

## Recent Developments in the ECJ

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## THE LAST YEAR

- 1.1 **A table of the cases decided, with references, is appended to my paper.**

### Judgments and Opinions

- 1.2 The ECJ has given 33 judgments in VAT cases since 1 May 2005. The first was in **RAL**, the reference from the Chancery Division, and the latest is in **Federation of Technological Industries**, the reference from our Administrative Court, in which judgment was given last week.
- 1.3 The CURIA website lists a further 4 VAT cases in which Advocates General have delivered their Opinions (in English) and in which judgments are still awaited.

### Statistical analysis of Judgments

- 1.4 28 Judgments were on references for preliminary rulings under Article 234;  
4 Judgments were in infraction proceedings brought by the Commission under Article 226. The Commission won all 4 cases;  
1 Judgment was in an action for an annulment of a Regulation and Directive (concerning administrative cooperation and mutual assistance by national authorities) brought by the Commission, under Article 230. The Commission failed.

### Who has been most prominent in the development of VAT law at the ECJ level?

- 1.5 Of the references decided by the ECJ in the last year, 12 were referred by UK courts or tribunals. Interestingly, in terms of which court is likely to refer, 5 were referred by the VAT & Duties Tribunal, 6 (including the 3 Bond House group of cases) were referred by the Chancery Division and, as stated **FTI** was referred by the Administrative Court in a judicial review. The next most frequent referrer of cases decided in the past 12 months was the Netherlands (with 5), an equally impressive rate, given its population.
- 1.6 So, whether you think the extent of VAT litigation in UK good or bad, English courts and tribunals and UK lawyers have been at the forefront in references. The UK has undoubtedly been responsible for the majority of the most interesting and important cases.
- 1.7 If a brief advert can be forgiven, of the 12 UK references no less than 11 featured barristers from Monckton, with 4 silks and 7 juniors appearing before the ECJ, many several times. In more than one case all UK parties were represented by barristers from Monckton.

Incidentally, the only Customs Duties case<sup>1</sup> decided on a reference from the UK in the same period featured a fifth silk from Monckton Chambers. So the UK, Monckton Chambers, and its clients have been conspicuously prominent in legal developments in indirect taxes at the ECJ level, especially VAT.

### Infraction proceedings

- 1.8 On a less cheery note, the UK also topped the list in infraction proceedings, being challenged in 2 cases and losing both: -
- (1) Reduced rate of VAT on commission received by auctioneers on certain sales by auction of works of art, temporarily imported into the UK;<sup>2</sup> and
  - (2) Obligations re Gibraltar, where despite the fact that the Sixth Directive does not apply, the UK was held to be obliged to implement Directive 77/799/EEC on mutual co-operation by competent national authorities.<sup>3</sup>
- 1.9 Nevertheless, despite the significance for those concerned in art auctions, where the judgment was an obvious blow, the infraction proceedings were small beer.

### Subject matter

- 1.10 The breakdown of the references by subject matter is also of interest (remember there were 28 Judgments, including the Halifax group of cases, and some concerned several articles of the Sixth Directive):
- (1) 7 featured Article 2;
  - (2) 6 concerned exemptions;
  - (3) 6 concerned input tax deduction, as did the 2 non-UK infraction proceedings;
  - (4) 5 concerned place of supply.
- 1.11 Other papers and talks at this Conference are devoted to the *Halifax* group of cases and *Kretztechnik*. I have left aside input tax deduction for that reason. This paper covers other important cases. Starting with the most recent.<sup>4</sup>

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<sup>1</sup> Case C-491/04, *Dollond & Aitchison Ltd v Commissioners of Customs & Excise*, decided 23 February 2006

<sup>2</sup> Case C-305/03 *Commission v United Kingdom*, decided 9 February 2006

<sup>3</sup> Case C-349/03 *Commission v United Kingdom*, decided 21 July 2005

<sup>4</sup> Of the other cases decided that I do not mention below, because of their subject matter, or specific, or rather prosaic nature a number are unlikely to figure large in many persons' thinking.

