traders have entered into commercial relations."

75. 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.

76. 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.

77. For those reasons, I propose to declare that the draft clause in the forthcoming Finance Bill is not unlawful under EU law.

78. I deal finally with two observations, the first of which was very much at the forefront of Mr Vaughan's oral submissions, and the second of the submissions of both Mr Vaughan and Mr Grodzinski: The British Government has changed its mind about the need to apply the proviso to mail order imports from the Channel Islands, even though the circumstances have not materially changed and are unlikely to do so; the judgment of the First Chamber in Har Vaessen Douane Service BV v Staatssecretaris van Financien (Case C-7/08) and the derogation granted to Denmark by the Council on 14 March 2005 demonstrate that selective disapplication would be viewed askance by EU authorities.

79. As to the first, it is clear that the Government has changed its mind. As a body responsible to an elected Parliament, it is entitled to do so, unless prohibited by EU law, which it is not.

80. Har Vaessen, on analysis, does not support either side's case. All that it decided was that the Netherlands were not entitled to deal with a claimed VAT abuse, bulk importation of separately addressed goods of small value sourced via a wholly owned subsidiary of a Dutch trading company in Switzerland, by disapplying a customs exemption in respect of the goods. It decided neither that there was an abuse of the VAT regime, nor that there was not. The Danish exemption, under Article 395 of the 2009 Directive, was necessary because Denmark only wanted to target consignments of specific types of goods, newspapers and magazines posted from the Aland Islands, not the generality of goods imported on mail order; see recital 4 to the decision. The choice of derogation as "the most appropriate solution" does not mean that if Denmark had wished to withdraw LVCR from all goods imported from the Aland Islands, it could not lawfully have done so.