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Pursuing the evolvement and purpose of the Cost Sharing Exemption in the EU VAT system

by

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HARN60 Master Thesis

Master's Programme in European and International Tax Law

2018/2019

Spring semester 2019

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Date submitted: June 7, 2019

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Summary

For some 21st of September associates with the lyrics of the famous song "September" by Earth, Wind & Fire. However, in the world of VAT the date 21st of September 2017 will go down in history, as the day when the Cost Sharing Exemption went a different course.

Until today the VAT exemption laid down in Article 132(1)(f) of the VAT Directive, commonly known as the Cost Sharing Exemption, has been limited in explanatory sources. Only 7 cases have been delivered by the CJEU on the subject followed by 3 VAT Committee working papers and 1 by the VAT Expert Group. As such the Cost Sharing Exemption had been widely used by all economic operators whose business activities are exempt from VAT.

It could be argued that the VAT exemption laid down in Article 132(1)(f) of the VAT Directive is the most complicated of all exemptions laid down in the VAT Directive, as its application requires the fulfilment of 5(!) cumulative criteria. Criteria from which each is more complicated that the other.

Change was inevitable, as at one point the CJEU faced a list of questions asking clarifications for all criteria. Perhaps it could be even argued that the nature of the questions may force to rethink the direct applicability of the provision, as the clarity of the exemption is put to the test.

Never the less, on the 21st of September, the CJEU delivered the judgements in *DNB Banka* and *AVIVA*, clearly stating that the Cost Sharing Exemption cannot be relied upon by taxable persons operating in the financial and insurance sectors, due to the fact that the scope of Article 132(1)(f) is limited (as the title suggest) to exemptions in the public interest.

However ground-breaking the judgments may be, the CJEU has still left questions unanswered, as well as in the light of the new conditions, created new uncertainties. Yet inevitably, the question in lot of minds is how did the CJEU come to this conclusion and was it the intention of the legislature to limit the scope of the Cost Sharing Exemption only to the public sector. The present thesis shall intend to tackle the question as to what is the purpose of the Cost Sharing Exemption and whether the decisions delivered by the CJEU in 2017 could have been predicted.

Preface

I would like to express my humblest gratitude for the opportunity to take part in the Master's Programme in European and International Tax Law which has been a once in a lifetime experience. The programme allowed me to gain a more broader view of the tax environment in the EU and significantly improve my knowledge in the field of tax. The opportunity to study in Lund University has given me personal growth and allowed me to pursue new experiences which I can cherish.

Firstly, and most importantly I would like to express my biggest thanks to my wife Kristīne. It is only thanks to her love and understanding, that allowed me to somehow combine work back home with full-time studies in Sweden. The time apart was not easy and it would not have been possible without her.

Secondly, I want to express gratitude to my family for encouraging me to pursue my studies and to continuously strive to better myself.

Third, it is essential to thank Ilona Butāne, who allowed me to pursue my academic venture whilst still working. It is truly that without her support I would not have managed the juggling between work and studies.

To the wonderful staff at Lund University, especially Cécile, Marta and Sigrid, I am happy to have had the opportunity to learn from you.

At the time of writing my thesis Kristīne and I are waiting for our firstborn to whom I want to dedicate this work. I cannot wait to start this new chapter in my life.

Abbreviation list

CJEU	Court of Justice of the European Union
Cost Sharing Exemption	VAT exemption provided in Article 132(1)(f) of the VAT Directive
Court	Court of Justice of the European Union
EU	European Union
First VAT Directive	First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes (JOP_1967_071_1301_004)
OECD	Organization of Economic Cooperation and Development
IGP	Independent groups of persons – as referred in Article 132(1)(f) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax
Second VAT Directive	Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes - Structure and procedures for application of the common system of value added tax (JOP_1967_071_1303_005)
Sixth Directive	Sixth Council Directive 77/338/EEC of 17 May 1977 on the harmonization of the laws of the member states relating to turnover taxes – Common System of value added tax: uniform basis of assessment (OJ L145/1)
VAT	Value added tax
VAT Directive	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L347, 11.12.2006, p.1)

