

EU VAT principles as interpretative aids to EU VAT rules: the inherent paradox

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

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I. Introduction

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 been both developed by the Court as fundamental principles of the system over an extended period, 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, namely: interpreting these rules in light with 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 in line with the principle of fiscal neutrality, will result in further erosion of the tax base, and legal uncertainty. The paper starts by presenting a typology of

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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 years 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 taken as an accurate method of determining the Court's preferences as regards 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 face of new economic realities, and that the challenge for the CJEU will be to reach the right 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 been both developed by the Court as fundamental principles of the system over an extended period of nearly five decades.

II.1 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.¹ The principle was enshrined in Article 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*’;² and it has also been consistently reiterated by the Court in cases dating back to the early 1980s.³ 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.’⁴

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 some consumption from tax base. The rationale for excluding consumption from tax base in 1960s / 1970s was essentially two-fold, namely: to replicate exclusions from tax based applicable under previous cumulative taxes; and to reflect the existence of technical obstacles to the application of

¹ On VAT as a tax on consumption, see J. Englisch, “VAT/GST and Direct Taxes: Different Purposes” in M. Lang, P. Melz, and 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, 545–553.

² 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.

³ 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.

⁴ CJEU, 6 October 2005, Case C-291/03, *My Travel*, ECLI:EU:C:2005:591.

VAT to some services, the so-called difficult-to-tax services. Overtime, 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 households; 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 increase employment in labour-intensive industries (e.g. hairdressing), or areas where price is particularly elastic (e.g., electronics), or both (e.g., restaurants).⁵

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

II.2 VAT as a Neutral Tax

Whilst there are various definitions of neutrality,⁶ generally, a neutral tax is one that does not influence commercial decisions.

⁵ 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), 154-171, for rates; and R. de la Feria and 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), 3-35, for exemptions.

⁶ See B. Terra and 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* (Laciar, 2015).

Taken in that sense, the neutrality of VAT is usually held as one of main reasons for its introduction: in Europe this much is made clear in the *Neumark Report*,⁷ which uses neutrality as the main argument for VAT against the - at the time common - use of cumulative taxes;⁸ and worldwide, the spread of VAT to over 150 countries has been attributed to its technical advantages, most notably neutrality.⁹

It is therefore unsurprising that the principle of VAT as a neutral tax was enshrined in 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.'*¹⁰

⁷ 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).

⁸ 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.

⁹ K. James, "Exploring the Origins and Global Rise of VAT", in *The VAT Reader* (Washington DC: Tax Analysts, 2011), 15-22; M. Keen, "VAT Attacks!" (2007) *International Tax and Public Finance* 14, 365–381; S. Cnossen, "Global Trends and Issues in Value Added Taxation" (1998) *International Tax and Public Finance* 5(3), 399-428; and M. Keen and B. Lockwood, "The Value-Added Tax: its Causes and Consequences" (2010) *Journal of Development Economics* 92(2), 138-151.

¹⁰ CJEU, 1 April 1982, Case 89/81, *Hong-Kong*, ECLI:EU:C:1982:121.

II.3 CJEU Typology of Principles

Alongside the above two fundamental principles of the EU VAT system, the CJEU has developed various sub-principles, 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 initially in cases where the Court concluded that the principle of fiscal neutrality precluded Member States from treating lawful and unlawful transactions differently for VAT purposes;¹¹ their existence was explicitly stated by the Court in *Commission v France*.¹²

Whilst is not always clear how VAT legal principles interact, a typology is proposed in Table 1.¹³ 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.

¹¹ 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.

¹² CJEU, 3 May 2001, Case C-481/98, ECLI:EU:C:2001:237.

¹³ 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.

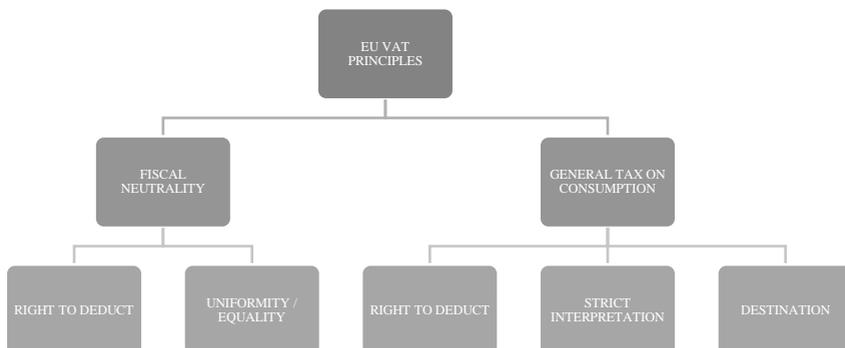


Table 1: Typology of EU VAT Principles

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.

