Michaelmas Term
[2019] UKSC 43
On appeal from: [2017] EWCA Civ 1584

JUDGMENT

Routier and another (Appellants) *v* Commissioners for Her Majesty's Revenue and Customs (Respondent)

before

Lady Hale, President
Lord Reed, Deputy President
Lord Carnwath
Lord Hodge
Lord Lloyd-Jones

JUDGMENT GIVEN ON

16 October 2019

Heard on 2 and 3 April 2019

Appellants
Alan Steinfeld QC
Marika Lemos
(Instructed by Irwin Mitchell LLP (Crawley))

Respondent
Kelyn Bacon QC
David Yates QC
(Instructed by HMRC Solicitor's Office (Bush House))

Intervener
(Robert James MacRae QC, Her Majesty's Attorney General for Jersey)
Conrad McDonnell
(Instructed by Law Officer's Department)

LORD REED AND LORD LLOYD-JONES: (with whom Lady Hale, Lord Carnwath and Lord Hodge agree)

1. The appellants in this case are the executors of Mrs Beryl Coulter, who died in Jersey on 9 October 2007, leaving her residuary estate on trust for purposes which are agreed to be exclusively charitable under English law. The appellants were appointed under Mrs Coulter's will as the trustees. They were domiciled in Jersey, and the proper law of the trust ("the Coulter Trust") was specified in the will as the law of Jersey. The estate included assets in the United Kingdom amounting to £1.7m.

2. At the time of Mrs Coulter's death, there was in force a treaty between the United Kingdom and Jersey which included provision for the exchange of information relating to income tax. In 2009 a further treaty (the United Kingdom/Jersey Tax Information Exchange Agreement) came into force, which included provision for the exchange of information relating to inheritance tax.

3. On 1 October 2010 the appellants retired as trustees (but not as executors) and were replaced by a UK resident trustee. On 12 October 2010 the will was amended so as to make the proper law of the trust the law of England and Wales. On 14 February 2014 the Coulter Trust was registered as a charity under the law of England and Wales.

4. Section 23 of the Inheritance Tax Act 1984 ("the Inheritance Tax Act") provides for an exemption from inheritance tax in respect of gifts to charities. On 29 May 2013 the respondents, Her Majesty's Revenue and Customs ("HMRC"), determined that Mrs Coulter's gift of her residuary estate to the Coulter Trust did not qualify for relief under section 23, as it had not been given to a charity within the meaning of that provision. That conclusion was based on the fact that the Coulter Trust was governed by the law of Jersey as at the date of Mrs Coulter's death, and on a construction of section 23 which limited relief to trusts governed by the law of a part of the United Kingdom. On the basis that Jersey was not a part of the United Kingdom for the purposes of section 23, it followed that relief was not available. The amount of inheritance tax due, if relief is not available, is about £567,000.

5. The appellants have appealed against that determination on the basis that it is incompatible with article 56 of the Treaty Establishing the European Community ("EC"), now article 63 of the Treaty on the Functioning of the European Union ("TFEU"). As we shall explain, that provision prohibits restrictions on the free movement of capital between EU member states, and between member states and

third countries. HMRC's primary response is that article 56 has no application to the facts of this case, on the basis that, although Jersey is not a part of the United Kingdom for the purposes of section 23, a movement of capital between the United Kingdom and Jersey should be regarded as an internal transaction taking place within a single member state. HMRC further argue that the restriction resulting from the adverse treatment of the Coulter Trust is in any event justifiable under EU law, in view of the fact that there was no mutual assistance agreement covering inheritance tax in force between the United Kingdom and Jersey at the date of Mrs Coulter's death.

6. The principal issues arising in the appeal are:

(1) whether Jersey forms part of the United Kingdom for the purposes of article 56 EC, and, if not,

(2) whether the refusal of relief under section 23 of the Inheritance Tax Act in respect of Mrs Coulter's gift of her residuary estate to the Coulter Trust is justifiable under EU law.

(1) The status of Jersey for the purpose of EU law relating to free movement of capital

7. Article 56 EC (now article 63 TFEU) provides:

> "(1) Within the framework of the provisions set out in this chapter, all restrictions on the movement of capital between member states and between member states and third countries shall be prohibited.
>
> *(2)* Within the framework of the provisions set out in this chapter, all restrictions on payments between member states and between member states and third countries shall be prohibited."

It is common ground between the parties that whereas article 56 applies in the United Kingdom, it does not apply in Jersey, in the sense that Jersey is not required to comply with the provisions of article 56. It is also common ground between the parties that article 56 applies to gifts to charities and that the limitation of tax relief on a gift to the Coulter Trust would, if article 56 were engaged, amount to a restriction on the free movement of capital. Since Jersey is not a member state, the

gift to the Coulter Trust was not a movement of capital between member states. The issue therefore turns on whether Jersey is to be regarded as a third country for the purposes of article 56.

The status of Jersey in domestic constitutional law

8. The relationship between the Channel Islands (which include the Bailiwick of Jersey) and the United Kingdom in domestic constitutional law was considered in some detail in the judgment of Lady Hale in *R (Barclay) v Lord Chancellor and Secretary of State for Justice (No 2) (Attorney General of Jersey intervening)* [2014] UKSC 54; [2015] AC 276, paras 6 to 18. The Channel Islands are not part of the United Kingdom and have never been British colonies or dependent territories. They are Crown Dependencies which enjoy a unique relationship with the United Kingdom and the Commonwealth through the Crown in the person of the Sovereign. The prerogative powers of the Crown as regards Jersey are exercised by Order in Council.

9. The Channel Islands were originally part of the Duchy of Normandy. At the Norman conquest of England in 1066, the Duke of Normandy became the King of England. When France took possession of continental Normandy in 1204, the Channel Islands retained their allegiance to the King of England. By the Treaty of Paris, 1259 France relinquished any claim to the Channel Islands. The Treaty of Calais, 1360 confirmed that the King of England shall have and hold all the islands which he "now holds" (*Minquiers and Ecrehos* case *(France v United Kingdom)*, ICJ Reports 1953, pp 47, 54). The relationship between the Channel Islands and the Crown has continued to observe the distinct laws and ancient customs of the Channel Islands which are rooted in Norman customary law. Successive sovereigns have confirmed by Royal Charter privileges and liberties to Jersey including an independent judicature. Jersey also has its own legislature.

