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The management of investment funds
- under Article 135(1)(g) in VAT Directive

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**ABBREVIATIONS**

<table>
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<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>AG</td>
<td>Advocate General</td>
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<tr>
<td>CJEU</td>
<td>Court of Justice of the European Union</td>
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<td>EU</td>
<td>European Union</td>
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<td>IMC</td>
<td>Investment fund Management Company</td>
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<td>ITC</td>
<td>Investment Trust Company</td>
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<td>OEIC</td>
<td>Open-Ended Investment Company</td>
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<td>TFEU</td>
<td>Treaty on the Functioning of the European Union</td>
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<td>VAT</td>
<td>Value Added Tax</td>
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<td>UCITS</td>
<td>Undertakings for Collective Investment in Transferable Securities</td>
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1. Introduction

1.1 Background

Investment funds act as financial intermediaries belonging to small investors who use it to collectively purchase financial securities. An investment fund provides broader selections of investment opportunities for investors along with greater management, lower investment costs within a limited risk level than investors might be able to obtain by investing on their own.

Investment funds as the means of the investment within European Union have been developed and become one of the most noticeable financial trends in recent decades. Due to investment funds’ rising importance, EU has pressed its certain moves in terms of legislative and economic factors. Essentially, fund investors can rely on fundamental freedoms concerning the free movement of capital guaranteed by the EC Treaty when investing in funds established in other Member States; further, can receive protection provided in this provision. In addition, the publication of the Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS Directive) has supported professionally managed investment vehicles in the financial market within the European Union.

During the processing of the investment, management companies of investment funds are supposed to supply financial services to investors. Since the establishment of investment fund is to facilitate the investment for small and individual investors, ‘the management of investment funds’ supplied by management companies to unit holders (investors) is subjected to the exemption of VAT in Article 135(1)(g) in Title IX of the VAT Directive (recasting the First and Sixth VAT Directives).
1.2. Objectives and methodology

From the wording of the provision ‘the management of special investment funds as defined by Member States’\(^1\), there are basically two main points which have been discussed for years namely the definition of management to be exempted and the discretion of Member States to define special investment funds in national law. The main purpose of the thesis, therefore, is to answer the following questions:

- What is covered by the concept of management of an investment fund?
- How this concept is examined and decided by CJEU’s judgment in recent selected cases?
- To what extent the discretion of the Member States shall be limited when they regulate requirements for investment funds under national law?
- Whether the interpretation of this exemption in conformity with EU law?

It is necessary to apply a legal dogmatic method by examining CJEU’s decisions on some certain cases along with relevant EU regulations and specialized academic writings. Accordingly, all the legal facts concerned will be recalled to deliver a solid legal background. In particular, the provision concerned is originally provided in the VAT Directive, and the concept of “investment funds” is also subject to UCITS Directive. Therefore, the thesis does not preclude the usage of these sources of law.

The focus of this thesis is to examine the concept of "the management of investment funds”. In this regard, the starting point begins with legal norms,

\(^1\) It also means that where a transaction qualifies as a management of an investment funds under national law of one country, it may get benefits from the exemption provisions by the law of that country while it may not exempt in another country.
then continues with decisions ruled by the Court, and reference to AG’s opinions. Each case law will be studied in the order of the ruling time so that the developments in each decision could be clearly defined.

1.3. Delimitations

The scope of this thesis will be limited only to the exemption provision in Article 135(1)(g) of the VAT Directive which is “the management of special investment funds as defined by Member States”. But first of all, a brief background relating to exemptions from indents (a) to (g) for financial services helps a part in the thesis. A major part of the thesis is based on CJEU’s case law. It will only focus on studying those cases in the interest of VAT Directive. Furthermore, although each Member State is granted the power to define specific conditions constituting an investment fund, the comparison between states’ regulations will be excluded from the thesis.

Since investment funds are also subject to UCITS Directive, some relevant provisions in this Directive will be used to provide the background. Particularly, the content merely deals with the provision concerned to the concept of “investment funds” provided specifically in Article 1(2) of UCITS Directive. Other economical terms or concepts will not be mentioned.

1.4. Structure of the thesis

This thesis is organized as follows: after an introduction in Chapter 1, Chapter 2 will examine the exempt financial transactions in VAT Directive and the interpretative methods used by the CJEU. Chapter 3 focuses on the concept of the management of investment funds. Chapter 4 discusses Member State’s power to define “investment funds” under the national law and how far they

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2 For a stable and rigid structure, only exemptions from indents (a) to (g) in the Article 135(1) of the VAT Directive are recalled.
could reach to exercise that discretion. Finally, summary and conclusions will be delivered in Chapter 5.

2. Exempt financial services in VAT Directive

2.1. Exempt financial transactions in VAT Directive

On 28 November 2006, Council Directive 2006/112/EC on the common system of value added tax (hereafter the VAT Directive), recasting the First and Sixth Directives, was adopted and entered into force on 1 January 2007. From the standpoint of harmonization within the Community, the First Directive of 11 April 1967, together with Second Directive, was the first stage in the harmonization of the turnover taxes in the EU community. The Sixth Directive, which issued on 17 May 1977, was considered to be the next step of harmonizing national laws in Member States.

As concluded from the Preamble of the VAT Directive, there appears a necessity to standardize exemptions in order to achieve a common basis of assessment. In particular, paragraph (35) of the Preamble states as follows:

“A common list of exemptions should be drawn up so that the Communities’ own resources may be collected in a uniform manner in all the Member States”.

