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CJEU – Recent Developments in Value Added Tax 2015

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Preface

The Court of Justice of the European Union (CJEU) is a driving force in the field of European Union indirect taxation. As the significance of VAT as a revenue source continues to surge, it is increasingly valuable and important for business practitioners, government representatives, and academics alike to have a forum for the thorough analysis and exchange of opinions on indirect taxation cases pending at the CJEU.

On December 14-15, 2015, the Institute for Austrian and International Tax Law of WU (Vienna University of Economics and Business) hosted a Conference: **Court of Justice of the European Union: Recent VAT Case Law**. This conference project began upon the initiative of the Taxation and Customs Union Directorate of the European Commission and was the third conference in this series held at the Institute. The conference was a resounding success and brought together leading academics, judges, government representatives, and business representatives from all over the world. The cases presented and the issues raised at the conference are published in this book.

We are very grateful to the authors who not only delivered impressive presentations and articles but also committed themselves to an extremely ambitious schedule which allowed for vivid exchanges during the conference. This allowed us to address an extensive number of areas as well as to publish this book.

We would like to express our sincere gratitude for Linde's cooperation and swift realization of this publication project.

Above all, we would like to thank the members of the Institute for Austrian and International Tax Law and, in particular Renée Pestuka, who was responsible for the organization and preparation of the conference and getting the book published. Likewise, Jenny Hill contributed greatly to the completion of the book by editing and polishing texts for the authors, many of whom were writing in English as a foreign language. Furthermore, we are also grateful to Draga Turić and Stephanie Zolles who also helped in organizing the conference and editing this book.

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Content

Part I

Guiding Principles and Burning Questions in the VAT Case Law oft he CJEU

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

Rita de la Feria

I. Introduction[1]

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 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.

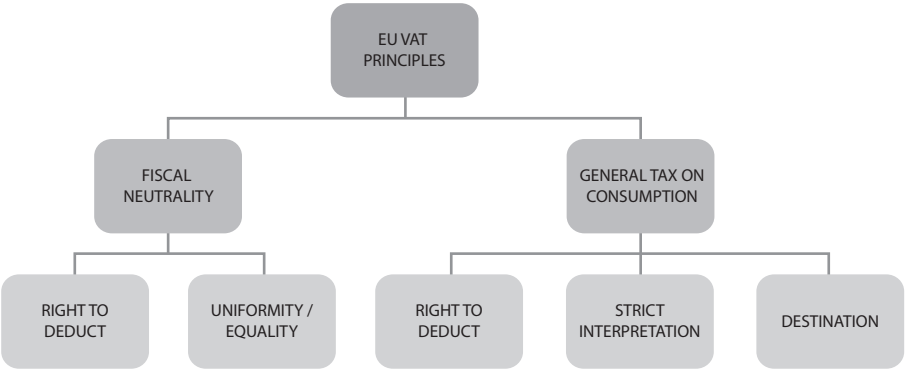

Figure 1: Typology of EU VAT Principles

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

CJEU Cases on Interpretation of VAT Exemptions: 2012-2015					
C-366/12	*Klinikum Dortmund*	Art. 132(1)(b)	Medical services	Strict Interpretation	2014
C-440/12	*Metropol Spielstätten*	Art. 135(1)(i)	Gambling	-	2013
C-461/12	*Granton Advertising*	Art. 135(1)(d) and (f)	Dealings in shares Dealings in payments	Strict Interpretation	2014
C-464/12	*ATP PensionService*	Art. 135(1)(d) and (g)	Dealings in payments Management of special investment funds	Fiscal Neutrality	2014
C-495/12	*Bridport and West Dorset Golf Club*	Art. 132(1)(m)	Sporting activities	Fiscal Neutrality	2013
C-584/13	*Mapfre asistencia and Mapfre warranty*	Art. 135(1)(a)	Insurance services	Fiscal Neutrality	2015
C-594/13	*«go fair» Zeitarbeit*	Art. 132(1)(g)	Welfare and social security work	Strict Interpretation	2015
C-595/13	*Fiscale Eenheid X*	Art. 135(1)(g)	Management of special investment funds	Fiscal Neutrality	2015
C-55/14	*Régie communale autonome du stade Luc Varenne*	Art. 135(1)(l)	Leasing of immovable property	Strict Interpretation	2015
C-114/14	*Commission v Sweden*	Arts. 132(1)(a)	Postal services	Fiscal Neutrality	2015
C-264/14	*Hedqvist*	Art. 135(1)(e)	Dealings in currency	Fiscal Neutrality	2015
C-334/14	*De Fruytier*	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 interpretation[41]. 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.

