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EU VAT Principles as Interpretative Aids to EU VAT Rules: The Inherent Paradox

Rita de la Feria

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I. Introduction¹

The EU VAT system is founded on two basic principles, namely the principle of VAT as a general consumption tax, and the principle of fiscal neutrality. Based on key elements of the VAT system as it was introduced in the 1960s, they have both been developed by the Court as fundamental principles of the system over an extended period of time, spanning almost five decades. Once exclusions from the tax base, such as exemptions and reduced rates, are introduced, however, these two principles became contradictory. This results in a dialectic struggle, whereby a choice must be made when interpreting VAT rules on exclusions. Interpreting these rules in light of the principle of VAT as a tax on consumption, and its corollary, the principle of strict interpretation, will result in a less neutral system. Interpreting these rules according to the principle of fiscal neutrality will result in further erosion of the tax base and legal uncertainty. The chapter begins by presenting a typology of European VAT principles based upon the jurisprudence of the CJEU. It then assesses that jurisprudence, insofar as exclusions from the tax base are concerned, namely rules on VAT exemptions, and rules on VAT reduced rates, highlighting this dialectic struggle, and identifying both the Court's traditional stand on it, and its more recent approach. An empirical assessment of the hypothesis is then presented, by reviewing a five year sample of cases on the interpretation of the scope of VAT exemptions and identifying for each case whether the CJEU decided on the basis of the principle of fiscal neutrality, or on the basis of the principle of strict interpretation. Whilst not meant to be considered as an accurate method of determining the Court's preferences as regards to interpretative methods, the exercise demonstrates not only a growing preference for fiscal neutrality, but also the increasingly casuistic nature of interpreting VAT rules on exclusions of the tax base. The paper concludes that these tendencies are likely to continue in the event of new economic realities, and that the challenge for the CJEU will be to reach the proper balance between promoting neutrality and eliminating distortions, without creating an environment of legal uncertainty, which will undermine confidence and economic growth.

II. EU VAT Principles

The EU VAT system is founded upon two basic principles, namely the principle of VAT as a general consumption tax, and the principle of fiscal neutrality. Based on key elements of the VAT system as it was introduced in the 1960s, they have both been developed by the Court as fundamental principles of the system over an extended period of approximately five decades.

1 Earlier versions of this paper, or sections therein, were presented at conferences/seminars held in Trier (March 2013), Leiden (May 2015), as well as in Vienna (December 2015). I am grateful to the organisers and for the comments received therein.

A. VAT as General Consumption Tax

Despite ambiguous terminology VAT is a general tax on consumption, and rationale for reference in the Treaties, and some earlier legislation to turnover taxes is merely historical.² The principle was enshrined in Art. 2 of the First VAT Directive which states that ‘*the principle of the common system of value added tax involves application to goods and services of a general tax on consumption*’³, and it has also been consistently reiterated by the Court in cases dating back to the early 1980s.⁴ In the more recent *My Travel*, the Court stated:

‘It is to be remembered that the basic principle of VAT is that it is a consumption tax designed to be borne only by the final consumer.’⁵

Yet, whilst as general tax on consumption VAT should apply to all consumption, the decision was made in the 1960s by the EU legislator to exclude certain consumption from the tax base. The rationale for excluding consumption from the tax base in 1960s/1970s was essentially two-fold, namely, to replicate exclusions from the tax base that was applicable under previous cumulative taxes, and to reflect the existence of technical obstacles to the application of VAT to some services, the so-called difficult-to-tax services. Over time, three additional explanations were given for the use of (merit) exemptions, and reduced rates, namely:

- **Vertical equity:** idea that these concessions limit the natural regressivity of VAT, i.e. that the tax weights more heavily on poorer income households; therefore, so applying exemptions to key products (e.g., food, healthcare, and education) would limit the impact of the tax on those households;
- **Positive externalities:** idea that these concessions increased consumption of so-called merit goods (e.g., books, cultural events, and sport activities);
- **Increase employment:** idea that application of reduced rates will ultimately lead to increased employment in labor-intensive industries (e.g., hairdressing), or areas where price is particularly elastic (e.g., electronics), or both (e.g., restaurants).⁶

2 On VAT as a tax on consumption, see J. Englisch, ‘VAT/GST and Direct Taxes: Different Purposes’ in M. Lang/P. Melz/E. Kristoffersson (eds.), *Value Added Tax and Direct Taxation – Similarities and Differences* (Amsterdam: IBFD, 2009); and D. Butler, ‘VAT as a Tax on Consumption: Some Thoughts on the Recent Judgement in *Parker Hale Ltd v Customs and Excise Commissioners*’ (2000) *British Tax Review* 5, pp. 545–553.

3 First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes, OJ 71, 14/04/1967, p. 1301.

4 CJEU, 26 March 1987, Case C-235/85, *Commission v Netherlands*, ECLI:EU:C:1987:161; CJEU, 29 February 1996, Case C-215/94, *Mohr*, ECLI:EU:C:1996:72; and CJEU, 18 December 1997, Case C-384/95, *Landboden-Agrardienste*, ECLI:EU:C:1997:627.

5 CJEU, 6 October 2005, Case C-291/03, *My Travel*, ECLI:EU:C:2005:591.

6 These arguments for exclusions from the tax base are analysed in detail in R. de la Feria, ‘Blueprint for Reform of VAT Rates in Europe’ (2015) *Intertax* 43(2), pp. 154–171, for rates; and R. de la Feria/R. Krever, ‘Ending VAT Exemptions: Towards A Post-Modern VAT’ in R. de la Feria (ed.), *VAT Exemptions: Consequences and Design Alternatives* (The Hague: Kluwer Law International, 2013), pp. 3–35, for exemptions.