10. Jersey is not an independent state in international law. The United Kingdom Government is responsible for the international relations and the defence of the Channel Islands. Under international law the United Kingdom Government has the power to extend to the Channel Islands the operation of a treaty which the United Kingdom has concluded.

The scope of application of EU law

11. Article 29 of the Vienna Convention on the Law of Treaties, 23 May 1969, provides that unless a different intention appears from a treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory.

Article 299(1) EC (now article 355 TFEU) makes specific provision for the territorial scope of EU law. It provides that the EC Treaty applies to the EU member states including the United Kingdom of Great Britain and Northern Ireland. The remainder of article 299 then makes special provision for the extent to which EU law applies to a number of countries and territories which have links with EU member states.

12. Article 299(3) provides:

> "The special arrangements for association set out in Part Four of this Treaty shall apply to the overseas countries and territories listed in Annex II to this Treaty.
>
> This Treaty shall not apply to those overseas countries and territories having special relations with the United Kingdom of Great Britain and Northern Ireland which are not included in the aforementioned list."

Annex II currently lists 21 territories as overseas countries and territories ("OCTs"). The list does not include the Channel Islands or the Isle of Man. Article 299(4) provides:

> "The provisions of this Treaty shall apply to the European territories for whose external relations a member state is responsible."

13. Article 299(6) makes express provision for the Channel Islands and the Isle of Man.

> "Notwithstanding the preceding paragraphs:
>
> …
>
> (c) this Treaty 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."

14. Further provision is made in additional treaties, such as the various treaties of accession, to give effect to article 299 in each specific case. In the case of the Channel Islands, Protocol 3 to the Treaty of Accession, 22 January 1972 sets out the "arrangements for those islands". Article 1(1) provides:

> "The Community rules on customs matters and quantitative restrictions, in particular those of the Act of Accession, shall apply to the Channel Islands and the Isle of Man under the same conditions as they apply to the United Kingdom. In particular, customs duties and charges having equivalent effect between those territories and the Community, as originally constituted and between those territories and the new member states, shall be progressively reduced in accordance with the timetable laid down in articles 32 and 36 of the Act of Accession. The Common Customs Tariff and the ECSC unified tariff shall be progressively applied in accordance with the timetable laid down in articles 39 and 59 of the Act of Accession, and account being taken of articles 109, 110 and 119 of that Act."

The reference to "quantitative restrictions" is to restrictions on the free movement of goods. Article 1(2) makes specific provision in respect of agricultural products and products processed therefrom. Article 3 applies the provisions of the Euratom Treaty to the Channel Islands. The effect of article 6 is that EU rules on free movement of persons within the EU do not apply to Channel Islanders unless they have at any time been ordinarily resident in the United Kingdom for five years or have a British parent or grandparent.

15. The combined effect of article 299(6) EC and Protocol 3 to the Act of Accession is that the rules of EU law relating to the common customs area, including the free movement of goods, apply in Jersey (*Jersey Produce Marketing Organisation Ltd v States of Jersey* (Case C-293/02) [2006] 1 CMLR 29 ("*Jersey Produce*")). However, save to the extent stated in Protocol 3, other rules of EU law do not apply in Jersey. In particular, EU rules on free movement of capital do not apply in Jersey. (The current EU provisions on the free movement of capital (ie article 56 EC, now article 63 TFEU) were only introduced in the Maastricht Treaty which entered into force in 1994.)

The submissions of the parties

16. Article 56 EC will be engaged if the movement of capital between the United Kingdom and Jersey is a movement of capital between member states or between a member state and a third country. On behalf of the appellants, Mr Alan Steinfeld QC submits that it is a movement of capital between a member state and a third country on the basis that Jersey is to be regarded as a third country for the purposes of article 56. That submission was accepted by the Court of Appeal (Lord Briggs, Arden LJ and Green J) in the present case ([2017] EWCA Civ 1584; [2018] 1 WLR 3013).

17. HMRC submit that this is incorrect and that a movement of capital between the United Kingdom and Jersey should be regarded as a transaction internal to a single member state, the United Kingdom. Ms Kelyn Bacon QC, on behalf of HMRC, submits that since Jersey is not a state with its own legal personality, it cannot formally have the status of a third country. It is, instead, a European territory for which the United Kingdom is responsible. While the EU has treated Jersey as having third country status for some specific purposes (see, for example, Decision 2008/393/EU on the adequate protection of personal data in Jersey [2008] OJ L 138/21, recital (5)), there is no categorical answer to the question whether it should be classified as a member state or a third country. Rather, the answer varies on a case-by-case basis according to the relevant legal framework and taking account of the objectives pursued by the Treaty arrangements for the territory in question. She submits that the question that has not yet been answered by the Court of Justice of the European Union ("CJEU") is whether, in respect of a European territory such as Jersey in which the Treaty provisions on the free movement of capital do not apply, a flow of capital between that territory and its own associated member state should also be regarded as a transaction between a member state and a third country, in other words whether it can be considered a third country as against its own member state. She submits that the fact that Jersey is a European territory for whose external relations the United Kingdom is responsible indicates that a movement of capital between the United Kingdom and Jersey should be regarded as an internal transaction taking place within a single member state, in the same way that a movement of capital between London and Edinburgh would be an internal transaction. She accepts, however, that the resolution of this issue is not *acte clair* and accordingly submits that if it is necessary for this court to decide this issue it should make a preliminary reference to the CJEU.

18. Her Majesty's Attorney General for Jersey ("the Attorney General") has intervened in the proceedings. On his behalf, Mr Conrad McDonnell submits that the effect of article 299 is that Jersey is a part of the EU for the purposes only of those provisions of EU law which are expressly specified as having effect there, with the result that it must be treated for such purposes as a part of a member state, namely the United Kingdom. He submits, however, that Jersey is not part of the EU

for the purposes of those provisions of EU law which, by virtue of article 299, do not have effect there and that, as it is not otherwise part of a member state, it must in this context be considered a third country. Mr McDonnell accepts that article 299 does not expressly state that where and to the extent that provisions of the EC Treaty apply to an overseas territory (article 299(3)) or to a European territory (article 299(4)-(6)) that territory is to be treated as part of one of the member states for such purposes. However, he submits that it is only in this way that article 299 can be effective since the relevant substantive provisions of EU law make provision only for the rights of citizens of one of the member states, or for transactions between two member states, or transactions between a member state and a third country. He submits, furthermore, that this is borne out by the logic of the decisions of the CJEU on the territorial scope of the EC Treaty.