Accordingly, Title IX of the VAT Directive introduces the list of exemptions. In the spirit of the VAT Directive, exemptions in Title IX shall be applied without prejudice to other Community provisions and in accordance

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3 Article 2 of the First Directive confirms a common system of value added tax involves the application to goods and services of a general tax on consumption and VAT shall be chargeable after deduction of the amount of value added tax borne directly by the various cost components.
with conditions\textsuperscript{4} which the Member States shall lay down for the purposes of ensuring the correct and straightforward application of those exemptions and of preventing any possible evasion, avoidance or abuse.\textsuperscript{5}

In the following, the main content focuses only the exemptions in Article 135(1) from indents (a) to (g) of the VAT Directive. The Article states as follows:

1. Member States shall exempt the following transactions:

(a) insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents;

(b) the granting and the negotiation of the credit and the management of credit by the person granting it;

(c) the negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit;

(d) transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection;

(e) transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collector’s items, that is to say, gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest;

\textsuperscript{4} Judgment of 19 January 1982, \textit{Ursula Becker v Finanzamt Münster-Innenstadt}, C-8/81, EU:C:1982:7, paragraph 32 and 33: “the conditions are intended by the Member States to ensure the correct and straightforward application of the exemptions, however, those conditions do not in any way affect the definition of the subject matter of the exemptions conferred”.

\textsuperscript{5} Article 131 of the VAT Directive.
(f) transactions, including negotiation but not management or safekeeping, in shares interests in companies or associations, debentures and other securities, but excluding documents establishing title to goods, and the rights or securities referred to in Article 15(2);
(g) the management of special investment funds as defined by Member States.

The purpose of the exemption for theses above-mentioned services has been never clarified clearly.\textsuperscript{6} It was suggested that these exemptions’ purpose are both theoretical (taxing capital may damage the economy) and pragmatic (financial services are difficult to tax).\textsuperscript{7} Or AG Colomer gave his opinion in case CSC Financial Services that the aim is to avoid the burden of certain services which would be liable to hamper the functioning of the market.\textsuperscript{8} Despite of those efforts to clarify the purpose of financial services’ exemption, the actual purpose still stays unclear.

\textbf{2.2. The interpretation of financial services in VAT Directive}

\textbf{2.2.1. Introduction}

Based on Article 267 TFEU, the CJEU has jurisdiction to give preliminary rulings on the interpretation of the Treaties\textsuperscript{9}, therefore it is required that specific methods must be applied for interpreting EC law. In this section

\textsuperscript{6} Report of the Committee on Economic and Monetary Affairs, A6-0344/2008, page 22

\textsuperscript{7} The OECD report on the indirect tax treatment of financial services and instruments. See also: Oskar Henkaw, \textit{Financial Activities in European VAT- A Theoretical and Legal Research of the European VAT System and the Actual and Preferred Treatment of Financial Activities} (Lund University, 2007) page 89

\textsuperscript{8} Yet, this suggestion was ignored by the CJEU. See also: Oskar Henkow, (2007) page 89

and due to the requirement of the thesis’s objectives, general interpretative principles for the EU VAT system, in which financial services’s exemption is a part, will be investigated first. Then, interpretative methods for those specific services are mentioned in the next subsection. Important criteria merely for determining financial services exemption are shown in the last subsection. The whole section 2.2 aims to deliver a brief and close approach to how “management of special investment funds” is analyzed by the CJEU (which will be introduced in later Chapters).

2.2.2. EU VAT general interpretative 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.¹⁰ The former principle was stated in Article 2 of the First Directive that ‘the principle of the common system of value added tax involves application to goods and services of a general tax on consumption’, whereas the principle of fiscal neutrality was clarified in a case-law basis ruled by the Court stating that the Preamble of the First Directive called for a need of harmonization … “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

Through the development of EU VAT system, other sub-principles have been developed based on these two fundamental principles.¹² Essentially, the principle of strict interpretation has taken its significance and becoming one of

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¹⁰ Lang et al (Eds), CJEU - Recent Developments in Value Added Tax 2015 (Linde Verlag GmbH, Wien 2016) page 2

¹¹ Judgment of 1 April 1982, Hong Kong Trade, C-89/81, EU:C:1982:121.

¹² They are the principle of strict interpretation of exemptions; the principle of contextual interpretation of exemptions; and the principle of uniform interpretation of exemptions. See also: Rita de la Feria, The EU VAT treatment of insurance and financial services (again) under review (EC Tax Review, Volume 16, Issue 2, 04/2007) page 81
the essential principles for exemption interpretation identified by the European Commission, together with fiscal neutrality principle. Regarding the principle of strict interpretation, the Court has consistently held that: “The exemptions provided for in Article 13 of the Sixth 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”.13

In so far as financial services exemptions are concerned as a part of VAT exemptions, some recent settle case-law have shown a trend of alternative application of those principles. For instance, regarding the scope of a specific exemption or the discretion powered to Member States under Article 135(1)(g) of the VAT Directive, the application of the principle of fiscal neutrality allows the acceptance that outsourcing and subcontracting of activities of the management of investment funds can still benefit from the exemption if required conditions are met;14 and it precludes the Member States from treating closed-ended funds and open-ended funds differently when the former is taxable while the latter is not.15 However, concerning the principle of strict interpretation, the Court states as follows:

“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”.