These exclusions from the tax base, however, had a very significant impact on neutrality.

B. VAT as a Neutral Tax

Whilst there are various definitions of neutrality,⁷ generally, a neutral tax is one that does not influence commercial decisions. Taken in that sense, the neutrality of VAT is usually considered as one of primary reasons for its introduction. In Europe, this much is articulated in the *Neumark Report*⁸ which uses neutrality as the main argument for VAT against the – at the time, common – use of cumulative taxes;⁹ and the worldwide, the spread of VAT to over 150 countries has been attributed to its technical advantages, most notably neutrality.¹⁰

It is, therefore, unsurprising that the principle of VAT as a neutral tax was enshrined in the First VAT Directive and was quickly developed by the CJEU as the principle of fiscal neutrality in its early case-law. In *Hong Kong*, one of the Court's earliest judgments on VAT, it stated:

[The Preamble to the First Directive] refers to the need to achieve such harmonisation of legislation concerning turnover taxes as will eliminate factors which may distort conditions of competition, and therefore, to secure neutrality in competition, in the sense that within each country similar goods should bear the same tax burden, whatever the length of the production and distribution chain.¹¹

C. CJEU Typology of Principles

In addition to the above mentioned two fundamental principles of the EU VAT system, the CJEU has developed various sub-principles which are, in essence, corollaries of the two main principles. The principles of VAT uniformity, equality, and elimination of distortions in competition have been developed as corollaries of the principle of fiscal neutrality. Although their existence was already somewhat implicit in several early cases, where the Court concluded that the principle of fiscal neutrality precluded Member States from treating lawful and unlawful

7 See B. Terra/J. Kajus, *A Guide to European VAT Directives 2015*, Volume 1 (Amsterdam: IBFD, 2015). For a new comprehensive study on neutrality, see C. Herbain, *VAT Neutrality* (Lacier, 2015).

8 European Commission, *The EEC Reports on Tax Harmonisation – The Report of the Fiscal and Financial Committee and the Report of the Sub-Groups A, B and C*, (Amsterdam: IBFD, 1963).

9 For a detailed analysis of the historical background to the introduction of VAT in Europe, see R. de la Feria, *The EU VAT System and the Internal Market* (Amsterdam: IBFD, 2009), at Chapter 2.

10 K. James, 'Exploring the Origins and Global Rise of VAT', in *The VAT Reader* (Washington DC: Tax Analysts, 2011), pp. 15-22; M. Keen, 'VAT Attacks!' (2007) *International Tax and Public Finance* 14, pp. 365-381; S. Cnossen, 'Global Trends and Issues in Value Added Taxation' (1998) *International Tax and Public Finance* 5(3), pp. 399-428; and M. Keen/B. Lockwood, 'The Value-Added Tax: its Causes and Consequences' (2010) *Journal of Development Economics* 92(2), pp. 138-151.

11 CJEU, 1 April 1982, Case 89/81, *Hong-Kong*, ECLI:EU:C:1982:121.

transactions differently for VAT purposes,¹² their existence was explicitly stated by the Court in *Commission v France*.¹³

Whilst it is not always clear how VAT legal principles interact, a typology is proposed in Table 1.¹⁴ According to this proposed typology, the principle of the right to deduct has been developed by the Court as both a corollary of the fiscal neutrality principle, and of the principle of VAT as a general tax on consumption. The principle of fiscal neutrality has another corollary, namely the principle of VAT uniformity or equal treatment; and the principle of VAT as a general tax on consumption has two corollaries, namely the principle of strict interpretation, as developed by the Court, and the destination principle, as set out in the Directive.

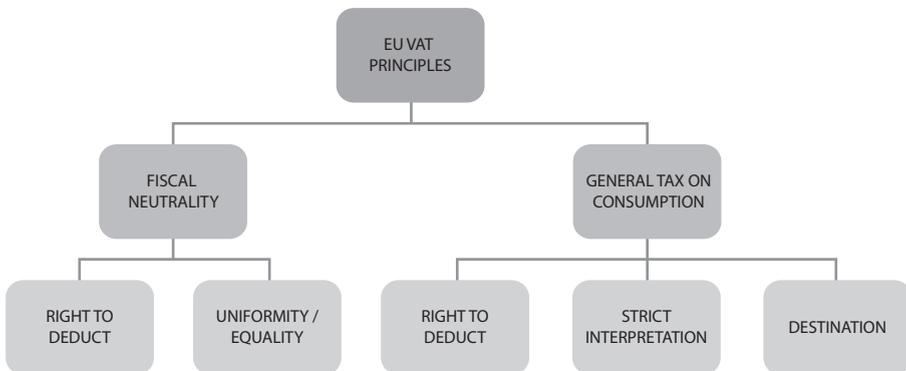


Figure 1: Typology of EU VAT Principles

III. Role of Neutrality on Interpretation of Exemptions

The role of the two fundamental principles of the VAT system, namely the principle of VAT as a general tax on consumption, and the principle of fiscal neutrality, as interpretative aids, is reflected in the CJEU interpretation of the exemptions' provisions.