1 Introduction

1.1 Background

The VAT Directive seeks to establish a common system of VAT throughout the EU.[1] One of the main cornerstones for the VAT system has been enshrined in the 2nd paragraph of Article 1, namely, that the VAT system shall entail a general tax which is applied on all stages of production and distribution.[2] However general a rule may be, there will always be instances where the general principles shall not apply. This is also the case for the VAT system, as the VAT Directive has foreseen a list of transactions which shall be exempt from VAT.

The presence of exemptions in the general VAT system has created a certain amount of hardship in the everyday life of the CJEU. Still the CJEU has managed to clearly establish, that when it comes to questions on the applicability of VAT exemptions, the interpretation of them must be strict, as exemptions are a derogation form the general principles of VAT.[3] Some VAT experts have even alleged the exemption system as being of a cancerous nature.[4]

While VAT exemptions might seem tempting, as at first glance it appears that the end consumer bares no VAT expenses, the reality often is different. An integral part of the VAT system, which ensures the neutrality of VAT and that the merchant does not bare VAT costs, is the deduction system.[5] As has been well established by the case-law of the CJEU, the VAT deduction system relieves the taxable person from the burden of VAT in so far as the transactions of that person are in themselves subject to VAT.[6]

Where the deduction system has been intended to relive of the VAT burden those taxpayers, whose economic activity is subject to VAT, those taxable persons whose economic activity is subject to exemptions are placed in a disadvantage. As the transactions performed are VAT exempt, VAT which

[1] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax
[2] Ibid. Article 1(2)
[3] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 35
[4] Terra B.J.M. and Kajus J. *A guide to the European VAT Directives Volume 1 Introduction to European VAT*, (IBFD 2018) p 452
[5] 1st subparagraph of Article 2(2) Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax
[6] See judgement of 18 October 2018, Case C-153/17, *Volkswagen Financial Services Ltd*, EU:C:2018:845 paragraph 40

has been incurred in previous stages of production and distribution cannot be deducted and remains as a burden (cost) for the taxable person.

Thus, those taxable persons operating in sectors exempt from VAT welcomed a mechanism which would allow to reduce the cost of non-deductible input VAT. That relief was found in the Cost Sharing Exemption provided for in Article 132(1)(f) of the VAT Directive.

As mentioned the Cost Sharing Exemption has a list of criteria, all of which shall be discussed in Chapter 2, to fulfil for application and each of them have some uncertainties. These questions had been addressed in some form in the level of the CJEU. However, there seemed to be a clear consensus that the Cost Sharing Exemption can be relied upon by all sectors which are subject to VAT exemptions prescribed in Articles 132 and 135 of the VAT Directive.[7] This notion was also followed in practice.[8]

The abovementioned came to an end on the 21st of September 2017, when the CJEU stated *"the supply of services which do not contribute directly to the exercise of activities in the public interest referred to in Article 132, but to the exercise of other exempt activities, in particular those referred to in Article 135 of that directive, cannot come under the exemption provided for in Article 132(1)(f) of Directive 2006/112"*.[9]

The decisions by the CJEU in both *DNB Banka* and *AVIVA* have brought significant changes. Firstly, it should be noted that the CJEU did not give an answer to any of the questions which were asked by the national courts in both mentioned cases. Furthermore, these decisions have made an essential change in the nature of questioning the Cost Sharing Exemption. Considering the fact that up until the judgements were delivered there seemed to be no indications of the limitations for the Cost Sharing Exemption, it is reasonable to ask the question as to, *what* was the purpose of the Cost Sharing Exemption in the first place, and *where* there any indications that insurance and financial sectors are excluded from the scope? In the light of the aforementioned, this thesis has been written.