The matter as to whether the principle of fiscal neutrality prevail the principle of strict interpretation has been aroused based on the fact that there are cases ruled on the basis of strict interpretation on the one hand, and ones in which the neutral elements are invoked on the other. As Rita de la Feria emphasizes on this perception, economy’s change results in changes in the hierarchy of interpretative principles. Therefore, one can notice that these two main underlying principles have been adopted alternatively and separately by the CJEU leading to different implications as can be seen from above examples.

2.2.3. Interpretative methods for financial services exemption

It needs to emphasize that it is necessary to understand the interpretation of the provisions on EU level. The matter of the interpretation is not solely a task in the EU level but also in the Member States level since national courts should interpret their regulations in conformity with EU law. The interpretative methods used by the CJEU are the linguistic (or textual), systematic (contextual) and teleological method. These methods are stated in the Vienna Convention on the law of the treaties.

The linguistic method is considered as the traditional method of interpretation, which considers the proper meaning of the written word in the

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17 Lang et al (Eds) (2016) page 7
18 Eleonor Kristoffersson & Pernille Rendah, Textbook on EU VAT (Iustus Förlag AB, Uppsala 2016) pages 27-30
20 Oskar Henkow (2007), page 15-17
provisions. This method is employed by the CJEU due to differences in Member States’ versions of regulations. Regarding the systematic method, generally, provisions should be interpreted “in the light of the provisions of Community law as a whole”. This implies that all the rules and principles in a legal system in which the provision concerned is a part would be taken into consideration in order to achieve a perfect interpretation. The last method, teleological, is adopted with regard to the objectives or purposes of the provision. It means that not only the purpose of a specific provision covered by this method but also the constitutional context is also taken into account.

Generally, the interpretation starts with the linguistic method then continues with the systematic and eventually the teleological method. In case Van Gend en Loos, however, the CJEU adopted that “According to the spirit, the general scheme and the wording of the EEC Treaty, Article 12 must be interpreted as producing direct effects and creating individual rights which national courts must protect”. Obviously, it is not always a trend to follow that order.

Exemptions for financial services is not an exception. Their interpretation must pursue those methods used by the CJEU, which can be exemplified by case C-334/14 Nathalie de Fruytier recently:

“The settled case-law further shows that the term used to specify the exemptions in Article 13 of the Sixth Directive are to be interpreted strictly, since they constitute exceptions to the general

21 Ben Terra & Julie Kajus (2017) pages 275-277
22 Ibid, pages 278 & 279.
24 Oskar Henkow (2007), page 15
Nevertheless, the interpretation of those terms must be consistent with the objectives pursued by those exemptions and comply with the requirements of the principle of fiscal neutrality inherent in the common system of VAT. Thus, the requirement of strict interpretation does not mean that the terms used to specify the exemptions referred to in Article 13 must be construed in such a way as to deprive the exemptions of their intended effect.”

2.2.4. Determining criteria for financial services exemption

As mentioned previously, financial services provided in Article 135(1) of the VAT Directive must follow interpretative methods and underlying principles adopted by the CJEU. Further, with regard to exemptions for financial services, the case C-2/95 SDC always serves as a noteworthy reference. From the CJEU’s decision in this case, the scope of the exemptions under Article 135(1) of the VAT Directive was considered and clarified clearly. This case set its significant position to the interpretation of the exemption provision for financial services.

There are three outstanding points which the Court examined. Firstly, the interpretation of the exemptions must be based on the nature of the services, rather than the parties supplying or receiving the services. How the services are performed is irrelevant and does not affect the application of the exemption. Secondly, services provided by a third party also falls within the

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28 Due to the scope of this thesis, the facts and the dispute are not recalled, only remarkable points from the ruling are mentioned.

scope of the exemption. Lastly, the Court emphasized that in order for a service to be determined as an exempt service, that service must view broadly, from a distinct whole and fulfill in effect the specific and essential functions of that provision. The fact that a service creates an essential element for completing an exempt transaction does not warrant the conclusion that the service which that element represents is exempt.

These criteria mentioned above in case SDC are further specified in later cases ruled by the Court. Taking case C-169/04 as an example, according to the CJEU, the service provided by a third party must follow the criterion of forming “a distinct whole”. Or in case C-275/11 GfBk, the criterion of “having the effect of performing the specific and essential functions” of management of a special investment fund is put more weight.

One can notice that the criteria set out in the case C-2/95 SDC has and still prove its significance since they are used constantly and firmly by the CJEU concerning exemptions for financial services.

3. The concept of “The management of investment funds”

As provided in Article 135(1)(g) of the VAT Directive (corresponding to Article 13B(d)(6) of the Sixth Directive), management transactions of special investment funds are exempt for the purpose of taxation as follows:

1. Member States shall exempt the following transactions:

   …

   (g) the management of special investment funds as defined by Member States;

30 Ibid paragraphs 55& 56.
31 Ibid paragraphs 64 &66.
32 Ibid paragraph 65.
... However, it must be noted that no definition of the term of “management” is contained in the provision. Therefore, the most important question is what is covered by the concept of management of an investment fund when a certain transaction is supplied.