A. Traditional Approach

The initial interpretation by the CJEU of VAT exemptions was clearly influenced by the principle of VAT as a tax on consumption. Faced with an increasing num-

12 CJEU, 22 September 1988, Case 286/86, *Happy Family*, ECLI:EU:C:1988:434; CJEU, 2 August 1993, Case C-111/92, *Lange*, ECLI:EU:C:1993:345; and CJEU, 11 June 1998, Case C-283/95, *Fischer*, ECLI:EU:C:1998:276.

13 CJEU, 3 May 2001, Case C-481/98, *Commission v France*, ECLI:EU:C:2001:237.

14 For an alternative interpretation of how the principles interact, see J. Englisch, 'VAT and General Principles of EU Law' in D. Weber (ed.), *Traditional and Alternative Routes to European Tax Integration* (Amsterdam: IBFD, 2010), Chapter 11.

ber of references from the early 1990s onwards, the Court quickly developed general guidelines on the interpretation of exemptions:

‘The exemptions provided for in [the Directive] are to be interpreted strictly since they constitute exceptions to the general principle that turnover tax is to be levied on all services supplied for consideration by a taxable person.’¹⁵

Hence, the principle of strict interpretation was born. Other interpretative principles were also developed by the CJEU, in particular the principle of contextual interpretation,¹⁶ and the principle of uniform interpretation of exemptions,¹⁷ but none of them had the significance, or the impact, of the principle of strict interpretation. Indeed, the Court’s traditional preference for strict interpretation of exemptions was reflected on two levels, namely as regards their objective scope, and the type of activities covered therein; and their subjective scope, and the type of supplies that can be covered by an exemption. This double limitation to the scope of – at least some – exemptions was reiterated by the Court on various occasions, until recently.¹⁸

This is not to say that strict interpretation was always adhered to. On the contrary, the first cases departing from strict interpretation date back to the late 1990s, and can be broadly divided into two categories. The first are cases concerning technical exemptions, particularly those applicable to financial services, which depart from strict interpretation, but are not explicitly based on the principle of fiscal neutrality.¹⁹ Resorting to the principle of fiscal neutrality was less necessary in these cases since the wording of the financial services exemptions does not always limit their subjective scope, and the cases primarily concerned out-

15 CJEU, 23 February 1988, Case 353/85, *Commission v United Kingdom*, ECLI:EU:C:1988:82; CJEU, 24 May 1988, Case 122/87, *Commission v Italy*, ECLI:EU:C:1988:256; CJEU, 11 August 1995, Case C-453/93, *Bulthuis-Griffioen*, ECLI:EU:C:1995:265; CJEU, 20 November 2003, Case C-212/01, *Unterpertinger*, ECLI:EU:C:2003:625; and CJEU, 10 June 2010, Case C-86/09, *Future Health Technologies*, ECLI:EU:C:2010:334, all of which regarding the interpretation of the exemption applicable to medical services, Art. 132(1)(b) VAT Directive; CJEU, 12 November 1998, Case C-149/97, *Institute of Motor Industry*, ECLI:EU:C:1998:536, regarding the interpretation of the exemption applicable to trade unions, Art. 132(1)(l) VAT Directive; and CJEU, 18 January 2001, Case C-150/99, *Stockholm Lindopark*, ECLI:EU:C:2001:34, on the interpretation of the exemption applicable to sport organizations, Art. 132(1)(m) VAT Directive.

16 As mentioned in *Kügler*, ‘exemptions constitute independent concepts of Community law which must be placed in the general context of the common system of VAT’, see CJEU, 10 September 2002, Case C-141/00, *Kügler*, ECLI:EU:C:2002:473, para. 29.

17 As referred in *Abbey National*, ‘exemptions provided for [in the Directive] have their own independent meaning in Community law which must be given a Community definition whose purpose is to avoid divergences in the application of the VAT system from one Member State to the other’, see CJEU, 4 May 2006, Case C-169/04, *Abbey National*, ECLI:EU:C:2006:289, para. 38. See also CJEU, 3 March 2005, Case C-428/02, *Fonden Marselisborg Lystbadehavn*, ECLI:EU:C:2005:126, para. 27; and CJEU, 1 December 2005, Joined Cases C-394/04 and C-395/04, *Ygeia*, ECLI:EU:C:2005:734, para. 15.

18 CJEU, 10 June 2010, Case C-262/08, *CopyGene*, ECLI:EU:C:2010:328.

19 CJEU, 5 June 1997, Case C-2/95, *SDC*, ECLI:EU:C:1997:278; and CJEU, 25 February 1999, Case C-349/96, *CPP*, ECLI:EU:C:1999:93.

sourcing and sub-contracting.²⁰ The second type are cases concerning merit exemptions, particularly those applied to medical activities, which explicitly depart from strict interpretation on the basis of the principle of fiscal neutrality.²¹ Express departure was necessary in these since the cases concerned both the type of services, and type of suppliers, and the wording of those provisions often limits both their subjective and objective scopes.²²

Yet, there was a clear sense that the above cases were the exception. Indeed, there were also numerous examples of cases where fiscal neutrality was invoked by the parties as a basis for departing from strict interpretation, just to be expressly dismissed by the Court.²³ Overall, the perception was that, in the hierarchy of interpretative principles under the traditional approach, strict interpretation had prevailed. As the economy changed, however, this was however set to change.

B. Strict Interpretation vs. Fiscal Neutrality

In 2006, the European Commission stated that the rule according to which the interpretation of exemptions must meet the requirements of the principle of fiscal neutrality was one of only three CJEU jurisprudential pillars regarding exemptions.²⁴ At the time, there was perhaps an element of wishful thinking to this statement, however, it is true that, by then, the seeds of change were already being sown.