[7] European Commission, VAT Committee, Working Paper No 654, Scope of the exemption for cost-sharing arrangements, taxud.d.1(2010)123337, Brussels, 3 March 2010 page 5

[8] European Commission, VAT Expert Group, VEG Nº 075, Implications of the CJEU judgements on cost-sharing for the financial and insurance sectors, taxud.c.1(2018)1016383, Brussels, 16 February 2018, page 2

[9] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 36 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 31

1.2 Aim

The VAT exemption provided in Article 132(1)(f) is one of the most complicated provisions in the VAT Directive, requiring the fulfilment of 5 cumulative criteria. Both *DNB Banka* and *AVIVA* raised questions regarding 3 out of the 5 criteria. However, the CJEU decided that the case should be settled by clarifying the criteria which was not questioned. The questions raised in *DNB Banka* and *AVIVA* still remain unanswered. As of the 21st of September 2017, the Cost Sharing Exemption can no longer be relied upon by taxable persons pursuing their business actives which are covered with the VAT exemption provided in Article 135.[10] Namely the financial and insurance sectors may no longer rely on the VAT exemption laid down in Article 132(1)(f) of the VAT Directive.

Before delivering the judgments in *DNB Banka* and *AVIVA*, the CJEU had previously ruled in its judgment in the *Taksatorringen* case that:

- first, the VAT exemptions laid down in Article 13 of the Sixth Directive must be interpreted strictly;[11]
- second, it is not intended to impose such an interpretation which would make the application of the exemption impossible.[12]

However, a mere 14 years later the Court decided to go a different way in interpreting Article 132(1)(f) of the VAT Directive. It all started with paragraph 29 of *DNB Banka* and paragraph 24 of *AVIVA*, where the CJEU stated that "*when interpreting a provision of EU law, to consider not only its wording but also the context in which it occurs and the objectives pursued by the rule of which it is part*".[13]

Considering the complexity of the provision as well as the strict interpretations of VAT exemptions followed by the CJEU, this thesis shall seek to examine the Cost Sharing Exemption from the point of view of its purpose and context. Taking into consideration that the interpretation of VAT exemptions is not a simple task, it is first essential to understand the purpose of the provisions which would help guiding the interpretation. By seeking the purposes of the Cost Sharing Exemption, this thesis shall also try to determine whether the limitation in scope as decides in 21st of September 2017 could have been predicted beforehand.

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[10] Ibid

[11] See judgment of 20 November 2003, Case C-8/01 *Taksatorringen*, EU:C:2003:621, para. 61

[12] Ibid. Para 62

[13] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 29 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 24

1.3 Method and material

In order to achieve the aim of the thesis the author shall use the legal dogmatic method. Primary and secondary EU legislation shall be used and interpreted in the light of their wording and context and purpose. The main source of law shall be the provisions of the VAT Directive. In addition, the relevant case-law of the CJEU along with other sources of doctrinal value, Advocate General opinions, VAT Committee working papers and articles by different authors shall be used. Considering that the aim of the thesis is to determine the purposes of the exemption, legislation preceding the current VAT Directive containing the said exemption shall be used. As the conditions of the application of Article 132(1)(f) are closely related to other Articles of the VAT Directive, besides analysing CJEU case-law explicitly dealing with said article, those cases relevant to the conditions of the Cost Sharing Exemption shall also be reviewed.

1.4 Delimitation

This thesis has been prepared in the view that the reader has a general understanding of the EU VAT system and the provisions of the VAT Directive. As was mentioned the CJEU left unanswered questions in *DNB Banka* and *AVIVA* judgments. However, this thesis will not look at the unanswered questions but rather focus on the purposes and the personal scope of the Cost Sharing Exemption. The territorial scope as well as an analysis on how the distortion of competitions criteria should be understood will not be looked at in this thesis and is for others to analyse in more depth.