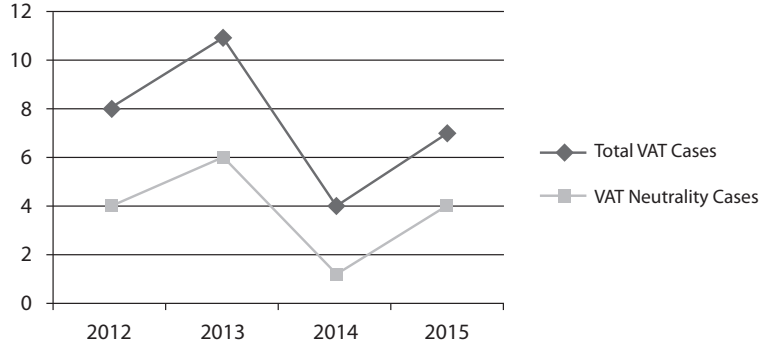

Diagram 1: Breakdown of VAT Exemptions Cases Decided on the Basis of the Fiscal Neutrality Principle

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, *Roders 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**
• Fiscal neutrality demonstrates a more sophisticated approach to interpretation of exemptions than pure strict interpretation.	• 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.
• Fiscal neutrality generally results in less distortive, more neutral, system.	• 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.

The Use of Soft Law by the European VAT Legislator, and What the CJEU Makes of It

Marie Lamensch

I. Introduction

For decades, soft law has played a role in the largely non-harmonized area of EU direct taxation. It more recently appeared in the harmonized area of EU VAT with the emergence of the VAT Committee guidelines (published since 2012), the adoption of 'explanatory notes' by the Commission (for the first time in 2014), and the opinions of the VAT Expert Group (since 2014). Beyond the EU borders, International VAT/GST guidelines are now also being developed under the auspices of the OECD of which substantial sections were endorsed by more than 100 states in 2014 and 2015. The objective of this chapter is to analyze and assess these four instruments including the influence that they have in the CJEU case law and to incite a discussion on the possible negative and positive uses of soft law in an EU harmonized area. The first primary conclusion that we can derive from this assessment is that the VAT Committee guidelines and the Commission explanatory notes do open the way to 'informal governance' in the area of VAT, which seems hardly reconcilable with the objective of harmonization. Our second main conclusion is that the VAT Expert Group opinions are the most desirable form of soft law currently available in the area of VAT because they open the way to an 'inclusive' type of governance in this field which, without doing away with the rule of law principle, is likely to be more efficient because it is more at pace with the realities on the ground.

II. Soft Law and its Emergence in EU Direct v. Indirect Taxation

Soft law includes any instruments with normative content that are not formally binding but do have legal relevance (e.g., rules of conduct, commitments, guidelines).[1] Soft law does not necessarily need to be issued by a sovereign entity or state but '*derives its strength from the fact that states and sovereign entities share its content, substance and goals*'. Accordingly, even private entities can issue soft law, '*whose influence and indirect binding value will be determined by the degree of acceptance among the addressees*'.[2] The debate concerning the relevance and effectiveness of soft law is rather polarized. Some tend to believe that soft law creates uncertainty and contributes to the disintegration of the entire legal system[3] and

1 Senden defines soft law as 'rules of conduct that are laid down in instruments which have not been attributed legally binding force as such, but nevertheless may have certain – indirect – legal effects, and that are aimed and may produce practical effects'. L. Senden, 'Soft Law, Self-regulation and co-regulation in European Law: Where Do They Meet?', in *Electronic Journal of Comparative Law*, 2005, p. 23.