The reasons for the Court's progressively stronger emphasis on fiscal neutrality in the interpretation of exemptions appears to be two-fold. The first, and perhaps most important, element has been the changes in economic reality, and particularly insofar as services covered by merit exemptions were concerned, these changes were massive. Whilst in the 1970s most of these services were performed by public entities, they are currently also supplied by private entities that are operating in market conditions. New services have also flooded the market primarily in the context of medical activities, and few in the 1970s could have envisaged the medical developments in the use of stem cells or cloning. In addition, the form in which services covered by both merit and technical exemptions are now

20 For a detailed analysis of these cases see R. de la Feria, 'The EU VAT Treatment of Insurance and Financial Services (Again) Under Review' (2007) *EC Tax Review* 2, pp. 74-89.

21 CJEU, 7 September 1999, Case C-216/97, *Gregg*, ECLI:EU:C:1999:390; CJEU, 11 January 2001, Case C-76/99, *Commission v France*, ECLI:EU:C:2001:12; CJEU, 20 November 2003, Case C-307/01, *d'Ambrumenil*, ECLI:EU:C:2003:627; and CJEU, 8 June 2006, Case C-106/05, *L.u.p.*, ECLI:EU:C:2006:380.

22 An analysis of the cases concerning in particular the medical exemptions is undertaken in R. de la Feria, 'Renúncia à Isenção de IVA por Estabelecimentos Hospitalares' (2015) *Revista de Finanças Públicas e Direito Fiscal* 8(1).

23 CJEU, 20 November 2003, Case C-8/01, *Assurandor-Societetet*, ECLI:EU:C:2003:621.

24 European Commission, *Consultation Paper on Modernising Value Added Tax Obligations for Financial Services and Insurances*, 2006, p. 10.

supplied has also fundamentally changed. In particular, there is a growing resource to new efficiency-maximization economic structures, such as outsourcing, which have subsequently increased the – already existing – dilemma of irrecoverable input VAT. The second reason for the Court's stronger emphasis on fiscal neutrality appears to be a simple accumulation of knowledge and experience. In the past, it had often, and rightly so, been accused of an over-simplistic approach to tax matters, including VAT exemptions. Seen in that light this new approach represents a natural jurisprudential evolution being witnessed in other areas, whereby there is a move towards a more complex, nuanced, interpretation of VAT rules, based on general VAT principles.

Regardless of the rationale, however, the CJEU's stronger emphasis on fiscal neutrality in the interpretation of exemptions has resulted in decreased emphasis on strict interpretation and a constant dialectic struggle between strict interpretation and fiscal neutrality. Why, one may ask? *Id est*, why is the preference for strict interpretation usually accompanied by a dismissal of fiscal neutrality, and vice-versa? The answer lies in the nature of exemptions; they are inherently non-neutral, they constitute in themselves a violation of the principle of fiscal neutrality. This inherent paradox has been implicitly acknowledged by the Court, and was expressly acknowledged by AG Jacobs over a decade ago:

'It is inherent in the existence of exceptions to the VAT system that they will interfere to some extent with the application of the principles of neutrality and of equality treatment. Whatever the merits of the decision [...], it forms an integral part of the Directive. In that in comparable situations, the treatment of taxable persons and persons excluded from the VAT system will inevitably be different.'²⁵

So that, in essence, interpreting exemptions often requires a choice between obliging one or the other of the two fundamental principles of VAT. Interpreting exemptions in line with the principle of VAT as a general tax on consumption will naturally lead to a strict interpretation of those exemptions. Interpreting exemptions in line with principle of fiscal neutrality may lead to a non-strict, even broad, interpretation of those exemptions.

There are many examples of this recurrent dialectic struggle between strict interpretation and fiscal neutrality, cases which factually appeared all too similar and yet were decided differently.²⁶ On the interpretation of exemptions for medical services, there is *Bulthuis-Griffioen*, on one side, and *Gregg* on the other;²⁷ as re-

25 CJEU, 2 June 2005, Case C-378/02, *Waterschap Zeeuws Vlaanderen*, ECLI:EU:C:2004:726, para. 38.

26 A struggle first noted by C. Amand, 'VAT for Public Entities and Charities – Should the Sixth Directive Be Renegotiated?' (2006) *International VAT Monitor* 6, pp. 433-443.

27 CJEU, 11 August 1995, Case C-453/93, *Bulthuis-Griffioen*, ECLI:EU:C:1995:265, and CJEU, 7 September 1999, Case C-216/97, *Gregg*, ECLI:EU:C:1999:390. See also S. Chirichigno/V. Seggre, 'Hospital and Medical Care by Commercial Hospitals under EU VAT' (2014) *International VAT Monitor* 2, pp. 78-81.

gards the interpretation of the exemption for sports activities, there is *Stockholm Lindopark*, on one side, and *Canterbury Hockey* on the other.²⁸ Recent decisions in gambling and in fund management services, however, are not only further evidence of this dialectic struggle but also of its intensification.