III.1 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 growing number of references from the early 1990s onwards, Court quickly developed general guidelines on 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.*¹⁴

And so the principle of strict interpretation was born. Other interpretative principles were also developed by the CJEU, in particular the principle of contextual interpretation,¹⁵ and the principle of uniform interpretation of exemptions,¹⁶ but none had the significance, or the impact, of the principle of strict interpretation. Indeed, Court's traditional preference for strict interpretation of exemptions was reflected at two levels, namely as regards their objective scope, and the type of activities covered therein; and their subjective scope, and the type of supplies which can be covered by exemption. This double

¹⁴ 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, Article 132(1)(b); 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, Article 132(1)(l); 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, Article 132(1)(m).

¹⁵ As mentioned in *Kluger*, '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, ECLI:EU:C:2002:473, at para. 29.

¹⁶ 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, ECLI:EU:C:2006:289, at para. 38. See also CJEU, 3 March 2005, Case C-428/02, *Fonden Marselisborg Lystbadehavn*, ECLI:EU:C:2005:126, at para. 27; and CJEU, 1 December 2005, Joined Cases C-394/04 and C-395/04, *Ygea*, ECLI:EU:C:2005:734, at para. 15.

limitation to the scope of – at least some – exemptions was reiterated by the Court on various occasions, until recently.¹⁷

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. These can be broadly divided into two types. The first are cases concerning technical exemptions, particularly those applicable to financial services, which depart from strict interpretation, but not explicitly based on the principle of fiscal neutrality;¹⁸ 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 concerned primarily outsourcing and sub-contracting.¹⁹ 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;²⁰ express departure was necessary in these, since the cases concerned both type of services, and type of suppliers, and the wording of those provisions often limits both their subjective and objective scope.²¹

¹⁷ CJEU, 10 June 2010, Case C-262/08, *CopyGene*, ECLI:EU:C:2010:328.

¹⁸ 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.

¹⁹ 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, 74-89.

²⁰ 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.

²¹ 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).

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.²² Overall the perception was that in the hierarchy of interpretative principles, under the traditional approach, strict interpretation had won the day. As the economy changed, this was however set to change.

III.2 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 as regards exemptions.²³ At the time, there was perhaps an element of wishful thinking to this statement, but it is true that by then the seeds of change were already being sown.

The reasons for the Court's progressive stronger emphasis on fiscal neutrality in the interpretation of exemptions appear to be two-fold. The first, and perhaps most important, element has been the changes in economic reality, and in particular insofar as services covered by merit exemptions were concerned, these changes were massive. Whilst in 1970s most of these services were performed by public entities, now they are also supplied by private entities, operating in market conditions; new services have also flooded the market, primarily as regards medical activities, and few in 1970s could have envisaged the medical

²² CJEU, 20 November 2003, Case C-8/01, *Assurandor-Societetet*, ECLI:EU:C:2003:621.

²³ European Commission, *Consultation Paper on Modernising Value Added Tax Obligations for Financial Services and Insurances*, 2006, at p. 10.

developments in the use of steam cells, or cloning. In addition, the form in services covered by both merit and technical exemptions are now supplied has also fundamentally changed; in particular, there is an increased resource to new efficiency-maximisation economic structures, such as outsourcing, which in turn have increased the – already existing – problem 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, been accused of over-simplistic approach to tax matters, including VAT exemptions. Seen in that light this new approach represents a natural jurisprudential evolution, 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 stronger emphasis on fiscal neutrality in the interpretation of exemptions has resulted in a lesser 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 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.*²⁴

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 principle of VAT as 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 for this recurrent dialectic struggle between strict interpretation and fiscal neutrality; cases which, on the facts, seemed all too similar, and yet were decided differently.²⁵ On the interpretation of exemptions for medical services, there is *Bulthuis-Griffioen* on one side, and *Gregg* on the other;²⁶ as regards the interpretation of the exemption for sports activities, *Stockholm Lindopark*, on one side, and *Canterbury Hockey*.²⁷ Recent decisions in gambling, as well as in fund management services, however, are not only further evidence of this dialectic struggle, but also of its intensification.

²⁴ CJEU, 2 June 2005, Case C-378/02, *Waterschap Zeeuws Vlaanderen*, ECLI:EU:C:2004:726, at para. 38.