## 2. THE FEDERATION OF TECHNOLOGICAL INDUSTRIES, C-384/04

- 2.1 HMRC and the Government did not just trust to winning the *Bond House/Optigen* references when it came to countering MTIC fraud. Unconfident of being able to use direct means to stop fraudsters, they also took a number of other steps.
- 2.2 The first was to introduce, in the Finance Act 2003, certain amendments to the Value Added Tax Act 1994 ('VATA 1994') with effect from 10 April 2003. These included in particular:
- (1) Provisions to impose "joint and several liability of traders in supply chain where tax unpaid" to quote the inelegant section heading, on supplies of phones and computers (including parts and accessories);<sup>5</sup>
  - (2) Power to require security as a condition of paying any VAT credit, or as a condition of a taxable person being supplied with goods.<sup>6</sup>
- 2.3 Subsequently the UK has also applied to the EC Commission, as announced by HM Paymaster General on 26 January this year, to derogate from the Sixth Directive and apply a reverse charge to the supply of typical MTIC goods, business to business, which would require the recipient of the supply rather than the supplier to account for and pay VAT on the supply of the goods. That would leave no-one with a large VAT Credit claim, but begs the question of where lines should be drawn when making a fundamental change in the structure of the tax (i.e. as to the person liable to pay the tax) as the reverse charge would apply to very ordinary supplies of ordinary goods within the UK.<sup>7</sup>
- 2.4 FTI brought a judicial review challenging the amendments introduced by FA 2003 as contrary to the Sixth Directive. Lightman J.<sup>8</sup> referred questions relating to articles 21 and 2 to the ECJ, giving FTI a fair wind by holding that they were likely to succeed. The Court of Appeal<sup>9</sup> was asked to overturn the reference and split, only a majority upholding the reference, and only then with "*real misgiving*". The Court of Appeal chose to encourage HMRC to apply the impugned law in the expectation of eventual victory in Luxembourg. For the Court of Appeal the end justified the means.

<sup>5</sup> See s 77A VATA 1994

<sup>6</sup> See Schedule 11, paras 4 (1A) – (5) VATA 1994

<sup>7</sup> By the way this appears to leave me and probably your firm or company paying the reverse charge when we buy a computer or phone for business use, if the derogation is authorised.

<sup>8</sup> *R (on the application of Federation of Technological Industries and others) v Customs and Excise Commissioners* [2004] STC 1008

<sup>9</sup> *R (on the application of Federation of Technological Industries and others) v Customs and Excise Commissioners* [2004] STC 1424

- 2.5 The ECJ<sup>10</sup> has refused to conclude that s. 77A VATA 1994, the joint and several liability provision, complies with article 21, the Administrative Court must decide, and has concluded that the security provision went beyond what was permitted to Member States by article 22.
- 2.6 The ECJ concluded (paragraphs 24 -26, 28-30):
- (1) The joint and several liability measure came within article 21 as it related to the person made liable for payment of VAT, not merely to the 'collection' of VAT;
  - (2) Member States were authorised by article 21(3), in certain situations, to make persons not otherwise liable for VAT jointly and severally liable for VAT. The situations included all those in articles 21(1) and (2);
  - (3) However, in exercising that power, Member States were required to comply with the general principles of Community law, including, in particular, legal certainty and proportionality. The Member State could aim to combat fraud by protecting the exchequer as effectively as possible, but measures must not go further than is necessary for that aim.
- 2.7 Thus far the ECJ's reasoning and conclusions are not radical. The steps in the logic follow, or can easily be extrapolated from Joined Cases C-286/94, C-340/95, C-401/95 and C-47/96 **Garage Molenheide BVBA v Belgium** [1998] STC 126, the input tax credit payment protective measures case, almost a decade old.
- 2.8 The ECJ appears to have been not much troubled by a power to impose joint and several liability that extended liability to a taxable person where "*at the time of the supply [presumably of the goods to him], that person knew or had reasonable grounds to suspect that the VAT payable in respect of that supply, or of any previous or subsequent supply, would go unpaid*". It also accepted that presumptions as to knowledge could be relied upon against the taxable person (see paragraph 32).
- 2.9 However it was anxious that such presumptions should not be formulated in such a way as to make it practically impossible, or excessively difficult for the taxable person to rebut them with evidence to the contrary (ibid).
- 2.10 This is interesting more for acceptance that an evidential burden can be placed on the taxable person in these circumstances, than recognition of some restriction on the UK in

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<sup>10</sup> Case C-384/04 *Commissioners of Customs & Excise v Federation of Technological Industries*

imposing presumptions. An interesting contrast can be drawn with the ECJ's attitude to the unjust enrichment defence that can be invoked by a Member State where repayment is sought by a taxpayer of VAT that has been paid when not due.<sup>11</sup> These presumptions against the taxpayer are frowned upon.