In so far as the exemption applicable to gambling services is concerned, the CJEU had previously stated in various cases that the principle of fiscal neutrality limits the level of discretion granted to Member States under Art. 135(1)(i) VAT Directive. In particular, fiscal neutrality precludes Member States from treating unlawful gambling as taxable, and lawful gambling as exempt;²⁹ it also precludes Member States from treating private gambling as taxable, and lawful gambling as exempt;³⁰ and it means that outsourcing and subcontracting of gambling activities can still fall within the scope of exemption.³¹ Yet, an interpretation based on the principle of fiscal neutrality was dismissed in the recent *Leo-Libera* case, where the Court held that Member States may treat one form of gambling as exempt, and another as taxable, as long as they are not in competition with each other.³² Less than a year later, this decision was followed by what has been regarded as a landmark decision in the context of the principle of fiscal neutrality: *Rank Group*.³³ The case established, for the first time, a neutrality test whereby it ruled that the different treatment of two suppliers of services that are: (a) identical or similar from the perspective of the consumer and; (b) which meet the same needs of the consumer, is sufficient to establish an infringement of the principle of fiscal neutrality.³⁴ Consequently, it has massive implications not only for the interpretation of exemptions, but also, as discussed below, for the interpretation of rate provisions.

Therefore, in less than two years, there were three CJEU decisions regarding the scope of the VAT exemption applicable to gambling services. In two of these, the Court decided on the basis of the principle of fiscal neutrality and, in the other, on the basis of the principle of strict interpretation.

As regards the exemption applicable to management services of special investment funds, it is clear that the principle of fiscal neutrality has played a crucial role in determining the scope of Art. 135(1)(g) VAT Directive. In particular, fiscal neutrality means that outsourcing and subcontracting of activities relating to

28 CJEU, 18 January 2001, Case C-150/99, *Stockholm Lindöpark*, ECLI:EU:C:2001:34, and CJEU, 16 October 2008, Case C-253/07, *Canterbury Hockey*, ECLI:EU:C:2008:571. See also F. Schulyok, 'The ECJ's Interpretation of VAT Exemptions' (2010) *International VAT Monitor* 4, pp. 266-270.

29 CJEU, 11 June 1998, Case C-283/95, *Fischer*, ECLI:EU:C:1998:276.

30 CJEU, 17 February 2005, Case C-453/02, *Linneweber*, ECLI:EU:C:2005:92.

31 CJEU, 14 July 2011, Case C-464/10, *Henfling and Others*, ECLI:EU:C:2011:489.

32 CJEU, 10 June 2010, Case C-58/09, *Leo-Libera*, ECLI:EU:C:2010:333.

33 CJEU, 10 November 2011, Case C-259/10, *Rank Group*, ECLI:EU:C:2011:719.

34 For an analysis of this case, see R. de la Feria 'Rank Group. VAT exemption on gambling. Principle of fiscal neutrality. Court of Justice' (2012) *Highlights & Insights on European Taxation* 1.

management services of special investment funds can still fall within scope of exemption, as long as they form a distinct whole, and are specific to, and essential for, the management of those funds;³⁵ and it also precludes Member States from treating the management of open-ended funds as exempt and management of closed-ended funds as taxable.³⁶ Yet the application of the principle was dismissed in two recent cases in favor of strict interpretation. It was held that strict interpretation precluded Member States from treating portfolio management activity as falling within the scope of the exemption,³⁷ and from treating investment funds pooling the assets of a retirement pension scheme as a ‘*special investment fund*’ since those funds were not ‘*sufficiently comparable*’ to be regarded in competition with exempt ones.³⁸ In one of these, namely *Deutsche Bank*, the dismissal of the application of the principle of fiscal neutrality was expressly stated by the Court:

‘[the principle of fiscal neutrality] cannot extend the scope of an exemption in the absence of clear wording to that effect. That principle is not a rule of primary law which can condition the validity of an exemption, but a principle of interpretation, to be applied concurrently with the principle of strict interpretation of exemptions’³⁹

In the same year that it decided on these two cases, however, the Court decided on another case concerning the scope of this exemption, based on the principle of fiscal neutrality, holding that the principle meant that outsourcing of advisory services concerning investment in transferable securities still fell within its scope.⁴⁰ So that in the period of approximately one year, it decided on the basis of strict interpretation in two cases, and on the basis of fiscal neutrality in one other.

Table 2 presents a recent sample of cases on the interpretation of the scope of VAT exemptions to include all the cases decided on the topic in the last four years. For each case, it is identified whether the CJEU decided – explicitly or implicitly – on the basis of the principle of fiscal neutrality or on the basis of the principle of strict interpretation.

35 CJEU, 4 May 2006, Case C-169/04, *Abbey National*, ECLI:EU:C:2006:289.

36 CJEU, 28 June 2007, Case C-363/05, *JP Morgan*, ECLI:EU:C:2007:391.

37 CJEU, 19 July 2012, Case C-44/11, *Deutsche Bank*, ECLI:EU:C:2012:484.

38 CJEU, 7 March 2013, Case C-424/11, *Wheels Common Investment Fund*, ECLI:EU:C:2013:144.

39 CJEU, 19 July 2012, Case C-44/11, *Deutsche Bank*, ECLI:EU:C:2012:484, para. 45. For a detailed analysis of this case, see R. de la Feria/C. Belim, ‘IVA nas Transacções Financeiras: Sobre o Tratamento da Gestão de Carteiras de Títulos’ (2012) *Revista de Finanças Públicas e Direito Fiscal* 5(4), pp. 259-276; see also F. Wersand/S. Cazes, ‘EU VAT and the Conundrum of Financial Investments’ (2013) *International VAT Monitor* 2, pp. 83-88.