²⁵ A struggle first noted by C. Amand in "VAT for Public Entities and Charities – Should the Sixth Directive Be Renegotiated?" (2006) *International VAT Monitor* 6, 433-443.

²⁶ 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 and V. Seggre, "Hospital and Medical Care by Commercial Hospitals under EU VAT" (2014) *International VAT Monitor* 2, 78-81.

²⁷ 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, 266-270.

In so far as the exemption applicable to gambling services is concerned, the CJEU had already stated in various cases that the principle of fiscal neutrality limits the level of discretion granted to Member States under Article 135(1)(i) of the VAT Directive, in particular: fiscal neutrality precludes Member States from treating unlawful gambling as taxable, and lawful gambling as exempt;²⁸ it precludes Member States from treating private gambling as taxable, and lawful gambling as exempt;²⁹ and it means that outsourcing and subcontracting of gambling activities can still fall within scope of exemption.³⁰ Yet, the 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.³¹ Less than a year later, this decision was followed by what has been regarded as a landmark decision insofar as the principle of fiscal neutrality goes: *Rank Group*.³² The case established, for the first time, a neutrality test, namely it ruled that the different treatment of two supplies of services which are: (a) identical or similar from the point of view 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.³³ It has therefore massive implications, not only for the interpretation of exemptions, but also, as discussed below, for the interpretation of rate provisions.

²⁸ CJEU, 11 June 1998, Case C-283/95, *Fischer*, ECLI:EU:C:1998:276.

²⁹ CJEU, 17 February 2005, Case C-453/02, *Linneweber*, ECLI:EU:C:2005:92.

³⁰ CJEU, 14 July 2011, Case C-464/10, *Henfling and Others*, ECLI:EU:C:2011:489.

³¹ CJEU, 10 June 2010, Case C-58/09, *Leo-Libera*, ECLI:EU:C:2010:333.

³² CJEU, 10 November 2011, Case C-259/10, *Rank Group*, ECLI:EU:C:2011:719.

³³ 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.

So that, in the space of less than two years, there were three CJEU decisions as regards 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 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 Article 135(1)(g) of the VAT Directive, in particular: fiscal neutrality means that outsourcing and subcontracting of activities relating to 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;³⁴ and it precludes Member States from treating management of open-ended funds as exempt, and management of closed-ended funds as taxable.³⁵ Yet the application of the principle was dismissed in two recent cases, in favour 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,³⁶ 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.³⁷ In one of these in particular, *Deutsche Bank*, the dismissal of the application of the principle of fiscal neutrality was expressly stated by the Court:

³⁴ CJEU, 4 May 2006, Case C-169/04, *Abbey National*, ECLI:EU:C:2006:289.

³⁵ CJEU, 28 June 2007, Case C-363/05, *JP Morgan*, ECLI:EU:C:2007:391.

³⁶ CJEU, 19 July 2012, Case C-44/11, *Deutsche Bank*, ECLI:EU:C:2012:484.

³⁷ CJEU, 7 March 2013, Case C-424/11, *Wheels Common Investment Fund*, ECLI:EU:C:2013:144.

*'[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'*³⁸

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.³⁹ 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, essentially all the cases decided on the topic in the last four years. For each case it is identified whether the CJEU decided - explicitly or implicitly - on the basis of the principle of fiscal neutrality, or on the basis of the principle of strict interpretation.

CJEU Cases on Interpretation of VAT Exemptions:

2012- 2015

³⁸ At paragraph 45. For a detailed analysis of this case, see R. de la Feria and 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), 259-276; see also F. Wersand and S. Cazes, "EU VAT and the Conundrum of Financial Investments" (2013) *International VAT Monitor* 2, 83-88.

³⁹ CJEU, 7 March 2013, Case C-275/11, *GfBk*, ECLI:EU:C:2013:141.