2 P. Pistone, in: M. Lang et al. (eds), *Value Added Tax and Direct Taxation, Similarities and Differences*' (IBFD, 2008), p. 1165. The author provides the example of the International Accounting Standards which have been issued by a private body but, nevertheless, have a significant impact with accounting and tax laws often making an explicit reference thereto.

3 J. Klabbers, 'The undesirability of soft law', in *Nordic Journal of International law*, 1998, pp. 381-391.

that traditional (hard) law is more effective, reduces transaction costs, and provides more legal certainty.[4] Others have noted that hard law decreases the costs of operating within a legal framework by strengthening commitments and reducing transaction costs, while soft law cannot yield all of these benefits but may lower costs and increase the chances of achieving some sort of agreement in the first place.[5] In this chapter, it is suggested that, in the area of EU VAT, soft law is being exploited to achieve different results, some of which, in our perspective are – upon closer look – rather negative and should, therefore, be avoided or at least be limited while others are perceived as positive and should be encouraged and developed.

The EU constitutes a legal order in its own right which includes a legislative power (the Council and the Parliament) that traditionally adopts binding legislation ('hard' as opposed to 'soft') based on proposals from the executive power (the Commission), with the objective to achieve full economic integration between the Member States through the harmonization of their regulatory systems and the coordination of their socio-economic policies. Last but not least, it also includes a judiciary power (the Court of Justice of the European Union, 'CJEU' or 'Court') whose task is to uphold directly applicable law[6] that allows the free movement of products and production factors and prescribes the non-discrimination between domestic and cross-border economic activities.[7] The main outcome of this legal order is the Internal Market of the EU, i.e., a single market without internal borders in which the free movement of goods, services, capital, and persons is assured and in which citizens are free to live, work, study, and conduct business.

In the field of EU direct taxation, soft law has emerged in the context of the absence of commitment by the Member States to harmonize their national legislations in that specific area out of sovereignty concerns.[8] An example of soft law in

4 E. Eberhartinger/M. Petutschnig, 'Practicing experts' views of BEPS: A critical Analysis', in *WU International Taxation Research Paper Series,* 2015, pp. 2014-01, with several references.

5 E. Eberhartinger/M. Petutschnig, 'Practicing experts' views of BEPS: A critical Analysis', in *WU International Taxation Research Paper Series,* 2015, pp. 2014-01, with reference to L. Blutman, 'In the trap of a legal metaphor: International Soft Law', in *International & Comparative Law Quarterly*, 2010, pp. 605-624.

6 A provision that has direct effect can be relied on by private persons before national courts (CJEU, 5 February 1963, Case C-26/62, *Van Gend and Loos*, ECLI:EU:C:1963:1). In practice, any EU law provision enacting obligations that are sufficiently clear and unconditional must be considered as having a direct effect. As a consequence, individuals may rely upon them irrespective of the existence or not of internal provisions implementing those rules. See K. Lenaerts/P. van Nuffel, *European Union l*aw, (Sweet & Maxwell, 2001), p. 809.

7 S. Van Thiel, in S. Van Thiel (ed), *VAT harmonization in the EU and unfinished business*, (CFE, 2008) p. 6.

8 In the field of direct taxation, it is more accurate to discuss 'coordination' rather than 'harmonization'. The Member States indeed only agreed to abide by specific commitments under the Parent Subsidiary Directive 2011/96/EU (designed to eliminate tax obstacles for profit distributions between parent companies and subsidiaries based in different Member States); the Merger Directive 2005/56/EC