40 CJEU, 7 March 2013, Case C-275/11, *GfBk*, ECLI:EU:C:2013:141.

CJEU Cases on Interpretation of VAT Exemptions: 2012-2015					
C-436/10	<i>BLM</i>	Art. 135(1)(l)	Leasing of immovable property	Strict interpretation	2012
C-44/11	<i>Deutsche Bank</i>	Art. 135(1)(g)	Management of special investment funds	Strict Interpretation	2012
C-174/11	<i>Zimmermann</i>	Art. 132(1)(g)	Welfare and social security work	Fiscal Neutrality	2012
C-210/11	<i>Medicom</i>	Art. 135(1)(l)	Leasing of immovable property	Strict interpretation	2013
C-224/11	<i>BGŻ Leasing</i>	Art. 135(1)(a)	Insurance services	Fiscal Neutrality	2013
C-259/11	<i>DTZ Zadelhoff</i>	Art. 135(1)(f)	Dealings in shares	Fiscal Neutrality	2012
C-275/11	<i>GfBk</i>	Art. 135(1)(g)	Management of special investment funds	Fiscal Neutrality	2013
C-299/11	<i>Gemeente Vlaardingen</i>	Art. 135(1)(k)	Building land	-	2012
C-326/11	<i>J.J. Komen en Zonen Beheer Heerhugowaard</i>	Art. 135(1)(j)	Buildings	Fiscal Neutrality	2012
C-392/11	<i>Field Fisher Waterhouse</i>	Art. 135(1)(l)	Leasing of immovable property	-	2012
C-424/11	<i>Wheels Common Investment Fund Trustees and Others</i>	Art. 135(1)(g)	Management of special investment funds	Strict Interpretation	2013
C-532/11	<i>Leichenich</i>	Art. 135(1)(l)	Leasing of immovable property	Fiscal Neutrality	2012
C-543/11	<i>Woningstichting Maasdriel</i>	Art. 135(1)(k)	Building land	Strict Interpretation	2013
C-18/12	<i>Město Žamberk</i>	Art. 132(1)(m)	Sporting activities	Fiscal Neutrality	2013
C-26/12	<i>PPG Holdings</i>	Art. 135(1)(g)	Management of special investment funds	Strict Interpretation	2013
C-91/12	<i>PCF Clinic</i>	Art. 132(1)(b)	Medical services	Fiscal Neutrality	2013
C-139/12	<i>Caixa d'Estalvis i Pensions de Barcelona</i>	Art. 135(1)(f)	Dealings in shares	-	2014
C-319/12	<i>MDDP</i>	Art. 132(1)(i)	Education services	Fiscal Neutrality	2013

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C-366/12	<i>Klinikum Dortmund</i>	Art. 132(1)(b)	Medical services	Strict Interpretation	2014
C-440/12	<i>Metropol Spielstätten</i>	Art. 135(1)(i)	Gambling	-	2013
C-461/12	<i>Granton Advertising</i>	Art. 135(1)(d) and (f)	Dealings in shares Dealings in payments	Strict interpretation	2014
C-464/12	<i>ATP PensionService</i>	Art. 135(1)(d) and (g)	Dealings in payments Management of special investment funds	Fiscal Neutrality	2014
C-495/12	<i>Bridport and West Dorset Golf Club</i>	Art. 132(1)(m)	Sporting activities	Fiscal Neutrality	2013
C-584/13	<i>Mapfre asistencia and Mapfre warranty</i>	Art. 135(1)(a)	Insurance services	Fiscal Neutrality	2015
C-594/13	<i>«go fair» Zeitarbeit</i>	Art. 132(1)(g)	Welfare and social security work	Strict interpretation	2015
C-595/13	<i>Fiscale Eenheid X</i>	Art. 135(1)(g)	Management of special investment funds	Fiscal neutrality	2015
C-55/14	<i>Régie communale autonome du stade Luc Varenne</i>	Art. 135(1)(l)	Leasing of immovable property	Strict interpretation	2015
C-114/14	<i>Commission v Sweden</i>	Arts. 132(1)(a)	Postal services	Fiscal neutrality	2015
C-264/14	<i>Hedqvist</i>	Art. 135(1)(e)	Dealings in currency	Fiscal neutrality	2015
C-334/14	<i>De Fruytier</i>	Art. 132(1)(b) and (c)	Medical services	Strict interpretation	2015

Table 1: Four Years' Sample of CJEU Cases on VAT Exemptions

These thirty cases were analyzed according to the adopted interpretative method, and the results are as follows. In four cases, the CJEU did not decide either on the basis of fiscal neutrality, or strict interpretation⁴¹. In approximately half of the analyzed cases, the Court interpreted the scope of the exemptions, explicitly or implicitly, in accordance with fiscal neutrality: four of the eight cases in 2012; six of eleven in 2013; one of four in 2014; and four of seven in 2015. Diagram 1 below provides

41 CJEU, 8 November 2012, Case C-299/11, *Gemeente Vlaardingen*, ECLI:EU:C:2012:698; CJEU, 27 September 2012, Case C-392/11, *Field Fisher Waterhouse*. ECLI:EU:C:2012:597; CJEU, 24 October 2013, Case C-440/12 *Metropol Spielstätten*, ECLI:EU:C:2013:687; and CJEU, 20 March 2014, Case C-139/12, *Caixa d'Estalvis i Pensions de Barcelona*, ECLI:EU:C:2014:174.

an annual breakdown of the number of VAT exemption cases decided on the basis of fiscal neutrality when compared to the overall number of cases on exemptions.