C-436/10	<i>BLM</i>	Art. 135(1)(l)	Leasing of immovable property	Strict interpretation	2012
C-44/11	<i>Deutsche Bank</i>	Art. 135(1)(g)	Management of special investment funds	Strict Interpretation	2012
C-174/11	<i>Zimmermann</i>	Art. 132(1)(g)	Welfare and social security work	Fiscal Neutrality	2012
C-210/11	<i>Medicom</i>	Art. 135(1)(l)	Leasing of immovable property	Strict interpretation	2013
C-224/11	<i>BGŻ Leasing</i>	Art. 135(1)(a)	Insurance services	Fiscal Neutrality	2013
C-259/11	<i>DTZ Zadelhoff</i>	Art. 135(1)(f)	Dealings in shares	Fiscal Neutrality	2012
C-275/11	<i>GfBk</i>	Art. 135(1)(g)	Management of special investment funds	Fiscal Neutrality	2013
C-299/11	<i>Gemeente Vlaardingen</i>	Art. 135(1)(k)	Building land	-	2012
C-326/11	<i>J.J. Komen en Zonen Beheer Heerhugowaard</i>	Art. 135(1)(j)	Buildings	Fiscal Neutrality	2012
C-392/11	<i>Field Fisher Waterhouse</i>	Art. 135(1)(l)	Leasing of immovable property	-	2012
C-424/11	<i>Wheels Common Investment Fund Trustees and Others</i>	Art. 135(1)(g)	Management of special investment funds	Strict Interpretation	2013

C-532/11	<i>Leichenich</i>	Art. 135(1)(l)	Leasing of immovable property	Fiscal Neutrality	2012
C-543/11	<i>Woningstichting Maasdriel</i>	Art. 135(1)(k)	Building land	Strict Interpretation	2013
C-18/12	<i>Město Žamberk</i>	Art. 132(1)(m)	Sporting activities	Fiscal Neutrality	2013
C-26/12	<i>PPG Holdings</i>	Art. 135(1)(g)	Management of special investment funds	Strict Interpretation	2013
C-91/12	<i>PCF Clinic</i>	Art. 132(1)(b)	Medical services	Fiscal Neutrality	2013
C-139/12	<i>Caixa d'Estalvis i Pensions de Barcelona</i>	Art. 135(1)(f)	Dealings in shares	-	2014
C-319/12	<i>MDDP</i>	Art. 132(1)(i)	Education services	Fiscal Neutrality	2013
C-366/12	<i>Klinikum Dortmund</i>	Art. 132(1)(b)	Medical services	Strict Interpretation	2014
C-440/12	<i>Metropol Spielstätten</i>	Art. 135(1)(i)	Gambling	-	2013
C-461/12	<i>Granton Advertising</i>	Art.135(1)(d) and (f)	Dealings in shares Dealings in payments	Strict interpretation	2014
C-464/12	<i>ATP PensionService</i>	Art.135(1)(d) and (g)	Dealings in payments Management of special investment funds	Fiscal Neutrality	2014
C-495/12	<i>Bridport and West Dorset</i>	Art. 132(1)(m)	Sporting activities	Fiscal Neutrality	2013

<i>Golf Club</i>					
C-584/13	<i>Mapfre asistencia and Mapfre warranty</i>	Art. 135(1)(a)	Insurance services	Fiscal Neutrality	2015
C-594/13	« <i>go fair</i> » <i>Zeitarbeit</i>	Art. 132(1)(g)	Welfare and social security work	Strict interpretation	2015
C-595/13	<i>Fiscale Eenheid X</i>	Art. 135(1)(g)	Management of special investment funds	Fiscal neutrality	2015
C-55/14	<i>Régie communale autonome du stade Luc Varenne</i>	Art. 135(1)(l)	Leasing of immovable property	Strict interpretation	2015
C-114/14	<i>Commission v Sweden</i>	Articles 132(1)(a)	Postal services	Fiscal neutrality	2015
C-264/14	<i>Hedqvist</i>	Art.135(1)(e)	Dealings in currency	Fiscal neutrality	2015
C-334/14	<i>De Fruytier</i>	Art. 132(1)(b) and (c)	Medical services	Strict interpretation	2015

Table 2: Four Years' Sample of CJEU Cases on VAT Exemptions

Making a breakdown of these thirty cases, according to the interpretative method adopted, the result is as follows: in four cases the CJEU did not decide either on the basis of fiscal neutrality, or of strict interpretation;⁴⁰ in approximately half the analysed cases the Court interpreted the scope of the

⁴⁰ 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.

exemptions, explicitly or implicitly, in line with fiscal neutrality: in four out of eight cases in 2012; in six out of eleven in 2013; in one out of four in 2014; and in four out of seven in 2015. Diagram 1 below provides an annual breakdown of the number of VAT exemptions cases decided on the basis of fiscal neutrality, when compared to the overall number of cases on exemptions.