3.1. The term of “management of special investment funds”


The Directive 85/611/EEC has proved its important part in establishing investment instruments for certain common funds and investment companies. In the Directive, common uniform rules have been laid down for the authorization of undertakings for collective investment in transferable securities along with necessary policies for the investment. It is also worth pointing out that particular tasks are set out to the management companies and depositaries, those have their functions to ensure the management carried out is in accordance to the law and the funds’ principles. In Annex II to Directive 85/611/EEC, a list of the functions in regard to the activity of professional management of those undertakings has been recorded. Most importantly, “inferences could be made from that provision for the interpretation of Article 13B(d)(6) of the Sixth Directive”.34 In particular, the list states as follows:

‘Functions included in the activity of collective portfolio management:
- Investment management
- Administration:
  (a) legal and fund management accounting services;
  (b) customer inquiries;

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34 Opinion of Advocate General Kokott derived on 8 September 2005 on case Abbey National, C-169/04, EU:C:2005:523, paragraph 73.
(c) valuation and pricing (including tax returns);
(d) regulatory compliance monitoring;
(e) maintenance of unit-holder register;
(f) distribution of income;
(g) unit issues and redemptions;
(h) contract settlements (including certificate dispatch);
(i) record keeping.

- Marketing’.

3.1.1.1. Case C-169/04 Abbey National

On 4 May 2006, the Court of Justice decided case C-169/04 Abbey National ruling on the meaning of the term “management”. The Court added that since there is no definition of that term, the provision in Article 13B(d)(6) of the Sixth Directive (now Article 135(1)(g) of the VAT Directive) must therefore be interpreted in the light of the context in which it is used and of the aims and scheme of the Directive, having particular regard to the underlying purpose of the exemption which it established.35 The decision from the Court sets out criteria for the classification of certain services qualifying as management services to be exempt, which relates to the list of activities of collective portfolio management in the Annex II to Directive 85/611/EEC mentioned above.

Abbey National Unit Trust Managers Limited is the manager of a number of authorized units trusts in London. The trustees of the trusts are Clydesdale, Citicorp, or HSBC which charge a general fee for their trustee functions. Citicorp was chosen to be the custodian of these four open-ended investment companies (‘OEICs’) and charges a general fee for its services.

However, for these OEICs, it does not act as custodian. In 2000, Inscape Investment Limited (part of Abbey National) entered into an agreement with the Bank of New York (the third-party manager) for the reporting of the performances, in particular, computing the amount of income and the price of units or shares, the valuation of assets, accounting, the preparation of statements for the distribution of income, the provision of information and documentation for periodic accounts and tax, statistical and VAT returns and the preparation of income forecasts. The third party also undertook to provide other services such as data processing, fund reconciliation, calculation and recording of charges and expenses, recording of corporate events, distribution of daily sub-fund prices to the press, production of tax and VAT returns and returns to the Bank of England, calculation of distribution rates and yields, and answers to enquiries from the taxpayers and/or the depositary. Abbey National was charged with VAT by several trustees of the trusts, and appealed against this. The appellant contends that the service supplied by Bank of New York are exempt from VAT because they constitute “management of special investment funds” under Article 13B(d)(6) of the Sixth Directive.

Portfolio management, for example, direct involvement in the transactions concerning the assets of the fund or decision-making under the management undeniably fall within the scope of the exemption. On the contrary, services relating to fund accounting and administrative services were

36 Ibid paragraph 26
37 Ibid paragraph 27
38 One must be cautious that not any portfolio management fall into the scope of exemption. See also Judgment of 19 July 2012, Deutsche Bank AG, C-44/11, EU:C:2012:484, paragraphs 31-35
regarded as taxable. Abbey National was against this interpretation and appealed to the VAT & Duties Tribunal against VAT charged on it.

The Court, firstly, examined the objective of the exemption is “to facilitate investment in securities for small investors”\(^{40}\) those have limited means of pooling capital for investment. The fiscal neutrality is always taken into consideration to ensure the choices of investors between direct portfolio management and investment carried out by professional management or investment company. Secondly, the Court relied on a number of arguments giving substantial outset for a transaction to be classified as an exemption. It also means the nature and characters of the service rendered are examined. In particular, the CJEU pointed out that administering undertakings for collective investment set out in Annex II to Directive 85/611/EEC, under the heading “Administration”, are specific enough to be covered by the definition of the term “management” in Article 13B(d)(6) of the Sixth Directive\(^{41}\) Next, the nature of the services is another decisive factor should be noted, rather than the person supplying or receiving the services. Moreover, the CJEU took the view that the wording in the Article 13B(d)(6) of the Sixth Directive does not preclude the management of special investment funds from being broken down into a number of separate services, even when they are rendered by a third-party manager\(^{42}\) The last requirement which the Court observes is that, in any event, services performed by a third-party manager in respect of the administrative management of the funds come within the concept of the


\(^{41}\) Ibid paragraph 64.

management if, viewed broadly, they form a distinct whole, and are specific to, and essential for, the management of special investment funds.43

3.1.1.2. The Annex II and the interpretation of Article 135(1)(g)

It is noticeable that the activities under the heading “Administration” in Annex II to Directive 85/611/EEC deliver a closer approach to the term “management of special investment funds”. However, as the AG Kokkot pointed out in her opinion, Annex II appears to describe the functions in favor of only management companies whereas particular tasks of the depositary are missing. This means a discrepancy compared to what is provided in the Article 13B(d)(6) of the Sixth Directive which concerns the management of common funds generally.44 The AG reviewed the concept of management in the Sixth Directive to be broader than the so-called definition in Annex II. In another word, the wording in the exemption provision in the Sixth Directive allows the function carried out by the depositary to be regarded as management, which may result in the exemption, while the seem-to-be insufficient context in Annex II is likely to narrow the application.