The jurisprudence of the CJEU

19. It is necessary to consider in some detail the relevant decisions of the Court of Justice on the territorial scope of the EC Treaty. On close examination they can be seen to reveal a clear and consistent approach. In particular, the question whether a territory is to be regarded as a third country is context specific and will depend on whether, under the relevant Treaty of Accession and supplementary measures, the relevant provisions of EU law apply to that territory.

20. *Van Der Kooy v Staaatssecretaris van Financien* (Case C-181/97) [1999] ECR I-483 concerned the entry into the Netherlands of the motor vessel "Joshua" from the Netherlands Antilles. At the relevant date article 227 of the EC Treaty (the predecessor of article 299 EC, considered above) defined the area of application of the Treaty by a list of member states which included the Kingdom of the Netherlands. The Netherlands Antilles form part of the Netherlands but, by way of derogation from article 227, had been added to the list of OCTs referred to in article 227(3), to which the general provisions of the Treaty did not apply. The national proceedings raised the question whether the entry of the vessel into the Netherlands was an intra-Community transaction in which case it would not have been subject to Value Added Tax under the Sixth Directive. Advocate General Ruiz-Jarabo Colomer considered that the Sixth Directive did not allow the entry of goods from an OCT to be classified as an intra-Community transaction. It was to be treated as an import. In his view:

> "Those countries and territories, which fall neither within the Community customs area nor within the scope of the Treaty - subject to the provisions applicable under the special Association rules in article 226(3) - do not constitute 'the territory of a member state' for the purposes of applying VAT.

> That conclusion, moreover, is consistent with the scheme of the Sixth Directive: if even certain national territories to which the Treaty is, in principle, applicable, are regarded for VAT purposes as 'third territories', *a fortiori* the same view must be taken of the OCT, whose links with the Treaty, as such, are less strong than those of the third territories." (at paras 36, 37)

The Court of Justice agreed. Under the special arrangements applicable to the OCTs, including the Netherlands Antilles, in the absence of express reference the general provisions of the Treaty did not apply to the OCTs.

> "Consequently, the entry into a member state of goods coming from the Netherlands Antilles cannot be categorised as an intra-Community transaction for the purposes of the Sixth Directive, unless a special provision so prescribes." (para 38)

21. A similar conclusion was drawn in *Commission of the European Communities v United Kingdom* (Case C-30/01) [2003] ECR I-9481. Under article 299(4) EC, the Treaty applies to Gibraltar as it is a Crown Colony for whose external relations the United Kingdom is responsible. However, the UK Act of Accession provided that certain Treaty provisions did not apply in Gibraltar. In particular, Gibraltar was excluded from the customs territory of the Community. In this case, brought by the Commission supported by Spain, the United Kingdom established that the exclusion of Gibraltar from the customs territory of the Community necessarily implied that neither the Treaty rules on free movement of goods nor the rules of secondary Community legislation intended, as regards the free circulation of goods, to ensure approximation of the laws of the member states, were applicable in Gibraltar. As a result, therefore, the status of Gibraltar is, in a sense, the converse of that of the Channel Islands. Whereas EU law generally applies in Gibraltar, EU law on free movement of goods does not. For the purposes of the present appeal, the observation of Advocate General Tizzano (at para 62) that "Gibraltar must be considered as a third country for the purposes of the Community provisions on movement of goods" is worthy of note.

22. By contrast, in the *Jersey Produce* case the CJEU held that Jersey was to be treated as if it were a part of the United Kingdom for the purposes of the application of specific Treaty provisions concerning the free movement of goods. Proceedings before the Royal Court of Jersey concerned the compatibility with Community law of the Jersey Potato Export Marketing Scheme Act 2001. The Royal Court made a preliminary reference to the Court of Justice which addressed the question whether the territory of the United Kingdom, the Channel Islands and the Isle of Man can be treated as the territory of a single member state for the purposes of the application

of Community rules on free movement of goods. The reasoning of the Court of Justice was as follows:

> "45. It is appropriate, first of all, to recall that the court has previously stated that, just as the distinction between Channel Islanders and other citizens of the United Kingdom cannot be likened to the difference in nationality between the nationals of two member states, neither, because of other aspects of the status of those Islands, can relations between the Channel Islands and the United Kingdom be regarded as similar to those between two member states (*Pereira Roque*, cited above, at paras 41 and 42).
>
> 46. It must be observed, next, that it is stated in article 1(1) of Protocol No 3 that the Community rules on customs matters and quantitative restrictions are to apply to the Channel Islands and the Isle of Man 'under the same conditions as they apply to the United Kingdom'.
>
> 47. Such wording suggests that, for the purposes of the application of those Community rules, the United Kingdom and the Islands are, as a rule, to be regarded as a single member state.
>
> 48. The same is true of the statement in the first subparagraph of article 1(2) of Protocol No 3, which refers to the levies and other import measures laid down in Community rules 'and applicable by the United Kingdom'."

The court then noted that such a construction of article 1 of Protocol 3 had also been applied by the Community legislature, before concluding:

> "54. It is clear from all the preceding points that, for the purposes of the application of articles 23 EC, 25 EC, 28 EC and 29 EC, the Channel Islands, the Isle of Man and the United Kingdom must be treated as one member state."

23. The passage at para 45 echoes the conclusion of the Court of Justice in *Pereira Roque v Lieutenant Governor of Jersey* (Case C-171/96) EU:C:1998:368; [1998] 3 CMLR 143, paras 42-43, a case on free movement of persons. In that case the court held that article 4 of Protocol 3 to the Act of Accession did not prohibit a

difference of treatment resulting from the fact that a national of another member state could be deported from Jersey under national legislation, notwithstanding that nationals of the United Kingdom were not liable to deportation. It was in that context that the court held that, as Channel Islanders were British nationals, the distinction between them and other citizens of the United Kingdom could not be likened to the difference in nationality between the nationals of two member states.