2.11 The presumptions in s. 77A(6) VATA 1994 kick in if the price payable by the taxable person facing joint and several liability was less than:

- (1) the lowest price that might reasonably be expected to be payable for them in the open market (s. 77A(6)(a));
- (2) the price payable on a previous supply of the goods (s. 77A(6)(b)).

2.12 If FTI encounter a court of the same outlook as the Court of Appeal that upheld the reference, the prospects for the s. 77A(6) presumptions being upheld must be good.

2.13 However, in my view s. 77A(6)(b) is disproportionate, or goes further than is necessary. It effectively assumes the person on whom liability is imposed knows what prices were paid by his supplier and his supplier's supplier, and so on up and down the supply chain, with no apparent reason for so doing. Obvious commercial considerations dictate sellers do not normally tell their buyers how much they have paid for the goods, and this presumption arises without there being any reason for the trader to suspect that normal commercial considerations do not apply. It appears to me, if this presumption has any weight at all, for it could conceivably be rebutted merely by evidence that the taxable person did not know other prices and that it would have been commercially unrealistic to make enquiries of a supplier, it comes too close to imposing strict liability.

2.14 S. 77(6)(b) is less obviously offensive, given it is rebuttable. However, the limitations of the general principles may require the test, whilst objective, to take into account the particular circumstances, or even attributes, of the trader on whom liability is being imposed and make allowances. The onus on HMRC to bring evidence to prove that the basis for the presumption is made out should also be heavy, especially in markets where HMRC themselves might have seen the pricing structure as heavily distorted by MTIC fraud.

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<sup>11</sup> Joined cases C-441/98 and C-442/98 *Kapniki Michailidis AE v Idryma Koinonikon Asphaliseon* [2000] ECR I-7145. At para 42 the ECJ stated: "although Community law does not preclude a Member State from refusing repayment of charges levied in breach of its provisions where it is established that repayment would entail unjust enrichment, it does preclude any presumption or rule of evidence intended to shift to the trader concerned the burden of proving that the charges unduly paid have not been passed on to other persons and to prevent him from adducing evidence in order to refute any allegation that the charges have been passed on."

2.15 The bottom line for the ECJ in *FTI* was (see paragraph 33):

*"Traders who take every precaution which could reasonably be required of them to ensure that their transactions do not form part of a chain which includes a transaction vitiated by VAT fraud must be able to rely on the legality of those transactions without the risk of being made jointly and severally liable to pay the VAT due from another taxable person."*

2.16 It may well be, given that HMRC requested traders in various "MTIC goods" to take certain steps, but only certain steps, that HMRC will have difficulty relying on the presumptions and upholding joint and several liability on those who followed their guidance, in the absence of some positive evidence from HMRC that those traders had some actual or constructive knowledge that VAT would go unpaid. That would not seem unfair on the exchequer. Despite the ECJ's broad endorsement of presumptions in principle, it is difficult to see how it can be fair/proportionate to put any, or any substantial, burden on the taxpayer to prove negatives in relation to fraud. Litigation could soon become excessively difficult for the taxable person. Clearly HMRC faced and face serious frauds, but assuming they were grave and patent, does that not suggest there should be evidence available to HMRC.

2.17 For the ECJ the UK's security provisions went too far and breached Article 22(8) because the UK legislation permitted security to be obtained from persons other than those actually liable for VAT under the ordinary workings of the Sixth Directive and those persons properly declared jointly and severally liable to pay VAT pursuant to article 21(3).

2.18 With the help of the ECJ and hindsight that flaw may now seem obvious. Security can be imposed on persons properly declared jointly and severally liable to pay VAT pursuant to legislation compatible with article 21(3).