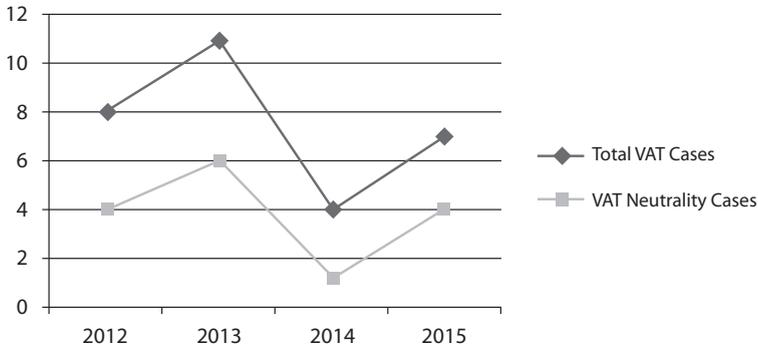


Diagram 1: Breakdown of VAT Exemptions Cases Decided on the Basis of the Fiscal Neutrality Principle

Whilst not meant to be taken as an accurate method of determining the Court's preferences as regards interpretative methods, this rough analysis does highlight not only a growing preference for fiscal neutrality, but also the increasingly casuistic nature of interpreting VAT exemptions. Indeed, whilst a propensity can be identified as regards some of the exemptions for either strict interpretation or fiscal neutrality – for example the Court appears to be more likely to adopt a strict interpretation of immovable property exemptions – it is also clearly the case that there is no exemption rule which has been interpreted exclusively on the basis of strict interpretation, or exclusively on the basis of fiscal neutrality.

Similar tendencies can also be observed in cases concerning the interpretation of rates' provisions, albeit to a lesser extent considering the lower numbers.

IV. Role of Neutrality on Interpretation of Rates

The acknowledgement by the Court of the role of fiscal neutrality, and of VAT uniformity or equal treatment as its corollary, in the interpretation of VAT rates, was a more recent development than the similar acknowledgement in the field of exemptions. Indeed, the first time its interpretative role was recognized was in *Commission v France*, a case dating back to the late 1990s.⁴²

A. Fiscal Neutrality Criteria

Another result of the previously mentioned case was that the criterion employed to determine whether or not a dissimilar VAT treatment violated the principle of fiscal neutrality appeared to have been whether the goods in question were or were not in competition with each other, as follows:

⁴² CJEU, 3 May 2001, Case C-481/98, *Commission v France*, ECLI:EU:C:2001:237.

‘It is clear that, in introducing and maintaining in force a VAT rate of 2.1 % solely for reimbursable medical products, the French legislation did not and does not infringe the principle of fiscal neutrality. Reimbursable and non-reimbursable medical products are not similar products in competition with each other [...] Once included in the list of reimbursable products, a medical product will, vis-à-vis a non-reimbursable medical product, have a decisive advantage for the final consumer’⁴³

This emphasis on the competing or non-competing, nature of the products in question was again reiterated in *Commission v Netherlands*, where the Court stated that the categories of the products in question ‘are not in competition, meaning that they can be subject to different rates of VAT’.⁴⁴ This is contrary to what the Court seems to be suggesting in its decision in *Rank Group*;⁴⁵ indeed, until that decision, the criterion used to determine whether or not different VAT treatments of two products violated the principle of fiscal neutrality was, in essence, whether the goods in question were or were not in competition with each other.

In *Rank Group* the CJEU revised this approach in a decision that would emerge as a key development for the principle of fiscal neutrality.⁴⁶ In it, the Court, relying upon an old judgment concerning excise duties,⁴⁷ sets-out a two-part test for establishing whether or not there is an infringement of fiscal neutrality, namely whether the products being treated differently for VAT purposes are comparable from the perspective of the customer *and* meet the same customers’ needs.

Whilst the decision concerned exemptions,⁴⁸ it was as regards the application of rates that the establishment of the neutrality test had an immediate impact. Indeed, in the immediate aftermath of the decision, some were quick to point out that that it was ‘highly likely’ that the criteria laid down in *Rank Group* would affect the application of VAT rates particularly to food, and that ‘the entire fabric of the manner in which VAT is applied to food’ would need to be re-examined.⁴⁹ The proposition seemed even more convincing in the context of another decision of the CJEU that same year concerning the interpretation of the term ‘foodstuff’ in the directive *Bog* where the Court,⁵⁰ without ever referring to fiscal neutrality, clearly departed from strict interpretation of exceptions to the general rule, by adopting a broad meaning of that term.

43 Ibid, at paras. 25 and 27.

44 CJEU, 3 March 2011, Case C-41/09, *Commission v Netherlands*, ECLI:EU:C:2011:108, para. 66. For a deeper analysis of these cases see R. de la Feria, *The EU VAT System and the Internal Market* (Amsterdam: IBFD, 2009), at Chapter 4.

45 CJEU, 10 November 2011, Case C-259/10, *Rank Group*, ECLI:EU:C:2011:719.

46 For a more detailed analysis of the impact of this case, see R de la Feria, ‘VAT: A New Dawn for the Principle of Fiscal Neutrality?’ (2011) *Oxford University Centre for Business Taxation Policy Paper*.

47 CJEU, 11 August 1995, Joined Cases C-367/93 to C-377/93, *Rodens and Others*, ECLI:EU:C:1995:261, para. 27.

48 See above.

49 V. Sloane, ‘VAT Focus – Rank and Fiscal Neutrality’ (2011) *Tax Journal* 1101, 20, 18 November 2011.

50 CJEU, 10 March 2011, Case C-497/09, *Bog*, ECLI:EU:C:2011:135.

With these two decisions in the same year, reliance on fiscal neutrality appeared to be clearly increasing, however, this perception was short-lived.