24. In *Prunus SARL v Directeur des services fiscaux* (Case C-384/09) [2011] I-ECR 3319; [2011] STC 1392 the Court of Justice considered the status of the British Virgin Islands ("the BVI") for the purposes of free movement of capital under article 56 EC (now article 63 TFEU). The BVI are one of the OCTs for which provision is made in article 299(3) EC. In a passage to which HMRC draw particular attention, Advocate General Cruz Villalon observed (at para 39):

> "All of the foregoing confirms that there is no categorical answer to the question whether an OCT should be categorised as a member state or a third country, and instead the answer varies on a case-by-case basis according to the relevant legal framework and taking into careful consideration the objectives pursued by the special arrangements for association laid down in Part Four of the TFEU."

However, the Advocate General also drew attention (at para 66) to the lacuna which would result should free movement of capital not apply to the OCTs.

> "… [T]he free movement of capital laid down in article 63 TFEU must apply to OCTs, since otherwise there would be a paradox in that a freedom granted to third countries would be denied to territories with which the Union has special relations."

25. The Court of Justice in *Prunus* noted (at para 20) that in view of the unlimited territorial scope of article 56 EC, it must be regarded as necessarily applying to movements of capital to and from OCTs. However, it considered that OCTs were to be treated as non-member states for the purposes of free movement of capital.

> "28. It is necessary to determine, first, whether, for the purposes of the application of the Treaty provisions on free movement of capital, OCTs are to be treated as member states or non-member states.

> 29. The court has already held that the OCTs are subject to the special association arrangements set out in Part Four of the Treaty, with the result that, failing express reference, the general provisions of the Treaty, whose territorial scope is in principle confined to the member states, do not apply to them … OCTs therefore benefit from the provisions of European Union law in a similar manner to the member states only when European Union law expressly provides that OCTs and member states are to be treated in such a manner.
>
> 30. It should be noted that the EU and FEU Treaties do not contain any express reference to movements of capital between member states and OCTs.
>
> 31. It follows that OCTs benefit from the liberalisation of the movement of capital provided for in article 63 TFEU in their capacity as non-member states."

26. Joined Cases C-24/12 and C-27/12 *X BV v Staatssecretaris van Financiën* [2014] STC 2394 concerned dividends paid by companies incorporated in the Netherlands to companies incorporated in the Netherlands Antilles which had been subjected to a dividend tax in the Netherlands. The Netherlands court requested a preliminary ruling on whether the EU rules on free movement of capital were to be interpreted as precluding a measure of a member state which was likely to hinder movements of capital between that member state and its own overseas countries and territories. Council Decision 2001/822 EC on the association of the overseas countries and territories with the European Community ("the OCT Decision"), which came into effect in its current form in 2001, made specific provision for free movement of capital between member states and OCTs. (The OCT Decision was not applicable in *Prunus* because the transaction in that case had occurred in 1998.) Article 47 stated that restrictions on payment and on movements of capital were prohibited between the EU and OCTs. Article 55(2) of the OCT Decision provided that nothing in the OCT Decision was to be construed to prevent the adoption or enforcement of any measure aimed at preventing the avoidance of taxes pursuant to the tax provisions of domestic fiscal legislation. In the course of his opinion, Advocate General Jaaskinen observed (at para 48):

> "Thus, movements of capital between the Netherlands and the Netherlands Antilles, in other words two territories having a different status with regard to the applicability of EU law, do not represent a purely internal situation. Therefore, article 56(1) EC is applicable and the Netherlands Antilles has to be

> considered as being in the same position in relation to the Netherlands as third countries."

The Court of Justice held (at paras 52-54) that the tax measure fell within article 55(2) of the OCT Decision and, as a result, there was no need to examine to what extent the rules of EU law applicable to the relations between the EU and OCTs apply between a member state and its own OCT.

27. *R (The Gibraltar Betting and Gaming Association Ltd) v Revenue and Customs Comrs (Government of Gibraltar intervening)* (Case C-591/15) EC:EU:C:2017:449; [2017] 4 WLR 167; [2017] STC 1300 concerned a new tax regime which required gambling service providers to pay gaming duty in respect of services provided to "UK persons" regardless of whether the gambling service provider was located in the United Kingdom or in another country. The claimant association, whose members were primarily Gibraltar-based gambling operators, brought proceedings for judicial review in the High Court of Justice maintaining that these were extra-territorial taxes which constituted an obstacle to freedom to provide services and which discriminated against service providers situated outside the United Kingdom and accordingly were incompatible with article 56 TFEU on freedom to provide services. The High Court made a preliminary reference to the CJEU. That court considered that the first question referred asked essentially whether article 355(3) TFEU (formerly article 299(4) EC) is to be interpreted as meaning that the provision of services by operators established in Gibraltar to persons established in the United Kingdom constitutes, under EU law, a situation confined in all respects within a single member state.

28. As we have seen, Gibraltar is the converse of Jersey in that, whereas only Community rules on free movement of goods apply in Jersey, Community rules with the exception of rules on free movement of goods apply in Gibraltar. In *Gibraltar Betting* Advocate General Szpunar concluded that the United Kingdom and Gibraltar are to be considered as a single member state for the purposes of the application of the Treaty rules on freedom to provide services. In his opinion he carried out a survey of the earlier authorities. He explained (at paras 43-45) the observation of Advocate General Jacobs in *Department of Health and Social Security v Barr and Montrose Holdings* (Case C-355/89) [1991] ECR I-3479 that the movement of workers between the United Kingdom and the Isle of Man was not "wholly internal to a member state", on the ground that article 2 of Protocol 3 to the Act of Accession provided that Community rules on free movement of workers do not apply to the Isle of Man. It was therefore logical that, for the purposes of those rules, the situation between the United Kingdom and the Isle of Man was not a purely internal one. He referred with approval (at para 35) to the conclusion of Advocate General Tizzano in *Commission v United Kingdom* that "Gibraltar must be considered as a third country for the purposes of the Community provisions on movement of goods". With regard to *Jersey Produce* he contrasted the situations of