2.19 However, although HMRC has not got exactly what it wanted, if the words of the ECJ on permissible imposition of joint and several liability are considered in isolation they are strikingly wide enabling a Member State:

*"to make a person jointly and severally liable for the payment of VAT if, at the time of the supply, that person knew or had reasonable grounds to suspect that the VAT payable in respect of that supply, or of any previous or subsequent supply, **would** go unpaid."*  
(emphasis added)

2.20 It must be hoped that this is firmly embedded in the fraud context. The requirements of proportionality and necessity may in practice operate very differently outside that context,

but as they appear on the page the words are perfectly apt to cover those dealing with companies that they suspected would become insolvent with liabilities to HMRC. Given HMRC's response to **Bond House**, I stress that the suspicion must be that VAT **would** go unpaid, not that it **might** go unpaid.

2.21 It had earlier been emphasised by the ECJ in **Bond House**, at paragraph 54, that the question whether the VAT on the earlier or later sale of the goods concerned has not been paid to the public purse is irrelevant to the right of the taxable person to deduct input VAT (citing C-395/02 **Transport Service** [2004] ECR I-1991, paragraph 26).

2.22 There should, in principle, not be a danger that the taxable person guaranteed the right to deduct input tax under article 17, can be fixed with joint and several liability to pay that very same tax as output tax under powers provided by article 21. Any other result would be self-defeating as the right to deduct would be cancelled out by the new liability. This should provide a further restraint on joint and several liability. The tests should be aligned. A person entitled to deduct input tax on the supply to him in the chain should not be made jointly and severally liable to pay output tax in respect of any other supply in the chain.

### 3. **BOND HOUSE (Joined Cases C-354/03, C-355-03 and C-484/03)** [2006] STC 419

3.1 Much ink has already been spread across many pages and it is easy to forget, after the long wait for a decision, that the judgment was only given on 12 January. However, 4 months have now passed and many taxpayers, including in particular many in respect of whom HMRC made a decision not to raise allegations of fraud, that must have been both conscious and convenient, appear to remain unpaid. The drama has not yet entirely moved on to the remedies "Endgame", although a Group Litigation Order may be coming soon, but is heading that way for many traders denied their legitimate claims for input tax credits.

3.2 Brian New is giving HMRC's view at this Conference, so without being too provocative, this paper deliberately attempts to set out what I expect to be an opposed view from another angle.

3.3 The ECJ held that the objective character of transactions was key, that each transaction must be regarded on its own merits and that the character of a particular transaction in the chain cannot be altered by earlier or subsequent events. It stated (paragraph 55):

*"transactions such as those at issue in the main proceedings, which are not themselves vitiated by VAT fraud, constitute supplies of goods or services effected by a taxable person acting as such and an economic activity within the meaning of Articles 2(1), 4 and 5(1) of the Sixth Directive, where they fulfil the objective criteria on which the definitions of those terms are based, regardless of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person..."*

- 3.4 If the ECJ had put a full stop there the judgment would have been an unmitigated defeat for HMRC. The words it added should not be considered to transform it into anything other than a thorough rejection of the argument on circularity and lack of economic activity that HMRC had advanced and relied upon, usually as their single reason, in denying traders input tax deduction. In fairness, HMRC appear to accept that.
- 3.5 The added words were *"...of which that taxable person had no knowledge and no means of knowledge."*
- 3.6 Thus HMRC had to discard its legal argument and turn to questions of fact related to fraud. This paper will not dwell on the legitimacy of doing so in existing litigation, especially that stood over awaiting the ECJ's judgment, but on HMRC's new position. HMRC embarked on a review of cases, reviewing their earlier decisions to refuse repayments, *"in the light of the ECJ guidance"*, to decide if repayments should now be found to be *"allowable"* (see Business Brief 01/06 of 19 January 2006). That hardly trumpeted that, given admissions made in tribunal proceedings or correspondence, many denied payment had just undeniably had a **right** to deduct upheld by the ECJ. In the Tax Journal HMRC<sup>12</sup> were less neutral. HMRC had avoided *"outright defeat"*. Moreover, HMRC's reading of the ECJ's *"helpful guidance on the right to deduct input tax where there is fraud"* was that *"the right to deduct input tax is not available if the taxable person in question had knowledge or the means of knowledge that there was fraud or possible fraud in the chain."*
- 3.7 HMRC's apparent view of the markets in which MTIC fraud was rife seemed to many to be such that every buyer and seller *"had ... means of knowledge that there was ... possible fraud in the chain"* in every supply chain, at least where, as on HMRC's view of the chains in issue, there was no apparent final consumer.