B. Strict Interpretation vs. Fiscal Neutrality

During 2014, a number of high profile cases on the application of reduced rates arrived at the CJEU which incited the debate as to whether or not the Court would apply the new criteria for fiscal neutrality as set out in *Rank Group* to these cases. At stake in all of them was the interpretation of the word 'books' and whether the provision in the VAT Directive that allows 'books' to be subject to a reduced rate of VAT should be extended to similar products which did not exist at the time the directive was approved, namely audio books, and e-books.

The cases, therefore, represented the perfect opportunity to test, not only the applicability of the new criteria set out in *Rank Group* of whether it would be confirmed as the new standard for fiscal neutrality. Also important would be to test the strength of fiscal neutrality itself, now that a test was available.⁵¹ The first question was clearly answered. In all of the cases, the Court reiterated the *Rank Group* test, confirming it as the criteria for establishing potential infringements of the principle fiscal neutrality. As regards the second aspect, however, namely the strength of the principle itself, this was considerably less clear.

In the first of this group of cases concerning non-physical books, namely audio books, the (3rd Chamber of the) CJEU left the decision to the national court on whether applying a VAT reduced rate to hardcopy books but not to audio books violated the principle of fiscal neutrality, as follows:

'It is for the referring court to ascertain [...] whether books published in paper form and books published on other physical supports are goods which are liable to be regarded by the average consumer as similar. For that purpose, it will have to assess whether those books have similar characteristics and meet the same needs, using the criterion of whether their use is comparable, in order to ascertain whether or not the differences between them have a significant or tangible influence on the average consumer's decision to choose one or other of those books.'⁵²

However, barely six months later, in two other decisions on the same theme, the (4th Chamber of the) Court, whilst reiterating the *Rank Group* test, ruled that the principle of fiscal neutrality cannot extend the scope of the reduced rates of VAT to the supply of electronic books.⁵³ How can these apparently opposing decisions

51 It is common for a legal principle to gain strength once a test is established; the most clear example of this dynamic is the prominence gained by the principle of prohibition of abuse of law once a test was established in *Halifax*, even though, arguably, it already existed before that case, see R. de la Feria, 'Prohibition of Abuse of (Community) Law – The Creation of a New General Principle of EC Law Through Tax' (2008) *Common Market Law Review* 45(2), pp. 395-441.

52 CJEU, 11 September 2014, Case C-219/13, *K Oy*, ECLI:EU:C:2014:2207, at para. 31.

53 CJEU, 5 March 2015, Case C-479/13, *Commission v France*, ECLI:EU:C:2015:141; and CJEU, 5 March 2015, Case C-502/13, *Commission v Luxembourg*, ECLI:EU:C:2015:143.

be explained? Apart from the potential impact of the practical dynamics of having similar cases being decided by different chambers, the only (acceptable) legal answer is that the difference results from the ongoing dialectics between the principle of strict interpretation and the principle of fiscal neutrality.

V. Concluding Remarks: Centrality of Neutrality for Future Debates

The rules concerning exclusions from the VAT base, namely exemptions and rates, in their majority, date to the introduction of the European VAT system. A changing, globalized, economy requires adapting those, unavoidably outdated provisions to new economic realities. Against this background, the CJEU response has been an increased reliance on general principles of the VAT system, and in particular the principle of fiscal neutrality, as interpretative aids.

This growing tendency is certainly praise-worthy. It not only represents a more sophisticated approach to the legal interpretation of rules excluding specific goods and services from the tax base; but, in the absence of political will to remove those exclusions, it assists in the construction of the least distortive, more neutral, system possible in the presence of exclusions. However, it does also present significant challenges. Indeed, the inherent paradox between the two fundamental principles of the European VAT system, namely that of VAT as tax on consumption and that of fiscal neutrality, means in practice that the CJEU is faced with a very difficult choice. In essence, as set out in Table 3, the more neutral the system is, the more uncertain it is as well and more significant the erosion of the tax base.

The Principle of Fiscal Neutrality as an Interpretative Aid	
Advantages	Challenges
<ul style="list-style-type: none"> Fiscal neutrality demonstrates a more sophisticated approach to interpretation of exemptions than pure strict interpretation. 	<ul style="list-style-type: none"> Strict interpretation had advantage of certainty; decisions of the CJEU have become more unpredictable based on casuistic analysis (strict interpretation vs fiscal neutrality) which undermines legal certainty.
<ul style="list-style-type: none"> Fiscal neutrality generally results in less distortive, more neutral, system. 	<ul style="list-style-type: none"> Further erosion of the tax base.

Table 2: Advantages and Disadvantages of Interpretation Based on Fiscal Neutrality

Of course this dialectic struggle between strict interpretation and fiscal neutrality is reminiscent of a much wider legal dialectic, namely that between security and fairness. As such, the challenge for the CJEU is in essence similar to that faced by many courts worldwide, namely to reach the right balance; the right balance between promoting neutrality and eliminating distortions, without creating an environment of uncertainty, which will undermine confidence and impede economic growth. For taxpayers this will also present a challenge, namely that of adapting to the casuistic nature of the Court's decisions in the areas of exemptions and rates and to naturally embrace – at least to some extent – the uncertainty that it is associated with.