the EU direct tax area is the Code of Conduct for Business Taxation under which the Member States agreed already in the 1990s to not introduce any new harmful tax measures ('standstill') and to roll back existing tax measures considered to be 'harmful' by a group of representatives of the Member States (so-called 'Primarolo Group').[9] This Code of conduct is generally regarded as an effective political instrument relying on peer pressure in an area where the Member States remain fully sovereign.[10] Also in the direct tax area, the Member States made extensive use of the OECD Model Treaty (a collective project that began in the 1950s) in their negotiations of bilateral tax treaties. Likewise, the OECD Transfer Pricing guidelines (first issued in 1995) are basically little more than a commentary on a number of the Model Treaty Articles, however, are much more influential and have developed as a basis for practice and jurisprudence in the EU (and beyond).[11] Soft law, therefore, is a route that appears to have been proven as satisfactory in the largely non-harmonized area of EU direct taxation when the adoption of hard law seemed impossible or overly difficult due to political reasons.[12] We should make no mistake about it, however: it has, in no way, been sufficient enough to protect the smooth functioning of the Internal Market. The wide interpretation by the CJEU of the directly applicable rights to equal treatment and freedom of movements in direct income tax cases indeed played a major role in

(aimed at removing fiscal obstacles to cross-border mergers); the Interest and Royalty Directive 2003/49/EC (designed to eliminate withholding tax obstacles in the area of cross-border interest and royalty payments within a group of companies); and the Administrative Cooperation Directive 2014/107/EU (providing for automatic exchange of financial account information between Member States). There is neither harmonization nor coordination whatsoever of the Member States' personal income tax legislations (only the Treaty Freedoms can be usefully relied upon). Discussions towards a 'Common Consolidated Corporate Tax Base' (CCCTB) have been ongoing for years but are currently in a deadlock. The idea is to come up with a common system for calculating the tax base of businesses operating in the EU under which groups using the CCCTB would be able to file a single consolidated tax return for the whole of their activity in the EU and to offset losses in one Member State against profits in another. The consolidated taxable profits of the group would then be shared out to the individual companies under a formula. Thus far, the Member States have not yet been able to agree on a suitable formula. The Commission will make a new proposal in 2016 based on two key changes to re-launch the discussions. First, it will propose a mandatory CCCTB (it was initially proposed as an optional system) because it would greatly assist in preventing profit shifting by companies that engage in aggressive tax planning to avoid taxes (in the overall BEPS context). Second, it will propose that the CCCTB is introduced with an incremental approach in order to increase chances of agreement by the Member States.

9 The Code was established in the conclusions of the Council of Economics and Finance Ministers (ECOFIN) of 1 December 1997.

10 See H. Gribnau, 'Improving the Legitimacy of Soft Law in EU Tax Law', in *International Tax Review,* 2007, 35. The author notes that the conclusions of the Primarolo group are presented as 'acquis communautaire' in the negotiations with new Member States. In this case, soft law has thus acquired particularly significant force.

11 The OECD Model Tax Convention is, for instance, regularly cited by the CJEU in its income tax case law. See, for example, CJEU, 12 May 1998, Case C-336/96, *Gilly*, ECLI:EU:C:1998:221.

12 C. Radelli, 'The Code of Conduct Against Harmful Tax Competition: Open Method of Coordination in Disguise', in *Robert Schuman Center for Advanced Studies EUI Working Paper*, 2002, p. 3: '*Almost invariably, soft law is used where the lack of political consensus blocks the road to traditional law-making processes*'.

upholding the economic integration process in which the Member States are engaged.[13]

The circumstances are quite different in the area of VAT in which the Member States have been engaged in a process of harmonization of their national indirect tax systems since the 1960s as a necessary step for the achievement of the Common Market (now the Internal Market).[14] The 1957 Treaty of Rome indeed already provided for the suppression of customs duties and measures with equivalent effect on intra Community trade[15] and for the adoption of a common customs tariff and a common commercial policy towards third countries.[16] The founding Member States also committed to abide by a prohibition of indirect tax discrimination against imports from other Member States.[17] The Treaty further called for the harmonization of all indirect taxes between them.[18] In practice, the Member States have agreed to comply with a harmonized VAT framework in the form of a succession of Directives.[19] However, harmonization of the Member States' VAT systems has been a lengthy and difficult process because, in spite of their commitment to harmonize their legislations in the indirect tax area, all tax decisions in the EU (direct and indirect) remain subject to the unanimity rule.[20] This requirement has become more burdensome due to the EU's successive increase from six to 28 Member States. The unanimity requirement inevitably re-

13 Art. 19 of the Treaty of the European Union provides that the CJEU's role is to '*ensure that in the interpretation and application of the Treaties the law is observed*', and credit is due to the Court for having widely interpreted the directly applicable rights to equal treatment and freedom of movements by sanctioning both direct and indirect forms of discrimination and also non-discriminatory restrictions to the basic freedoms in the field of direct income taxation. See S. van Thiel, 'The direct income tax case law of the European Court of Justice, Past trends and future developments', in *Tax Law review*, 2008.