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<sup>12</sup> Issue No 823 6 February 2006, Case Comment by Ian Heron, HMRC Central Compliance.

- 3.8 In my view what the ECJ appears to HMRC to be saying is not what it actually said. It first referred to *"the possible fraudulent nature of another transaction in the chain"* in paragraph 51, which proceeded on the basis that the transactions, said not to be supplies by HMRC, were **not** vitiated by VAT fraud and were supplies *"regardless... of the possible fraudulent nature of another transaction in the chain..."*. Nowhere else in the ECJ's findings (paragraphs 36 to 54) was there a reference to "possible fraud" again until it set out its answer at paragraph 55.
- 3.9 The ECJ saw the right to deduct as only liable to be cut down if the taxable person knew or had means of knowing that another prior or subsequent transaction is vitiated by fraud (see paragraph 52). That begs the interesting question of when a transaction is vitiated by VAT fraud, presumably fraud relating directly to it. It is, however, a fairly robust indication that "means of knowledge of **possible** fraud in the chain" is not to the point. The quotation from paragraph 51 in paragraph 55, referring to possible fraud, should be read in that light and in the light of the conclusion in paragraph 55 on the right to deduct input tax. The right to deduct input tax cannot be affected unless the person is claiming to deduct *"knowing or having any means of knowing"* that *"another prior or subsequent transaction **is** vitiated by fraud."* The test relates to knowledge of actual fraud, not the possibility of fraud, which seems to me to be impossible to exclude in general terms and an inappropriate test. HMRC's test goes against the grain of the judgment and cannot be right for that reason, even if there can be debate about the literal reading of certain passages in the judgment.
- 3.10 Leaving that aspect of the knowledge test aside, when is a VAT supply vitiated by fraud? The ECJ was surprisingly, perhaps studiously, unhelpful. The answer would appear likely to turn on the intention of the supplier or recipient of the particular supply in question. A supply made as part of a fraud, but not of a fraud on HMRC, seems highly unlikely to lose its nature as a supply and thus not be subject to VAT (e.g. a ringer sold as a champion racehorse). However, can it really be the case that a person entering into a transaction that has all the usual attributes of a VAT supply can 'vitate' the supply by means of his own fraudulent intention not to account to HMRC for VAT on the supply and thus render the transaction not subject to VAT at all. 'Vitated' means *"destroy or impair the legal validity of"* according to the OED. Does the ECJ simply mean that the right to deduct input tax of the recipient of the supply, with knowledge or means of knowledge of the actual fraud of the seller is lost.

## 4. EXEMPTIONS

### C-498/03 Kingscrest [2005] STC 1547

- 4.1 The ECJ dealt with 6 cases on exemptions. Perhaps the most interesting was **Kingscrest**, relating to the supply of services in a residential care home for adults and children's homes. Kingscrest wanted its supplies to be taxable, so that it could recover input tax, as all of its clients were local authorities who could get refunds of all VAT chargeable on Kingscrest's supplies pursuant to s. 33 VATA 1994. In 2002 HMRC had failed to persuade the High Court<sup>13</sup> that Kingscrest's supplies were exempt under item 4 of group 7 of Schedule 9 VATA 1994, as it then was, implementing article 13(A)(1)(b), the hospital and medical care exemption. It was a case of some public interest, I recall particularly to the Daily Mail, who produced a first page headline, as it raised a prospect that individuals might have to pay VAT on residential care for themselves or their relatives.
- 4.2 Group 7, items 4 and 9 of Schedule 9 VATA 1994, the latter being the welfare services exemption, were amended (with prospective effect) by the VAT (Health and Welfare) Order, SI 2002/762, from 21 March 2002. Kingscrest again claimed taxable status for its supplies asserting it was a body that fell outside the exempting provisions of article 13(A)(1)(g), welfare services, and (h), child protection services, as it was profit making and not 'charitable' under English law.
- 4.3 The ECJ effectively ruled that Kingscrest's supplies fell within the exemptions.
- (1) It emphasised that as exemptions have independent Community law meanings, specific conditions relating to the status of the service provider within those exemptions must also have such independent meanings. Exemption could not turn on the application of the English law of charities, even though the English version of the Directive referred to "*organisations recognised as charitable by the Member State concerned*";
  - (2) The exemption could apply to supplies by private bodies that aimed to be profit-making;
  - (3) In exercising its discretion to apply the exemption to supplies by private profit-making entities, a Member State had to abide by Community law principles, in particular the principles of equal treatment and fiscal neutrality.