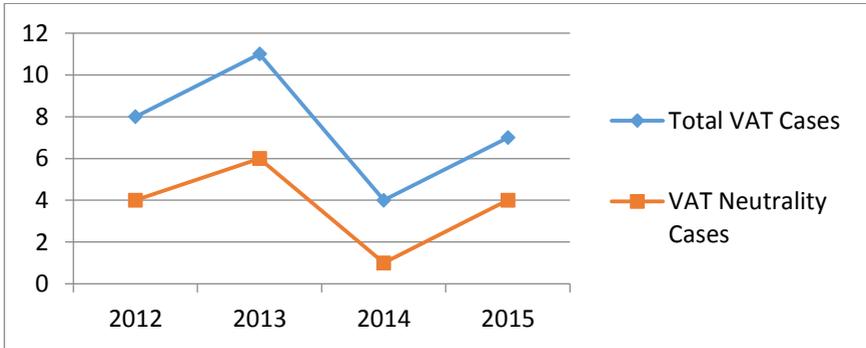


Diagram 1: Breakdown of VAT Exemptions Cases Decided on the Basis of the Fiscal Neutrality Principle

Whilst of course 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, albeit to a lesser extent given the lower numbers, in cases concerning the interpretation of rates' provisions.

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 recognised was in *Commission v France*, a case dating back to the late 1990s.⁴¹

IV.1 Fiscal Neutrality Criteria

It resulted from that case also that, the criterion used to determine whether or not a dissimilar VAT treatment violated the principle of fiscal neutrality seemed to have been whether the goods in question were or not in competition with each other, as follows:

'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

⁴¹ CJEU, 3 May 2001, Case C-481/98, ECLI:EU:C:2001:237.

*will, vis-à-vis a non-reimbursable medical product, have a decisive advantage for the final consumer'*⁴²

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 product in question '*are not in competition, meaning that they can be subject to different rates of VAT*'.⁴³ So that, as opposed to what the Court seems to be suggesting in its decision in *Rank Group*,⁴⁴ 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 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.⁴⁵ In it, the Court, relying upon an old judgment concerning excise duties,⁴⁶ 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 point of view of the customer, *and* meet the same customers' needs.

Whilst the decision concerned exemptions,⁴⁷ it was as regards the application of rates that the establishment of the neutrality

⁴² *Ibid*, at paragraphs 25 and 27.

⁴³ CJEU, 3 March 2011, Case C-41/09, ECLI:EU:C:2011:108, at paragraph 66. For a deeper analysis of these cases see R. de la Feria, n. 8 above, at Chapter 4.

⁴⁴ CJEU, 10 November 2011, Case C-259/10, ECLI:EU:C:2011:719.

⁴⁵ 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*.

⁴⁶ CJEU, 11 August 1995, Joint Cases C-367/93 to C-377/93, *Rodens and Others*, ECLI:EU:C:1995:261, paragraph 27.

⁴⁷ See point II.B. above.

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 have to be re-examined.⁴⁸ 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,⁴⁹ 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.

With these two decisions in the same year, reliance on fiscal neutrality appeared clearly on the rise, but this perception was short-lived.

IV.2 Strict interpretation vs. Fiscal Neutrality

In the last year a number of high profile cases on the application of reduced rates arrived to the CJEU raising the debate as to whether the Court would apply (or not) 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 which 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.

⁴⁸ V. Sloane, "VAT Focus – Rank and Fiscal Neutrality" (2011) *Tax Journal* 1101, 20, 18 November 2011.

⁴⁹ CJEU, 10 March 2011, Case C-497/09, ECLI:EU:C:2011:135.

The cases therefore represented the perfect opportunity to test, not only the applicability of the new criteria set out in *Rank Group* – was it to be confirmed as the new standard for fiscal neutrality? – but importantly also, to test the strength of fiscal neutrality itself, now that a test was available.⁵⁰ The first question was clearly answered: in all 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, and 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

⁵⁰ 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), 395-441.

*have a significant or tangible influence on the average consumer's decision to choose one or other of those books'*⁵¹

Yet, 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 reduced rates of VAT to the supply of electronic books.⁵² How to explain these apparently opposing decisions? 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, date in their majority to the introduction of the European VAT system. A changing, globalised, 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.

⁵¹ CJEU, 11 September 2014, Case C-219/13, *K Oy*, ECLI:EU:C:2014:2207, at paragraph 31, our underline.

⁵² 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.

This growing tendency is certainly praise-worthy: not only does it represent 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 also, and the bigger the erosion of the tax base.

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

Table 3: 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 too will represent a challenge, namely that of adapting to the casuistic nature of Court's decisions in the areas of exemptions and rates, and to naturally embrace – at least to some extent – the uncertainty that comes with it.

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