Significant distortion of competition

Indirect Tax | Tax voice

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In the first of a two part article, Ian Harris provides a critical analysis of the *National Roads Authority* case

Introduction

Early in 2017, the CJEU handed down Judgment in *National Roads Authority v Revenue Commissioners* [*C-344/15*] on the significant distortion of competition condition in the second sub-paragraph of Article 13(1) of the EC Principal VAT Directive; this is the provision that lays down the conditions that must be met in order to treat the activities of public bodies as non-VATable (effectively, outside the

scope of VAT: not simply exempt).

In his Opinion, Advocate-General Szupnar had suggested there must be a presumption of distortion of competition wherever an activity is, or may be, undertaken by both public bodies and private operators.

This was an argument raised by HMRC but roundly rejected by both the High Court and the First-Tier Tribunal on remittal in the seminal case on significant distortion of competition, *Isle of Wight Council & others* [*C-288/07*] when this case returned to the UK Courts from the ECJ.

Unusually declining to follow the Advocate-General's Opinion, the CJEU has also rejected this presumption and broadly upheld the position established in *Isle of Wight Council* that it is for the tax authorities to demonstrate, on the basis of an economic evaluation, that a significant distortion of competition would result from treating the activities of a public body as VAT-free.

This is extremely good news for public bodies, though it leaves largely unresolved – in the UK at least – the question of how an aggrieved private operator may cite significant distortion of competition if it believes its activities to be in competition with the public sector. Currently it appears the only effective remedy is Judicial Review but this is a complex and costly remedy.

NRA: the background

The National Roads Authority (NRA) was established under the Roads Act 1993 as an independent public authority responsible for the construction and management of national roads in the Republic of Ireland. According to that legislation (Section 17(1)), the NRA's prime statutory duty is to secure the provision of a safe and efficient network of national roads throughout the country.

Under Sections 56 and 57, the NRA may make toll schemes on selected national roads and, under Section 61, is authorised to make bye-laws relating to those schemes. Under Section 59, the NRA may then collect such tolls as are specified in those bye-laws.

However, under Section 63, the NRA may, alternatively, enter into an agreement whereby the collection of tolls is entrusted to a private operator. Apart from the right to collect tolls, such agreements impose obligations on those private operators

regarding the construction and maintenance of the toll road and its ongoing management.

In fact, the majority of national toll roads in Ireland are managed by private operators on the basis of such agreements; just two, the Westlink Toll Road (part of the Dublin Ring Road) and the Dublin Tunnel (linking Dublin with the Port), are directly managed by the NRA with the NRA collecting the tolls.

Although both the NRA and private operators historically accounted for VAT on road tolls, the NRA sought repayment of that VAT from the Revenue Commissioners on the grounds that, as a body governed by public law, when it directly manages toll roads, the NRA is acting as a 'public authority' under Article 13(1) and not as a taxable person.

The Revenue Commissioners disagreed and the NRA appealed to the Appeal Commissioners who referred the matter to the CJEU, in essence asking whether the second sub-paragraph of Article 13(1) means that, where toll roads are operated by both the NRA as a public body and by private operators, the former must be treated as a taxable person due to the presumption that a significant distortion of competition would otherwise arise, even if there is no real possibility of direct competition between toll roads operated by the NRA and those managed by private operators.

Advocate-General Szupnar's Opinion

Having rehearsed familiar concepts pertinent to the 'significant distortion of competition test' in the second sub-paragraph of Article 13(1) – concepts to a large extent definitively established by the Court in *Isle of Wight Council* – the Advocate-General observed that the true intention of that test is to re-apply the general rule that all economic activities are subject to VAT where treating a public body as a non-taxable person would cause a significant distortion of competition.

The Advocate-General, therefore, concluded that the second sub-paragraph of Article 13(1) should be interpreted as establishing a presumption that distortions of competition will occur.

Specifically, Advocate-General Szupnar felt the Court's reasoning in *Isle of Wight Council* can only be interpreted as meaning that, where an activity is carried on by a public body under a special legal regime but at the same time is, or may be, carried

on by private operators under general legal conditions, it must be presumed there will be distortions of competition, irrespective of the actual situation on the particular market in question.

The Advocate-General, therefore, concluded that, whenever national law permits a public body to entrust the performance of an activity to private operators but at the same time to also engage in that activity itself, it must be presumed there will be distortions of competition if VAT is not levied by the public body but is due from the private operators.

Implications of the Advocate-General's Opinion

Had the Advocate-General's Opinion been followed by the Court it would have raised a fundamental point not already established by the case-law, the presumption of distortion of competition where an activity is, or may be, undertaken both by public bodies and by private operators.

Otherwise, Advocate-General Szupnar's Opinion offered nothing radically new but did pull together the themes that have emerged, especially since the decision in *Isle of Wight Council*. Indeed, the Advocate-General gave a reasoned view on the impact on competition of outsourcing, something considered inconclusively by the First-Tier Tribunal in *Isle of Wight Council* [*(2012) UKFTT648(TC)*].

The Court's Judgment

As it turned out, the Court chose not to follow Advocate-General Szupnar's Opinion, holding that:

> 'The second sub-paragraph of Article 13(1)… must be interpreted as meaning that… a body governed by public law which carries on an activity consisting in providing access to a road on payment of a toll may not be regarded as competing with private operators who collect tolls on other toll roads pursuant to an agreement with the public law body concerned under national statutory provisions.'

While confirming that the second sub-paragraph of Article 13(1) is intended to restore the general rule that any activity of an economic nature is subject to VAT and so must be interpreted widely, the Court reiterated that that does not mean the provision should be interpreted so as to deprive it of effectiveness as, arguably, a

presumption of distortion of competition would.

Rather, referring back to the seminal *Carpaneto* case (*Ufficio Distrettuale delle Imposte Dirette di Fiorenzuola d'Arda & others v Comune di Carpaneto Piacentino & others* [*joined cases C-231/87 and C-129/88*]), the CJEU observed that determining whether a distortion of competition would be caused necessarily involves an assessment of all the economic circumstances.

The CJEU, therefore, concluded that the second sub-paragraph of Article 13(1) pre-supposes, first, that the activity in question is carried on in competition, actual or potential, with private operators and, second, that the different treatment of those activities for VAT purposes leads to significant distortion of that competition, which though must be assessed having regard to all the economic circumstances.

Importantly, the Court held that the mere presence of private operators on a market, without account being taken of matters of fact, objective evidence or an analysis of the market, cannot demonstrate the existence of either actual or potential competition or of a significant distortion of that competition.