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<sup>13</sup>*Customs and Excise Commissioners v Kingscrest Associates Ltd* [2002] STC 490

- (4) Though the ECJ left the final conclusion to the VAT & Duties Tribunal, it seemed to flag it as highly likely that both principles had been complied with, because exemption was extended to all organisations registered under the Care Standards Act 2000.

4.4 A small point of interest, making exemption depend on satisfying domestic regulatory welfare legislation seems to have made it appear neutral and non-distortive to the ECJ, quite unlike the use by Germany of reference to domestic criminal legislation to confine the exemption for gambling under article 13B(f) which proved objectionable to the ECJ in *Fischer v Finanzamt Donaueschingen* (Case C-283/95) [1998] STC 708.

#### **Kinderopvang Enschede C-415/04**

4.5 The ECJ also examined article 13(A)(1) (g) and (h), together with (i), in Case C-415/04 ***Kinderopvang Enschede***. The case concerned the exemption of intermediary services as between parents of children and the providers of welfare, child protection and education. The ECJ's test was whether the intermediary services were "*essential to the provision of quality childcare*" and it considered that screening and training providers could be regarded as essential and exempt, but that merely maintaining lists of suitable carers was not essential, and so not exempt. The ECJ emphasised that the basic purpose of the intermediary services must not be to obtain additional income for the service provider by carrying out transactions which are in direct competition with those of commercial enterprises liable for VAT. Thus the threat of distortion of competition and, hence, fiscal neutrality, played a role here too. Fiscal neutrality becomes something of an "exemption theme".

#### **Solleveld C-433/04**

4.6 Case C-433/04 ***Solleveld*** concerned the limits that could be imposed by a Member State on the application of the article 13A(1)(c), paramedical and medical care exemption, where therapeutic treatments were provided by physiotherapists and psychotherapists. Member States, said the ECJ, were entitled to make the exemption depend on a combination of definition of the qualifications of the paramedical providers of services and specification of types of care in respect of which each paramedical profession was qualified. The Member States' discretion in specifying requirements was, expectedly, subject to the principles of equal treatment and fiscal neutrality. Paramedical providers could expect exemption if their qualifications ensured a level of care equivalent to that given by other providers benefiting from the exemption.

### **Abbey National C-169/04**

- 4.7 The other UK reference concerning exemptions was the **Abbey National** case. It dealt with the exemption of the management of special investment funds under article 13B(d)6. At the crux of the decision, rather than break much new ground, the ECJ can be seen to be extending principles formulated in earlier financial services exemption cases, especially *Case C-2/95 Sparekassernes Datacenter (SDC) v Skatteministeriet* [1997] STC 932 and *Case C-235/00 CSC Financial Services Ltd v Customs and Excise Commissioners* [2002] STC 57.
- 4.8 This judgment too starts from the need to identify the exemption's independent meaning in Community law. The ECJ emphasised, applying the principle of fiscal neutrality, that the legal basis of the fund (contract/trust/statute) could not be a factor in determining whether exemption applied. Fiscal neutrality remained prominent throughout the analysis, emphasis being placed on the ability of operators of funds to choose a form of organisation based on strictly commercial, as opposed to fiscal, considerations.
- 4.9 In interpreting "management", and the real dispute was as to the exemption of a raft of delegated services relating to the funds performed by a third party "manager", the ECJ adopted the familiar contextual and purposive approach. However, in my view unusually, and much assisted by AG Kokott, the ECJ seems to have got a real grip on the purpose of an exemption under article 13B(d). Such greater rigour is to be welcomed. The ECJ said (at paragraph 62):

*"the purpose of the exemption...is, particularly to facilitate investment in securities for small investors by means of investment undertakings. [Article 13B(d)(6)] is intended to ensure that the common system of VAT is fiscally neutral as regards the choice between direct investment in securities and investment through undertakings for collective investment."*

- 4.10 The conclusion was that services performed by a third party manager in respect of administrative management of investment funds are exempt if, viewed broadly, they form a distinct whole and are specific to, and essential for, the management of those funds.