In addition, the AG added that if the activities under heading “Administration” in Annex II to Directive 85/611/EEC are regarded as a description of the typical functions of the management company, this approach would lead to a harmonization between the exemption provision in the Sixth Directive and the Directive 85/611/EEC. By doing so, the functions in the list should not be seen as a definition of the management services of a common fund albeit a consultation obviously could be made for the interpretation of the term “management”. Indeed, Article 5(2) of the Directive 2001/107/EC

43 Ibid paragraphs 70 & 71.

44 Opinion of AG Kokott delivered on 8 September 2005 on case Abbey National, C-169/04, EU:C:2005:523, paragraph 81
amending Directive 85/611/EEC states that the list of functions mentioned in Annex II is “non-exhaustive”.

3.1.2. Non-listed management

As mentioned in the previous part, in order to determine whether services are regarded as exempted transactions, one could evoke the list in Annex II to Directive 85/611/EEC. However, it is noticeable that a special effort of interpretation is required as the list is non-exhaustive. The issue in question is that whether services which are not mentioned in Annex II may benefit from VAT exemption and under what conditions the transactions is determined for that purpose.

3.1.2.1. Case C-275/11 GfBk

GfBk is a German undertaking whose objects are the dissemination of information and recommendations relating to the stock market, the provision of advice relating to investment in financial instruments and the marketing of financial investments. In 1999, GfBk entered into a contract with an investment fund management company (‘IMC’). GfBk thereby undertook to advise the IMC in the management of the fund and constantly to monitor the fund and to make recommendations for the purchase or sale of assets. GfBk was also required to pay heed to the principle of risk diversification, to statutory investment restrictions… and to investment conditions. GfBk’s remuneration is calculated on the basis of a percentage by reference to the average monthly value of the investment fund. With regard to the period 1999 to 2002, the German tax administration took the view that GfBk’s advisory

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45 Judgment of 7 March 2013, GfBk, C-275/11, EU:C:2013:141
46 Judgment of 7 March 2013, GfBk, C-275/11, EU:C:2013:141, paragraph 14
47 Ibid paragraph 16
services to the IMC was not covered by the “management of special investment funds” within the meaning of Article 13B(d)(6) of the Sixth Directive.

On 7 March 2013, the Court delivered the judgment. According to the Court, it is necessary to examine whether the advisory services provided by a third party concerning investment in transferable securities is intrinsically connected to the activity characteristic of an IMC, so that it has the effect of performing the specific and essential functions of management of a special investment fund. In this regard, the CJEU shows the agreement to AG Cruz Villalón’s opinion in which there should be an intrinsic connection\textsuperscript{48} between a service and the activity rendered by a common fund. Basically, services consisting in giving recommendations to an IMC to purchase and sell assets are observed to have such relation, which is a typical activity of an investment fund and consists in the collective investment in transferable securities of capital raised from the public. The Court continued to emphasize that despite the fact that advisory and information services are not listed in Annex II to Directive 85/611/EEC, this does not affect the inclusion of those services in the category of specific services to fall within the scope of “management”.\textsuperscript{49} It is because the Directive 2001/107/EC states itself in Article 5(2) that the list in the annex is not exhaustive. AG Kokkot indeed represented the same view in her opinion for the case Abbey National previously. The AG emphasized that “the concepts in Annex II to Directive 85/611 are regarded not a definition of the management services of a common fund but a description of the typical function of the management company”.\textsuperscript{50}

\textsuperscript{48} Ibid paragraph 23

\textsuperscript{49} Judgment of 7 March 2013, GfBk, C-275/11, EU:C:2013:141, paragraph 25

\textsuperscript{50} Opinion of AG Kokott delivered on 8 September 2005 on case Abbey National, C-169/04, EU:C:2005:523, paragraph 79
The judgment by the Court only accepted one of three criteria that the AG proposed, which is the intrinsic connection of the services to the activity of the fund. The two remaining conditions that were passed over are the degree of autonomy and the temporal permanence of the services (it must be continuous or foreseeable over time). According to the AG’s perspective, those criteria, together, are capable of reflecting a rather more precise content of the rule of specificity and distinctness if viewed broadly. However, from the arguments, the CJEU only considered the nature of the services concerned in respect of the relationship between services to activity characteristic of an IMC to determine whether advisory services is “management of special investment fund”.

3.2. Conclusions

There contains apparently no definition of the term of “management of special investment funds” provided in the exemption for financial services. Therefore, the scope of the provision has been defined on a case by case basis. In case C-169/04 Abbey National, a number of criteria was introduced to determine whether services are subject to Article 135(1)(g) of VAT Directive (Article 13B(d)(6) of the Sixth Directive). Remarkable points include:

- Annex II to Directive 85/611/EC can be used as inference for the interpretation of the “management” in the provision;
- Functions can be broken down into a number of separate services, even when they are rendered by a third party;
- Administrative and accounting management can come within the scope of the exemption;
- The nature of services that matters rather than the person supplying or receiving the services.