Gibraltar and Jersey and observed that in the case of Jersey article 355(5)(c) TFEU (formerly article 299(6)(c) EC) constituted a lex specialis in relation to article 355(3) TFEU (formerly article 299(4) EC). He then continued (at para 48):

> "… As a result of that specialised provision, the Treaty rules do not apply fully but apply only in part to Jersey, within the limits laid down by the specific regime created for it. In this respect, the general legal situation regarding Jersey is identical to that of the Isle of Man.
>
> 49. Now, and this is the crux of the matter: *Jersey Produce Marketing Organisation* was about the Treaty provisions on the free movement of goods. Contrary to the situation in *Barr and Montrose Holdings*, no rules of the specific regime applied to the Channel Islands. Consequently the court held that 'for the purpose of the application of [articles 28, 30, 34 and 35 TFEU,] the Channel Islands, the Isle of Man and the United Kingdom must be treated as one member state'.
>
> 50. Nothing else can or should, in my view, be said of the situation of the UK and Gibraltar when it comes to the freedom of provision of services under article 56 TFEU."

29. The Grand Chamber of the Court of Justice agreed with the conclusion of Advocate General Szpunar. It held that the provision of services by operators established in Gibraltar to persons established in the United Kingdom constitutes, as a matter of EU law, a situation confined in all respects within a single member state. Its reasoning appears at paras 35-43 which need to be set out in full.

> "35. It is true that the court has previously held, as observed by all the interested parties, that Gibraltar does not form part of the United Kingdom (see, to that effect, judgment of 23 September 2003, *Commission v United Kingdom* (Case C-30/01) [EU:C:2003:489], para 47, and 12 September 2006, *Spain v United Kingdom* [(Case C-145/04) EU:C:2006:543], para 15).
>
> 36. That fact is not, however, decisive in determining whether two territories must, for the purposes of the applicability of the provisions on the four freedoms, be treated as a single member state. Indeed, the court has previously held,

in para 54 of the judgment of 8 November 2005, *Jersey Produce Marketing Organisation* …, that, for the purposes of the application of articles 23, 25, 28 and 29 EC, the Channel Islands, of which the Bailiwick of Jersey forms part, the Isle of Man and the United Kingdom must be treated as a single member state, notwithstanding the fact that those islands do not form part of the United Kingdom.

37. In reaching that conclusion, the court, after observing that the United Kingdom is responsible for the Bailiwick of Jersey's external relations, relied in particular on the fact that, according to article 1(1) of Protocol No 3 on the Channel Islands and the Isle of Man annexed to the 1972 Act of Accession, EU rules on customs matters and quantitative restrictions are to apply to the Channel Islands and to the Isle of Man 'under the same conditions as they apply to the United Kingdom', and on the fact that no aspect of the status of those islands suggests that relations between the islands and the United Kingdom are akin to those between member states (see, in that regard, judgment of 8 November 2005, *Jersey Produce Marketing Organisation*, …, paras 43, 45 and 46).

38. As regards, in the first place, the conditions under which article 56 TFEU is to apply to Gibraltar, it is true that article 355(3) TFEU does not state that article 56 is to apply to Gibraltar 'under the same conditions as they apply to the United Kingdom'.

39. That said, it should be recalled that article 355(3) TFEU extends the applicability of the provisions of EU law to the territory of Gibraltar, subject to the exclusions expressly provided for in the 1972 Act of Accession, which do not, however, cover freedom to provide services.

40. Furthermore, the fact, relied on by the Government of Gibraltar, that article 56 TFEU is applicable to Gibraltar, by virtue of article 355(3) TFEU, and to the United Kingdom, by virtue of article 52(1) TEU, is irrelevant in that regard. In an analogous context, the fact that EU rules on customs matters and quantitative restrictions apply to the Channel Islands and to the Isle of Man, pursuant to article 1(1) of Protocol No 3 annexed to the 1972 Act of Accession, and to the United Kingdom, pursuant to article 52(1) TEU, has not prevented the

court from concluding that, for the purposes of the application of those rules, those islands and the United Kingdom are to be treated as a single member state (judgment of 8 November 2005, *Jersey Produce Marketing Organisation* …, para 54).

41. In the second place, there is no other factor that could justify the conclusion that relations between Gibraltar and the United Kingdom may be regarded, for the purposes of article 56 TFEU, as akin to those existing between two member states.

42. To treat trade between Gibraltar and the United Kingdom in the same way as trade between member states would be tantamount to denying the connection, recognised in article 355(3) TFEU, between that territory and that member state. It is common ground in that regard that it is the United Kingdom that has assumed obligations towards the other member states under the Treaties so far as the application and transposition of EU law in the territory of Gibraltar is concerned (see, in that regard, judgments of 23 September 2003, *Commission v United Kingdom* (Case C-30/01) EU:C:2003:489, paras 1 and 47, and 21 July 2005, *Commission v United Kingdom* (Case C-349/03) EU:C:2005:488, para 56), as the Advocate General observed in point 37 of his Opinion.

43. It follows that the provision of services by operators established in Gibraltar to persons established in the United Kingdom constitutes, under EU law, a situation confined in all respects within a single member state."

The position of the European Commission

30. On behalf of the Attorney General, Mr McDonnell also draws our attention to the current practice of the European Commission which, he submits, demonstrates that the Commission treats Jersey as a "third country" for all purposes other than those connected with the Common Customs Area. He refers to three examples.

(1) EU Directive 95/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data provides in article 25 that restrictions apply to the transfer of personal data out of the EU to third countries, unless those third countries are found by the Commission to have adequate data protection standards. Commission

Decision 2008/393/EC of 8 May 2008 provides that Jersey meets these standards. Paragraph 5 of the Preamble states:

> "The Bailiwick of Jersey is one of the dependencies of the British Crown (being neither part of the United Kingdom nor a colony) that enjoys full independence, except for international relations and defence which are the responsibility of the United Kingdom Government. The Bailiwick of Jersey is therefore to be considered as a third country within the meaning of Directive 95/46/EC."

(2) Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms provides for Commission Decisions on equivalence of supervisory and regulatory regimes in third countries. Commission Implementing Decision 2014/908/EU includes Jersey in the list of "equivalent third countries and territories" in Annexes I, IV and V.