14 For an evolution from the Common market to the Internal Market, see R. De la Feria, 'The EU VAT System and Internal market', in *IBFD doctoral series*, 2009, p. 28.

15 Customs duties were a primary target of the 1957 Rome Treaty (see its Art. 12, a provision that had direct effect). Arts. 13 to 17 provided for the gradual removal of customs duties (roll back or phase out) by providing an automatic annual reduction in the duty ceilings (applied duties) during a transitional period of ten years. By 1969, customs duties on intra Community trade (and all measures with equivalent effect) were completely banned with direct effect.

16 Art. 3 of the 1957 Treaty of Rome.

17 Art. 95 of the 1957 Treaty of Rome and current Art. 110 Treaty on the Functioning of the European Union, 'TFEU'.

18 The application of the unanimity rule to tax matters in the EU has been successively based on Art. 99 of the 1957 Treaty of Rome, Art. 93 of the 1922 Treaty of Maastricht and Art. 113 TFEU, which currently reads as follows: '*The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition*'.

19 The current 'EU VAT Directive' is Council Directive 2006/112 of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1).

20 The unanimity rule applies to all tax matters including harmonization of taxes and related issues such as administrative cooperation and the fight against tax fraud while the co-decision procedure applies in most other areas of competence.

sulted in sometimes vague and incomplete rules most often coupled with options, exceptions, and derogations.

The CJEU played a major role in 'filling the gaps' in the area of EU VAT by adopting approximately 700 decisions over the past 45 years. There has been an inflation of decisions in the last ten years which is probably due partly to the expansion of the EU with new Member States whose national tax administrations and courts may have been struggling in understanding the peculiarities of the EU VAT system and partly to a rapidly changing economic landscape in the context of globalization as well as the new communication and telecommunication methods. The 28 Member States indeed seem to find it extremely difficult to reach unanimous agreements on the necessary adaptations or interpretations to be given to the EU VAT system in this new economic context.[21]

'Judicial harmonization', as coined by de la Feria in the field of EU VAT, has many advantages including, in particular, no requirement for political consensus and the authoritative value of the Court's decisions.[22] However, there are also substantial disadvantages. An initial question is whether the CJEU played a legitimate role by filling the gaps left by the legislator. We previously mentioned the substantial role that the Court played in the field of direct taxation where it has upheld the constitutionally guaranteed minimum of economic integration thereby acting as a 'Constitutional Court'. As far as VAT is concerned, Art. 113 TFEU provides that the Council '*shall (…) adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition*'. The use of '*shall*' in this case indicates that Member States committed to pro-actively harmonize their legislations '*to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market*'. Because areas of ambiguity have remained throughout the years with inevitable consequences on the smooth functioning of the Internal Market, we share the opinion that the Court was entitled to utilize its freedom of interpretation to reach the set objective thereby acting as a 'Supreme Court' by ensuring the correct application of secondary law.[23] As stated by Vanistendael: '*Member States should*

21 See, for example, the decisions of the Court concerning the concept of fixed establishment in the cases CJEU, 4 July 1985, Case C-168/84, *Berkolz*, ECLI:EU:C:1985:299; CJEU, 16 September 2004, Case C-396/02, *DFDS,* ECLI:EU:C:2004:536 and CJEU, 17 July 1997**,** Case C-190/95, *ARO Lease*, ECLI:EU:C:1997:374 which eventually found their way into Implementing Regulation 282/2011.

22 R. De la Feria, 'The Legal Significance of VAT Committee Guidelines', presentation made at the International VAT Conference KMLZ held in Tegernsee (Munich) on 26 June 2014. See, by the same author, 'The EU VAT System and Internal market', *IBFD doctoral series*, 2009, p. 260 (2009).