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51 Opinion of AG Cruz Villalón delivered on 8 November 2012 on case GfBk, C-275/11, C-275/11, paragraph 27
Yet, the list under the heading “Administration” in Annex II to Directive 85/611/EEC is not the only proof on which one can lean. From settle case-law based on the statement in Article 5(2) of the Directive 2001/107/EC amending Directive 85/611/EEC that the list of functions mentioned in Annex II is “non-exhaustive”, consequently, one can agree that those services which contain advisory and information elements can also benefit from the VAT exemption for investment funds. Once again, the nature of services- the factor of fundamental connection connected to the fund’s activity is recalled to improve that such services perform the specific and essential functions of management of a special investment fund.

One can draw a conclusion that the room of interpretation of the term “management” does not limit itself only in the list in Annex II to Directive 85/611/EC. On a further consideration, services which do not follow the list can be exempted, provided that they perform required decisive elements.

4. Investment funds

The provision provided in Article 135(1)(g) of the VAT Directive (Article 13B(d)(6) of the Sixth Directive not only concerns totally on the management. Member States is allowed to specify its regulation on the definition of investment funds. Therefore, this section investigates the discretion granted to the Member States and how far this power could extent. Changes in the clarification of the concept of investment funds would be delivered later.

4.1. Investment funds under Member State’s law

The increased importance of the investment fund as a means of investment within the EU has been taken into account since the first Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws,
regulations and administrative provisions relating to UCITS. The UCITS Directive has laid down a number of structural obligations for UCITS, forming the background for the functions of investment funds. The latest Directive 2009/65/EC, replacing the Directive 85/611/EEC, contains uniform standards on investment funds, allowing the cross-border offer of investment funds and lays out main regulations governing UCITS at EU level. In this Directive, an undertaking is considered as a UCITS following the provision in the Article 1(2) of UCITS Directive as follows:

“2. For the purposes of this Directive, and subject to Article 3, UCITS means an undertaking:
(a) with the sole object of collective investment in transferable securities or in other liquid financial assets referred to in Article 50(1) of capital raised from the public and which operate on the principle of risk-spreading; and
(b) with units which are, at the request of holders, repurchased or redeemed, directly or indirectly, out of those undertakings’ assets. Action taken by a UCITS to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regarded as equivalent to such repurchase or redemption.”

Open-ended and closed-ended funds are two common investment funds but only open-ended funds qualify as UCITS according to UCITS Directive. In contrast, closed-ended funds are excluded from the Directive.⁵² From that legal context of the UCITS Directive, the Commissioners of HM Revenue and

⁵² Article 3(a) of the UCITS Directive.
Customs, United Kingdom made a decision relating VAT charge on Claverhouse since it is a closed-ended investment fund.\textsuperscript{53}

On 28 June 2007, the Court delivered the ruling in case C-363/05 Claverhouse. Unlike the case of Abbey National which concerns open-ended funds, Claverhouse is an investment trust company (‘ITC’) relating to closed-ended funds which generally are not entitled to exemption from VAT under national law. With regard to the question whether “special investment funds” are capable of including closed-ended funds, the Court observed that there is no definition of the words “special investment funds” laid down in Article 13B(d)(6) of the Sixth Directive. From that finding, the Court continued to refer the case Abbey National’s judgment explaining that the term “special investment funds” covers both undertakings for collective investment constituted under the law of contract or trust law or under status, regardless of their legal form.\textsuperscript{54} Moreover, the Court also emphasized that, by referring the AG’s opinion, despite the fact that Directive 85/611/EC does not apply to closed-ended funds, it does not preclude closed-ended funds from being covered by the exemption in Article 13B(d)(6) of the Sixth Directive. Admittedly, each directive pursues their own different objectives and subjects. When the Sixth Directive was adopted, Community terminology in the field of special investment funds was not yet harmonized.\textsuperscript{55} As the Commission points out apparently in the sixth recital of the preamble to the directive, closed-ended funds are not excluded definitely from the coordinating measures laid down by


\textsuperscript{54} Ibid paragraph 26.

\textsuperscript{55} Ibid paragraph 32.
that directive, which may lead to an implication that this type of investment funds might be harmonized at a later stage.\textsuperscript{56}

Regarding to the phrase “as defined by Member States” in Article 13B(d)(6) of the Sixth Directive, the Court attached significance to the limits of the discretion empowered to Member States in that provision in order to ensure the principle of fiscal neutrality in the common system of VAT regards the choice between investing directly in securities and investing through management companies. As mentioned in chapter 2, the principle of fiscal neutrality plays an important part in determining the scope of the exemption in Article 135(1)(g) of the VAT Directive. Following that, the Court observed that the consideration of neutrality aspects includes the principle of elimination of the distortion in competition, which is established once that supplies of services are in competition and are treated unequally or differently for the purpose of VAT. It was emphasized that any application under national legislation, for instance, the selection regulating which investment funds are eligible for the exemptions and those which are not, which results to the exclusion of the management of special closed-ended funds from the exemption does not appear justified to the objective of that provision and to the principle of fiscal neutrality. Member States, when exercise their discretion to determine specific conditions connected to an exemption, must have regard to the objectives pursued by that provision while guaranteeing the principle of fiscal neutrality for investors.