(3) The Alternative Investment Fund Managers Directive ("AIFMD"), Directive 2011/61/EU, regulates the management of unlisted investment funds, including hedge funds. Managers established outside the EU are permitted to do business in the EU only if their jurisdictions are approved as having similar regulatory standards. In July 2016 the European Securities and Markets Authority (ESMA) advised the European Parliament that Jersey was one of 12 "non-EU countries" which should be granted such approval (ESMA/2016/1138 and 1140).

Discussion

31. On behalf of HMRC Ms Bacon submits that the only case concerning free movement of capital in which the present issue was directly raised before the CJEU was *X BV*, because it concerned relations between a member state and a territory linked with that same member state, namely the Netherlands and the Netherlands Antilles. In that case, however, the court declined to answer this particular question by deciding the case on the basis of the OCT Decision. She nevertheless draws attention to the fact that before the Netherlands Supreme Court (Hoge Raad) made the reference to the CJEU, the Netherlands Court of Appeal had concluded that the movement of capital from the Netherlands to the Netherlands Antilles was an internal matter governed by domestic law, on the ground that the Netherlands and the Netherlands Antilles were part of the same international legal entity. (See the judgment of the CJEU at para 32.) Furthermore, in the Netherlands Supreme Court

Advocate General Wattel had come to the same conclusion in his opinion (Case No 11/00483, conclusions of AG Wattel dated 23 December 2011).

32. As HMRC rightly accept, only limited weight can be put on the decision of the Netherlands Court of Appeal and the opinion of Advocate General Wattel in the national proceedings in *X BV*. In the event, it was not necessary for the CJEU to decide the point and the actual decision has no direct application to Jersey as Jersey is not an OCT. On the other hand, however, it seems to us that the clear explanation by Advocate General Jaaskinen (cited above at para 25) to the effect that movement of capital between the Netherlands and the Netherlands Antilles, two territories having a different status with regard to the applicability of EU law, is not a purely internal situation and that the Netherlands Antilles is to be considered as being in the same position in relation to the Netherlands as third countries, is entitled to considerable weight.

33. It is, nevertheless, a central plank of HMRC's case on this issue that a transaction between a member state and its own associated territory cannot be regarded as a transaction between a member state and a third country. HMRC accept that a movement of capital from another member state to Jersey would be a transfer to a third country within article 56, but maintain that a transfer from a member state to its own associated territory should be regarded as a purely internal situation as in *Jersey Produce* and *Gibraltar v Commission*. Here Ms Bacon draws particular attention to the close economic links between the United Kingdom and Jersey, one of the matters referred to by Advocate General Leger in *Jersey Produce* (at para 34, footnote 27), as accounting for the specific regime reserved to the Channel Islands and the Isle of Man. She observes that, although Jersey is not in a formal currency union with the United Kingdom, there is *de facto* monetary union between the United Kingdom and Jersey. Jersey has a currency board arrangement with sterling. As part of the background, reference is also made to the fact that the Organisation for Economic Co-operation and Development ("OECD") Convention was extended to Jersey by the United Kingdom on 20 July 1990 and that the OECD Codes of Liberalisation of Capital Movements and Current Invisible Operations apply to Jersey. Similarly, the Multilateral Convention on Mutual Administrative Assistance in Tax Matters of the OECD and the Council of Europe, signed in Strasbourg on 25 January 1988, entered into force in respect of Jersey on 1 June 2014.

34. In this regard, HMRC also rely on the reasoning of the CJEU in *Jersey Produce* cited at para 7 above. HMRC submit that the Court of Justice there advanced two reasons for its conclusion. One was the wording of article 1 of Protocol No 3 to the Treaty of Accession, referred to in paras 46 and 47. The other was the more general point, stated at para 45, that relations between the Channel Islands and the United Kingdom cannot be regarded as similar to those between two member states. Both of these reasons, it is submitted, are then picked up at para 54 as leading to the conclusion that the Channel Islands and the United Kingdom must

be treated for this purpose as one member state. Ms Bacon submits that para 45 in itself would be sufficient to support the conclusion and draws attention to the fact that the Court of Justice in *Gibraltar Betting* at para 37 referred to both aspects of *Jersey Produce*. We are unable to accept this submission. In our view, the Court of Justice at para 45 is simply setting the context within which the Treaty provisions operate and this general statement lacks the degree of specificity which would be required to provide an independent basis of decision. The decision is clearly founded on the notion that Community rules on free movement of goods apply to Jersey with the result that it is, for that purpose, to be treated as part of the United Kingdom.

35. The decisions of the Court of Justice in this area provide a systematic and consistent approach to resolving issues such as the present. The question whether a territory is to be regarded as a third country is context specific and will depend on whether, under the relevant Treaty of Accession and supplementary measures, the relevant provisions of EU law apply to that territory. The proximity of the ties between a member state and the territory in question is not a factor justifying departure from that scheme. Thus, the reasoning of the Court of Justice in *Van der Kooy* and in *Commission v United Kingdom* is consistent with and supportive of the Attorney General's submission. Similarly, the observation of Advocate General Jaaskinen in *X BV* (at para 48) that the Netherlands Antilles should be treated as a third country is entirely in accord with this approach. In each case, the transaction was not regarded as internal to the member state concerned because the relevant rule of EU law did not apply in the associated territory. That was the case notwithstanding the fact that the territory was associated with the member state in question. Conversely, in *Jersey Produce* the Community rules on free movement of goods applied in Jersey with the result that it was, for that purpose, to be treated as part of the United Kingdom. In the same way, in *Gibraltar Betting* Community rules on free movement of services applied both in the United Kingdom and to Gibraltar with the result that the provision of services by operators established in Gibraltar to persons established in the United Kingdom was a situation confined within a single member state. As Mr McDonnell put it in his submissions on behalf of the Attorney General, the CJEU has determined that for the purposes of the Treaty provisions which apply in those territories, they should be treated as part of the European Union, but for the purposes of the Treaty provisions which do not apply in those territories, they should be treated as "third countries".