### **Ygeia Joined Cases C-394/04, C-395/04**

- 4.11 In Joined Cases C-394/04 and C-395/04 **Ygeia**, the ECJ held, that the supply of telephone services and the hiring out of televisions to in-patients by persons covered by Article 13A(1)(b) of the Sixth Directive, hospital and medical care exemption, and the supply by

those persons of beds and meals to people *accompanying* in-patients do not amount, as a general rule, to activities closely related to hospital and medical care within the meaning of the exemption. The essentially pragmatic approach recognised it could be otherwise if the supplies were not directed simply to comfort, or well-being, but were essential to achieve the therapeutic objectives of the hospital and medical care. In that case and where the basic purpose of the supplier is not to obtain additional income for itself by carrying out transactions which are in direct competition with those of commercial enterprises liable for VAT, the exemption might apply, said the ECJ. Thus the threat of distortion of competition and, hence, fiscal neutrality again, feature large.

### **Jyske Finans C-280/04**

- 4.12 In *Jyske Finans* the ECJ held that the Article 13(B)c, exempting supplies of goods in respect of which input tax deduction was blocked, did not preclude taxation of resales of goods acquired from persons who could not declare VAT and where no input tax had been deductible for *that* reason.

### **Theme**

- 4.13 The clear thread running through the judgments on exemption is the importance of preserving fiscal neutrality, which appears to have been far more relevant in terms of outcomes than the still always recited principle of approach that exemptions, as exceptions to the general rule that supplies are subject to VAT, must be strictly construed. That requirement is perhaps now, save in extreme cases, not much of a driver. What appears to have led the ECJ to its decisions, whether on article 13A, when examining conditions on and extent of the exemptions of activities in the public interest, or 13B, in particular the financial services exemptions, is, essentially, preventing exemptions from distorting competition and influencing questions of the form and structure of business operations, which should be commercially driven, so long as the exemption does not seem plainly to be being over-stretched. It is distortion of competition, not the need to keep the exemption narrow for the sake of it, which is at the fore of the ECJ's decision to prevent hospital care providers supplying TVs exempt and to allow the UK to extend welfare and child protection exemptions to regulated private profit-making bodies.
- 4.14 Anyone considering whether an exemption applies, after having looked for close parallels in the authorities, could do worse than test his/her view in terms of which answer least risks disrupting fiscal neutrality and distorting competition.

## 5. OTHER CASES

- 5.1 The place of supply cases make an interesting group, with boats (cruise ships and boat show services) making their customarily high number of appearances. **RAL** [2005] STC 1025 is perhaps of the most interest and will by now have been long digested. The ECJ held, by-passing other complex issues, that article 9(1) did not take precedence over article 9(2) and that a supply of services of enjoyment of gaming machines installed in amusement arcades located in the UK were to be regarded as constituting entertainment or similar activities within the meaning of art 9(2)(c). Therefore the place where those services were supplied was the place where they were physically carried out, the arcades. Thus whether or not the supplier was established in the EU was of no moment.
- 5.2 Case C-41/04 **Levob** [2006] STC 766, the ECJ held that a supply of basic computer software alongside customisation services was a single supply of services for VAT purposes, even though there was not a single price, applying the **CPP** approach. The place of supply was governed by the third indent of article 9(2)(e), under "services of engineers and other similar services", as customisation was likely to be carried out by engineers, and the place of supply to be determined by reference to establishment(s) of the customer.
- 5.3 In **Köhler** [2006] STC 469, the ECJ examined the place of supply of supplies made from a boutique on a cruise ship. It held, interpreting article 8(1)(c), that a supply of goods effected on a ship during a stop in a third (non-EU) territory (where passengers could disembark) was deemed to be made outside the scope of the Sixth directive.
- 5.4 In C-114/05 **Gillan Beach Ltd**, involving supplies of boat show services, the ECJ expressed (at paragraph 17) an interesting view on article 9(2):

*"The overall purpose of Article 9(2) of the Sixth directive is therefore to establish a special system for services provided between taxable persons is included in the price of the goods."*

That is understandable, by reference to the 7<sup>th</sup> recital to the Directive, but to me only if it is "an" overall purpose. The purpose of article 9(2)(c) was said to be "similar" and the indents unified by the complex nature of the services covered. An inclusive service by an exhibition organiser to exhibitors in a fair or an exhibition hall falls within article 9(2)(c) first indent.