\textsuperscript{56} The scope of application of the UCITS Directive is defined by the sixth recital as follows: “Whereas the coordination of the laws of the Member States should be confined initially to collective investment undertakings other than of the closed-ended type ...; whereas regulation of the collective investment undertakings not covered by the Directive poses a variety of problems which must be dealt with by means of other provisions, and such undertakings will accordingly be the subject of coordination at a later stage; ...;”
4.2. The extension of “investment funds”

Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to UCITS has been amended recently by Directive 2001/108/EC of the European Parliament in which Article 1(1) and (2) provides:

1. The Member States shall apply this Directive to undertakings for collective investment in transferable securities (hereafter referred to as UCITS) situated within their territories.

2. For the purpose of this Directive, and subject to Article 2, UCITS shall be undertakings:

   - the sole object of which is the collective investment in transferable securities and/or in other liquid financial asset referred to in Article 19(1) of capital raised from the public and which operates on the principle of risk-spreading,
   
   and

   - the units of which are, at the request of holders, re-purchased or redeemed, directly or indirectly, out of those undertakings’ assets.

Action taken by a UCITS to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regarded as equivalent to such re-purchase or redemption.

Based upon the above, undertakings for collective investment in transferable securities must pursue the sole object of investing in transferable securities and/or in other financial assets based on the principle of risk spreading to be regarded as investment funds, under UCITS Directive. One question arising is that whether those above conditions are sufficient for a undertaking is to be regarded as ‘special investment funds’ within the meaning
of Article 13B(d)(6) of the Sixth Directive and whether there are other conditions should be met for this consideration.

4.2.1 Case C-595/13 Fiscale Eenheid X NV

Company A belongs to a Dutch fiscal entity ‘Fiscale Eenheid X NV’. In 1996, A was contracted to provide services to three Netherlands real estate investment companies founded by a number of pension funds. The services include: physically managing the assets of the client, including buying and selling real estate; acting as managing director of the companies; carrying out statutory and administrative tasks; carrying out financial reporting, data processing, and internal audit. Fiscale Eenheid X NV took the view that all of the tasks carried out by company A are covered by the tax exemption of special investment funds in Article 13B(d)(6) of the Sixth Directive. The Dutch Supreme Court referred questions to the CJEU funds investing in property could fall to be SIFs for the purpose of the VAT management exemption. The case is the first time the CJEU had to deal with funds investing in assets other than securities and other financial instruments.

The CJEU confirmed that the assets which a fund invested in are not of relevance to determine whether the fund is a special investment fund. Article 13B(d)(6) of the Sixth Directive merely refers to special investment funds in general, without mentioning any specific form of investment or making a distinction on the basis of the assets in which the funds are invested.\(^{57}\)

Therefore, it is apparent that that provision contains no exclusion of other forms of investment except the investment in securities. Instead of that, the Court points out other criteria which are believed to be more specific and appropriate for VAT exemption purpose. In particular, the Court, by referring to

the AG’s opinion, set out certain requirements that a fund must meet to be regarded as a special investment fund. Those include the fact that the investment companies must display characteristic identical to undertakings for collective investment as defined by the UCITS Directive and carry out the same transactions or, at least, display features that are sufficiently comparable for them to be in competition with such undertakings. In that regard, investment companies could be regarded as “special investment funds” where:

- capital is pooled from more than one investor who bears the risk connected with the management of the assets assembled in those companies;
- the capital is invested with a view to purchasing, owning, managing and selling immovable property in order to derive a profit therefrom;
- the profits will be distributed to all unit-holders in the form of a dividend based on the increase in the value of their holding;
- those companies are subject to specific State supervision”

In comparison to the definition of undertakings for collective investment in transferable securities set out in UCITS Directive, it can be noticed that a new requirement of “specific State supervision” has been considered and added. Consequently, this decision is believed to widen the scope of the fund management exemption when other undertakings which qualify those requirements may benefit from the exemption.

59 Ibid paragraphs 40 & 64.
4.2.2. UCITS Directive and the extension of “investment funds”

It is impossible to argue that the decision by the Court in case C-595/13 Fiscale Eenheid X NV negate partly or totally the UCITS Directive’s position of defining undertakings for collective investment in transferable securities. Indeed, the Court emphasizes clearly that UCITS Directive was intended to basically form an important background for understanding the functions and functioning of these investment vehicles. Following that, Member States exercise their discretion to define what is and is not a special investment fund along with the regulation of investment funds consistent with EU community’s aim. The sixth recital in the preamble to the UCITS Directive along with Article 24 and Article 19(1)(e), as amended by Directive 2001/108, indicate that the coordination of legislation is set out to cover not only UCITS but also other collective investment undertakings. Investment in transferable securities is therefore only one of the particular forms of regulated investment.60

4.3. Conclusions

It can be seen from above-mentioned cases that there is no restriction both in the VAT Directive and UCITS Directive which limits the scope of this exemption. Regarding each Member State’s power to lay out specific conditions for exemptions, one must bear in mind that despite different exemptions’ objectives, when Member States exercise their discretion, generally, they must guarantee common principles and ensure the effects of EU laws. The exemption for the management of special investment funds also follows that trend. In particular, the principle of fiscal neutrality always

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60 This interpretation is supported again in Directive 2011/61, which represents at EU further step in the harmonization of specific State supervision of investment, indicates in recital 34 and 58 in the preamble apparently that this Directive also applies to real estate funds.
receives careful consideration by the CJEU when a specific case is taken into account.