36. In our view the decision of the Court of Justice in *Prunus* is determinative of the present issue before this court. In that case, which pre-dated the OCT Decision which made specific provision for free movement of capital between member states and OCTs, the Court of Justice held that for the purposes of the free movement of capital the BVI were to be treated as non-member states. (Here, the court clearly regarded the terms "non-member states" and "third countries" as synonymous. It explained at para 20 of its judgment that article 56 EC, which prohibits "all restrictions on the movement of capital between member states and between member

states and third countries", has unlimited territorial scope and must be regarded as necessarily applying to movements of capital to and from OCTs.) For the reasons stated above, that decision is not distinguishable on the ground that the BVI are not associated with France. In this way, as Advocate General Villalon observed in respect of OCTs in *Prunus* at para 39, the answer varies on a case-by-case basis according to the relevant legal framework and taking into consideration the objectives pursued by the special arrangements for association.

37. In the present case it is clear that, as the EU rules on free movement of capital do not apply in Jersey, Jersey is to be considered a third country for the purpose of a transfer of capital from the United Kingdom. Capital has moved from a member state where article 56 applies to a territory where it does not and that cannot be considered a purely internal situation. Accordingly, we would decline to make a preliminary reference on this point to the CJEU.

(2) Whether the refusal of relief is justifiable under EU law

38. Since EU rules on the free movement of capital apply to transfers of capital between the United Kingdom and Jersey, and it is accepted, as explained at para 6 above, that the refusal of relief under section 23 of the Inheritance Tax Act to the Coulter Trust constitutes a restriction on such free movement, the remaining question is whether the restriction is justifiable under EU law.

39. The Court of Appeal concluded that it was, following two hearings before differently constituted panels. At the first hearing, before Moore-Bick, Tomlinson and Kitchin LJJ, the court considered the construction of section 23 as a matter of domestic law, leaving aside the effect of EU law, and concluded that in order to qualify for relief the trust under which property was held for charitable purposes must be governed by the law of some part of the United Kingdom and be subject to the jurisdiction of the courts of the United Kingdom: [2016] EWCA Civ 938; [2017] PTSR 73; [2016] STC 2218. In so holding, the court upheld the decision of Rose J: [2014] EWHC 3010 (Ch); [2015] STC 451.

40. It is necessary to explain the basis on which the Court of Appeal arrived at that interpretation of section 23. So far as material, section 23 is in the following terms:

> "(1) Transfers of value are exempt to the extent that the values transferred by them are attributable to property which is given to charities.

…

> (6) For the purposes of this section - (a) property is given to charities if it becomes the property of charities or is held on trust for charitable purposes only; … and 'donor' shall be construed accordingly."

Section 272 of the Inheritance Tax Act, as it stood at the relevant time, provided that:

> "'Charity' and 'charitable' have the same meanings as in the Income Tax Acts."

Section 989 of the Income Tax Act 2007 ("the Income Tax Act") defined "charity" for the purposes of the Income Tax Acts as follows:

> "'charity' means a body of persons or trust established for charitable purposes only."

41. Reading section 23(1) and (6) of the Inheritance Tax Act together with section 989 of the Income Tax Act, it follows that transfers of value are exempt to the extent that the values transferred by them are attributable to property which (a) becomes the property of a body of persons or trust established for charitable purposes only, or (b) is held on trust for charitable purposes only. Those alternatives have been described in these proceedings as the two limbs of section 23(6).

42. On the face of these provisions, the Coulter Trust would appear to qualify for relief. Its purposes are charitable purposes under English law. It is irrelevant under the legislation that those purposes are to be carried out outside the United Kingdom. There is nothing on the face of any of the provisions which confines the scope of the relief to trusts which are governed by the law of a part of the United Kingdom and are subject to the jurisdiction of courts in the United Kingdom.

43. However, in *Camille & Henry Dreyfus Foundation Inc v Inland Revenue Comrs* [1956] AC 39, a case decided long before the United Kingdom's entry into the EEC, it was held by the House of Lords that the phrase "trust established for charitable purposes only", in section 37 of the Income Tax Act 1918, must be interpreted as being implicitly limited to trusts which were governed by the law of some part of the United Kingdom and were subject to the jurisdiction of the courts of the United Kingdom.

44. Since the same phrase appears in the definition of "charity" in section 989 of the Income Tax Act, and section 272 of the Inheritance Tax Act requires "charity" and "charitable" to be given the same meaning in that Act as in the Income Tax Acts, the Court of Appeal concluded that the gloss placed in *Dreyfus* on the language now found in section 989 of the Income Tax Act was also incorporated, by means of section 272 of the Inheritance Tax Act, into section 23 of that Act. Accordingly, relief under section 23 was available only to trusts which were governed by the law of some part of the United Kingdom and were subject to the jurisdiction of the courts of the United Kingdom. The court rejected the appellants' argument that a distinction should be drawn in that regard between the first and second limbs of section 23(6). It followed that the Coulter Trust, being established under and governed by the law of Jersey, was not a charity within the meaning of section 989 of the Income Tax Act, and that Mrs Coulter's will did not effect a gift of property to a charity within the meaning of section 23(1) of the Inheritance Tax Act.

45. At the first hearing of the appeal, the Court of Appeal allowed the grounds of appeal to be amended so as to raise for the first time arguments based on EU law, which were then considered at a second hearing before Arden and Briggs LJJ and Green J. At that hearing, HMRC accepted that the domestic interpretation of section 23 arrived at following the first hearing, reflecting the construction placed on the definition of "charity" for income tax purposes in the *Dreyfus* case, violated the principle of freedom of movement of capital. However, they argued that the refusal of relief in the present case was nevertheless justified under EU law, since they had to be able to confirm that a claimant for relief under section 23 was carrying out charitable objects, and for that purpose had to be able to enforce the co-operation of official channels in the country where the claimant was based. They submitted that it was therefore necessary for there to be a mutual assistance agreement in force between the United Kingdom and the country in question. In the absence of such an agreement, the refusal of relief was justifiable under EU law. The absence of such an agreement between the United Kingdom and Jersey at the time of Mrs Coulter's death was, they submitted, conclusive in favour of their case on justification.