23 It may even be argued that the Court could play a more pro-active role as a Constitutional Court in the area of VAT by accepting the task of assessing the conformity of the VAT Directive with the Treaty in the same way that it assesses national legislations as it has decided in several cases that the application of the Treaty freedoms is subject to limitations in harmonized areas. See, for example,

not have the illusion that they can have their national cake and eat the European one: they must choose and face the consequences'. Europe should be authorized to intervene in the national tax systems for implementing and enforcing the tax conditions that affect the operation of the Single Market within the Economic and Monetary Union.'[24]

This having been said, depending upon the CJEU for filling the gap of the EU harmonized VAT system is a method that clearly has its limits.[25] Courts decisions only address the specific situations and questions that are submitted to it. Such a fragmented approach is admittedly not optimal. Also, the CJEU primarily has the power to interpret existing EU legislation and, if need be, to declare national legislations incompatible therewith but not to create new ones.[26] Finally, each Court's decisions may incite additional questions.[27]

It is in this particular context that soft law appeared in the area of EU VAT. The remainder of this chapter will focus on four soft law instruments that are relevant for the EU VAT system. Three are specific to the EU, namely: the VAT Committee guidelines (Section 2); the Commission explanatory notes regarding the place of supply of telecommunications, broadcasting, and electronic services (Section 3); and the VAT Expert Group opinions (Section 4). The fourth originates from the OECD, i.e., the International VAT/GST guidelines (Section 5) and has a much wider geographical impact. The legal force and weight of these respective instruments in the case law of the CJEU will be assessed, however, issues of legiti-

CJEU, 17 April 2007, Case C-470/03, *AGS-COS.MET,* ECLI:EU:C:2007:213 and CJEU, 5 April 2001, Case C-123/00, *Bellamy,* ECLI:EU:C:2001:214. The Court did not refuse to assess the VAT Directive concerning the Treaty in the case CJEU, 26 October 2010, Case C 97/09*, Schmelz*, ECLI:EU:C:2010:632, however, the result is a rather lenient constitutional control of the VAT Directive. To be noted, however, that some authors have questioned the legitimacy of the Court's role in filling the gaps left by the legislator. See R. De la Feria, 'The EU VAT System and Internal market', *IBFD doctoral series*, 2009, p. 281 et seqq. Member States themselves have challenged the Court's jurisdiction in early cases. See CJEU, 26 February 1991, Case C-15/81*, Gaston Schul*, ECLI:EU:C:1991:77, para. 25; CJEU, 17 November 1993**,** Case 415/85, *Commission v Ireland*, ECLI:EU:C:1993:891, para. 8 and CJEU, 21 June 1988, Case C-416/85, *Commission v United Kingdom*, ECLI:EU:C:1988:321, para. 8.

24 F. Vanistendael, 'A Window of Opportunity of Europe: Member States Cannot have their National Cake and Eat the European one', *EC Tax Review*, 2003, p. 2.

25 Cross-border ruling may also be available, but it does not offer the same level of legal certainty, in the first place, because these rulings are not offered by all the Member States and do not have *erga omnes* effects but also because the cross-border ruling procedure does not guarantee that the Member States concerned '*will agree on the VAT treatment of the transactions envisaged*'. See http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/traders/cross_border_rulings/cbr_info-notice-to-the-public_en.pdf, accessed on 20 February 2016.

26 R. De la Feria, 'The EU VAT System and Internal market', *IBFD doctoral series*, 2009, p. 279.

27 R. De la Feria, 'The Legal Significance of VAT Committee Guidelines', presentation made at the International VAT Conference KMLZ held in Tegernsee (Munich) on 26 June 2014. See also J. Swinkels, 'Combating VAT avoidance', *International VAT Monitor, 2005, p. 246: '[T]he case law of the ECJ, on one hand, provides clarifications on the existing provisions of the Sixth Directive but, on the other hand, also makes application of those provisions more difficult. Every ECJ judgment appears to give rise to new questions*'.