In addition, the restriction which limits the scope of the term of investment funds seems to be non-exist both in the VAT Directive and UCITS Directive. The CJEU has clarified that the objective of this exemption is to facilitate investment in securities for small investors, hence, in order to avoid differently unequal treatment between direct and indirect investment. From that finding, the CJEU adds new requirements of “specific State supervision” in case C595/13 Fiscale Eenheid X NV to requirements for investment funds originally provided in UCITS Directive previously. Whether investment companies are subject to specific State supervision or not must be based on the fact that those companies display identical required characteristics or at least features that are sufficiently comparable to other undertakings for collective investment under UCITS Directive, regardless of the nature of underlying investment assets.

5. Summary and Conclusions

5.1. The concept of “the management in special investment funds”

The exemption provision provided in Article 135(1)(g) of the VAT Directive (recasting Article 13B(d)(6) of the Sixth Directive has changed in a significant manner regarding the term of the management per se and the concept of special investment. First, it is settled case-law ruled by the CJEU that there has been a tendency of interpretation which seems to widen the scope of this exemption. Those activities of management which are not listed originally in the Annex II to Directive 85/611/EC which is used to make inference for the interpretation of this exemption, still are subject to the exemption if the criteria of ‘distinct whole’ in case C-2/95 SDC is identified, or
in another word the effect of performing the specific and essential functions of management of a special investment fund is determined.\textsuperscript{61}

Secondly, the CJEU has clarified newly added requirement of “specific State supervision” to the set of requirements for undertakings to be deemed as special investment funds. The Court referred to the AG’s opinion that only investment funds that are subject to specific State supervision can be subject to the same conditions competition and appeal to the same circle of investors. Those other types of investment funds may, therefore, in principle, be eligible for the exemption in Article 135(1)(g) of the VAT Directive if the Member State provides for specific State supervision of those funds also.\textsuperscript{62} However, although emphasizing the need for specific State supervision for undertakings to be considered as special investment funds, the CJEU leaves the assessment to national court without giving any further guidance on the extent of specific State supervision. Therefore new question may be brought out as to what extent Member State can exercise their discretion on this supervision. This seeming extension of investment funds consequently might face certain implicit limitation contained within it.

5.2. Is there a strict interpretation?

Generally, when dealing with the interpretation of exemption, the CJEU takes the view that “since exemptions are exceptions to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person, they should be interpreted strictly in order to achieve a harmonized tax system”.\textsuperscript{63} However, a strict interpretation does not literally mean that

\textsuperscript{61} Judgement of 13 March 2014, \textit{ATP Pension Service}, C-464/12, EU:C:2014:139, paragraphs 61 & 62 & 65 also adopted the same reasoning in favor of the criteria of “distinct whole”.


\textsuperscript{63} See footnote n.9 above.
exemption provisions must be explained and clarified in a manner which may result in a narrow application. As AG Jacobs’s opinion in case C-267/00 Zoological Society of London, the exemptions should not be whittled away by interpretation. In his view, “both the exemptions and any limitations on them must be interpreted consistently to the initial purpose and objective which they are intended and no more”. Similarly, the CJEU also concluded that “the exemptions referred to in Article 13 should be construed in such a way as to deprive the exemptions of their intended effect”.

Turning back to the exemption in Article 135(1) (g) of the VAT Directive, the CJEU has repeatedly stated that the objective of this exemption is “to facilitate investment in securities for small investors”. Accordingly, in order to answer the question as to whether it is a strict interpretation or whether this interpretation is in line with EU law, this inherent objective is always taken into consideration.

In the view of settled case-law referred to Article 135(1)(g) of the VAT Directive, both strict interpretation and fiscal neutrality principles are adopted by the CJEU. Studying on recently ruled cases related to the management of investment funds, the decisions seem to follow an extensive approach when

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64 See the Opinion of AG Sharpston in case Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing v Staatssecretaris van Financiën, C-407/07, EU:C:2008:713. See also: Rita de la Feria (ed), VAT Exemptions Consequences and Design Alternatives (EUCOTAX Series on European Taxation, Volume 37, The Netherlands 2013) page 100


66 See footnote n.27 above.

67 According to Richard Lyal, “exemptions must not be extended beyond their natural scope, having regard to the function they perform in the VAT system. The CJEU’s statement above is “simply a reminder” that exemptions should be limited as much as possible”. See also: Rita de la Feria (ed) (2013) pages 99-100


69 See Lang et al (Eds), (2016), Table 1: Four Years’ Sample of CJEU Cases on VAT Exemptions, page 12
interpreting these exemptions. In case of *Abbey National*, the Court took the view that principle of fiscal neutrality precludes different treatment among economic operators carrying out the same transactions. The application of Article 13B(d)(6) of the Sixth Directive is made to all undertakings for collective investment and their participants.\(^{70}\) The judgment in case *JP Morgan Fleming Claverhouse Investment Trust* added that the principle of fiscal neutrality does not require the transactions to be identical.\(^{71}\) Case of *GfBk* also refers to the principle of fiscal neutrality adopting the inclusion of advisory services in exempt management services.

It is not to say that the principle of strict interpretation is dismissed when interpreting the exemption under Article 135(1)(g) of the VAT Directive. Cases such as *Deutsche Bank, Wheels, PG Holdings* were interpreted according to this principle. However, the growing of the principle of fiscal neutrality application in recent cases basically shows the *increasingly casuistic nature of interpreting VAT exemptions*.\(^{72}\) Obviously, there is no specific rules in favor of any of those principles.


\(^{72}\) Lang et al (Eds), (2016) page 13.
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