46. The Court of Appeal, in a judgment given by Arden LJ with which the other members of the court agreed, concluded that the availability of relief under section 23 of the Inheritance Tax Act could not, in conformity with EU law, be limited by the restriction imposed by the *Dreyfus* decision, but that it would be justified for section 23 to contain a right for HMRC to verify information about an overseas charity by means of a mutual assistance agreement: [2017] EWCA Civ 1584; [2018] 1 WLR 3013; [2018] STC 910, para 88. That meant, they said, that the appeal must fail, since there was no such agreement in force between the United Kingdom and Jersey at the time of Mrs Coulter's death.

47. In saying that, the court appears to have been anticipating its decision later in the judgment that, although section 23 contained no such right for HMRC to verify

information by means of a mutual assistance agreement, such a right could be read into section 23 as a matter of judicial interpretation. The court also reached its conclusion that the appeal must fail because of the absence of a mutual assistance agreement between the United Kingdom and Jersey at the time of Mrs Coulter's death notwithstanding its finding (para 84) that HMRC had no need of a mutual assistance agreement in the present case:

> "The position in this case is that the taxing authority does not need to verify any information. HMRC do not seek any information from the appellants. HMRC accept that the objects of the Coulter Trust are charitable for the purposes of UK law. They do not suggest that the position was any different at the date of Ms Coulter's death. Likewise, HMRC do not suggest that the terms of the Coulter Trust would not be enforced in Jersey if there was any failure to apply the assets of the Coulter Trust for charitable purposes or that the position was any different at the date of Ms Coulter's death."

48. Arden LJ had earlier noted (para 78) that a "potential difficulty for the court" was that there was no provision in section 23 of the Inheritance Tax Act requiring that a mutual assistance agreement must be in force. She observed that Parliament could, in conformity with article 56, limit the relief under section 23 to cases in which the charity was based in an EU country or in a third country which had such an agreement with the United Kingdom. It had not however done so.

49. Nevertheless, Arden LJ considered that such a requirement could be read into section 23 as a matter of interpretation, citing authority concerned with the application of section 3 of the Human Rights Act 1998. In her view, section 23 was to be interpreted as permitting relief to be given from inheritance tax:

> "where the relevant 'charity' both [satisfies] UK law requirements concerning a 'charity' and [is] based in (a) an EU country or (b) a third country which [has] an information exchange agreement with the UK."

By "satisfies UK law requirements" was meant "that the purposes of the charity are charitable according to UK law and that the charity is subject to the supervision of the courts in the country in which it is based".

Discussion

50. On its face, section 23 of the Inheritance Tax Act does not impose any restriction on the free movement of capital. In particular, it does not discriminate between gifts to charities governed by the law of the United Kingdom and gifts to charities governed by the law of other EU member states or third countries. It is, on its face, entirely compliant with article 56 EC. That is so even if section 272 of the Inheritance Tax Act and section 989 of the Income Tax Act are taken into account, since those provisions, on their face, are equally non-discriminatory.

51. The only relevant restriction which existed at any material time, and with which this appeal is concerned, is the restriction imposed by the judicial gloss which was placed on the words now found in section 989 of the Income Tax Act in the case of *Dreyfus*: a restriction which, when incorporated into section 23 of the Inheritance Tax Act, has the effect of confining relief under that provision to trusts governed by the law of a part of the United Kingdom and subject to the jurisdiction of United Kingdom courts. There can be no doubt that the *Dreyfus* gloss on the language of section 989 of the Income Tax Act, as applied to section 23, is incompatible with article 56 EC. It is plain that the restriction of relief from inheritance tax to trusts governed by the law of a part of the United Kingdom cannot be justified under EU law.

52. Article 56 EC is directly applicable as law in the United Kingdom, and must be given effect in priority to inconsistent national law, whether judicial or legislative in origin. It follows that the *Dreyfus* gloss on the language of section 989 of the Income Tax Act cannot be applied to section 23 in situations falling within the scope of article 56. The resultant position is as set out in para 49 above: applying section 23 without incorporating the *Dreyfus* gloss, there is no relevant restriction on the availability of relief beyond the conditions appearing on the face of the provision. That result is in conformity with article 56. Since it is undisputed that the Coulter Trust satisfied those conditions at the relevant time, it follows that it qualifies for the relief.

53. That is the conclusion which the Court of Appeal should have reached, once it had decided that the *Dreyfus* gloss on the language of section 989 of the Income Tax Act, if incorporated into section 23 of the Inheritance Tax Act, imposed a restriction which was incompatible with article 56. Having reached that decision, the court could not apply that entirely judge-made restriction, and therefore had to apply section 23 without the gloss placed on the language used in section 989 of the Income Tax Act in the *Dreyfus* case. It would then have arrived at a result which complied with article 56.

54. With great respect to the Court of Appeal, it should not have concerned itself with a hypothetical restriction concerned with the existence of mutual assistance agreements, even if it considered that such a restriction might have been justifiable under EU law and might have been imposed by Parliament. The fact was that there was no such restriction in existence. Neither section 23 of the Inheritance Tax Act nor section 989 of the Income Tax Act made relief for trusts in third countries conditional on there being a mutual assistance agreement in place. The fact that such a restriction, if it had existed, might have been in conformity with EU law did not mean that it could be imposed by the court, by means of a purported interpretation of the language used in section 23.

55. Having reached the conclusion that section 23 of the Inheritance Tax Act can be brought into conformity with article 56 by disapplying the *Dreyfus* gloss on the meaning of the words contained in section 989 of the Income Tax Act, and that, having done so, the gift to the Coulter Trust qualifies for relief under section 23, it is unnecessary for this court to decide the other issues in dispute between the parties: in particular, whether the Court of Appeal was correct to hold that the *Dreyfus* gloss applied to both limbs of section 23(6), and whether it was correct to hold that a general requirement that there be a mutual assistance agreement in place at the time of the testator's death would constitute a justifiable restriction on freedom of movement of capital under EU law. The Court of Appeal's decision cannot stand, even if it was correct in its determination of those issues.

Conclusion

56. For these reasons, we conclude that article 56 EC applied to Mrs Coulter's gift of assets in the United Kingdom to trustees in Jersey, that the refusal of relief from inheritance tax on that gift under section 23 of the Inheritance Tax Act was in breach of article 56, and that the appeal should therefore be allowed.