- 5.5 In Case C-210/04 **FCE Bank plc**, The ECJ concluded that a fixed establishment, which is not a legal entity distinct from the company of which it forms part, established (as a branch) in a Member State different from that of the company, and to which the company provided

services should not be treated as a taxable person, even if costs were imputed to it in respect of those services.

- 5.6 Cases on article 26, the Tour Operator's special scheme, Case C-291/03 *My Travel* and Case C-200/04 *Ist* [2006] STC 52 are all of some interest.

## 6. TRENDS: A FEW THOUGHTS

### **Role of the ECJ: Establishing the overriding principles and leaving national courts to fill in the framework.**

- 6.1 The ECJ has left the professions, HMRC and the courts and tribunals with much working out to do. *Halifax* and *FTI* are clear examples, as *Bond House* appears to be, although both HMRC and taxpayers appear to see clear vindication for very different points of view in the last judgment, and there does not yet appear to have been a "show down" leading to a decision.
- 6.2 To an extent it was ever thus. However, year by year it becomes ever clearer that in many areas, but particularly where the concern is essentially with redressing, or containing the malfunctioning of the VAT system, the ECJ sees its role as identifying the basic obligation, responsibility, or power of the Member State, and, having emphasised that the general principles of Community law have a prominent role to play, leaving it to national courts to ensure that those principles are followed.

### **Fundamental articles in Sixth Directive?**

- 6.3 Some commentators have identified, and not without some reason, a trend towards the ECJ treating some articles of the Sixth Directive as more fundamental and less flexible than others. That remains unproven and may tend to reflect, if there is a pendulum effect, that we are at particular point on the swing of the pendulum. As for articles 2 and 4, HMRC's approach in *Bond House*, at least to those for whom circularity and the over-riding fraudulent intent of "ring masters" did not seem enough to prevent "ordinary" sales of goods by traders, accepted to be innocent, from being economic activity and supplies, the ECJ's robust line, upholding the existence of supplies without hesitation and focusing on possible limitations on the right to deduct input tax, should probably be taken as little more than a reflection of the extremity of argument it rejected, and the UK felt able to adopt in the perturbing MTIC context. *Kretztechnik*, however, showed the ECJ, at least from the UK's perspective, taking transactions out of the scope of VAT

## Cross-over from references concerning direct tax

6.4 Direct tax disputes, in particular the GLO's (Group Litigation Orders) have spawned a large number of references to the ECJ. The upturn of litigation in this area is feeding through into aspects of VAT litigation and can be expected to continue so to do. As an example the UK Courts' application of the ECJ's decision in (Joined cases C-397/98 and C-410/98) **Metallgesellschaft Ltd v Inland Revenue Commissioners** [2001] STC 452<sup>14</sup> has led to many taxpayers who have overpaid VAT seeking to claim an EC law entitlement to compound interest at a commercial rate. There is a July directions hearing in the VAT & Duties Tribunal at which 50 odd appeals are listed for directions and the Court of Appeal made an improbable reference in *R (on the application of British Telecommunications plc) v Revenue and Customs Commissioners*, given that that appeal is in respect of payments of VAT voluntarily (albeit mistakenly) made with no apparent breach of EC law by the UK.

## 7. AND FINALLY...

7.1 Perhaps there should be a prize for the national court making the least necessary and most amusing reference decided in the last 12 months. My vote goes to the *Hof van Beroep te Antwerpen* (Belgium) in **BAT Intl Ltd** [2006] STC 158, who could not quite bring themselves to decide whether the theft of goods could be classified as a 'supply of goods for consideration' within the meaning of Article 2, and hence subject to VAT, without the guidance of the ECJ. BAT Intl Ltd, the victim of the thefts, was, I suspect, not amused, even though, inevitably, victorious in the ECJ.<sup>15</sup>

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<sup>14</sup> *Sempra Metals Ltd (formerly Metallgesellschaft Ltd) v Inland Revenue Commissioners* [2004] STC 1178 (Park J.); *Sempra Metals Ltd (formerly Metallgesellschaft Ltd) v Inland Revenue Commissioners* [2005] STC 687, C.A.

<sup>15</sup> The Belgian Government's only consolation was that the Greece intervened to support them.