1.5 Outline

In the thesis the author shall begin with giving an overview of the cumulative criteria that need to be fulfilled in order for the Cost Sharing Exemption to be applicable. Each criterion shall be analysed separately and more emphasis shall be given to the criteria dealing with the IGP. The author shall afterwards continue with analysing the developments leading up to the judgments of 21st of September 2017. The opinions of AG shall be viewed in more detail as well as the history of the Cost Sharing Exemption shall be discussed. The Thesis shall the end with the conclusions of the author.

2 The Cost Sharing Exemption

2.1. Criteria of application of Article 132(1)(f)

What makes the Cost Sharing Exemption stand out from all other exemptions laid down in the VAT Directive is its complexity and share volume of cumulative criteria that need to be fulfilled in order for the exemption to take effect. Article 132(1)(f) of the VAT Directive provides that Member States shall exempt from VAT *"the supplies by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to cause distortion of competition."*[14]

As agreed by tax scholars[15] and VAT committee working papers[16] there are in total 5 cumulative criteria which need to be met, in order to apply the exemption:

1) There is an independent group of persons providing services
2) The members of the IGP carry on a downstream activity which is exempt form VAT or to which the members are not taxable persons[17]
3) The services provided are directly necessary for the execution of the services mentioned in point 2.
4) Remuneration of those services is equivalent to the exact share of the respective member
5) The exemption does not distort competition.

[14] Article 132(1)(f) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

[15] Carolina Sá Duarte, *What Future for the Cost-sharing Exemption? Considerations under the VAT Directive and the CJ Case Law*, Tilburg University, 2016-2017 and Anastasia-Kyriaki Iliopoulou, *VAT grouping and the Cost-Sharing Exemption: Similarities, Differences, and their Interactions*, Lund University, 2017-2018

[16] European Commission, VAT Committee, Working Paper No 654, Scope of the exemption for cost-sharing arrangements, taxud.d.1(2010)123337, Brussels, 3 March 2010 page 3, reconfirmed in European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015 page 4 and European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis (II), taxud.d.1(2015)2162037, Brussels, 30 September 2015 page 2

[17] Until the decisions in DNB Banka and AVIVA there did not seem to be limitations to this criterion

One might assume, that a provision so complex as the one under review, would have a long list of case-law where the CJEU would interpret and explain all of the criteria. It is therefore unorthodox that there is but a handful of cases and explanatory notes on the Cost Sharing Exemption. To be more exact, 7 cases, 3 VAT Committee working papers and 1 document by the VAT Expert Group which dealt with Article 132(1)(f) of the VAT Directive. As of the time of this thesis there are 2 pending cases dealing with the subject[18].

Before analysing the purpose and historical developments of the Cost Sharing Exemption it is first necessary to give a brief overview of each criterion. Each criterion shall therefore be discussed further below.

2.1.1 Independent group of persons

The first criteria of application of the Cost Sharing Exemption is the existence of an independent group of persons. However, this is even more complicated in the sense that the criterion is surrounded with more conditions which cannot be omitted. To begin with, the wording of Article 132(1)(f) of the VAT Directive clearly defines that VAT shall be exempt for: *"Supplies of services by independent groups of persons [..]"*.[19] Therefore, in order for the VAT exemption to apply there must be a service, and that service must be provided by an independent group of persons.

Furthermore, the wording of the provision also states *"[..] for the purpose of rendering their members the services [..]"*.[20] Therefore, the services which shall be subject to the VAT exemption must be provided by the IGP to other persons, yet those other persons which receive the services must be members of the IGP.

Thus, the first criterion of application requires the existence of a group (IGP), which consists of members. What is even more important, that group (IGP) must be capable of providing services, as clearly stated in the wording of the provision.

It is now essential to determine what is the status of the IGP. To understand this, the scope of VAT should be looked at. Namely, considering that an exemption is a derogation form the general VAT system[21], that means that in

[18]Application of the cases: OJ C 301 from 27.8.2018, p.17 and OJ C 131 from 08.04.2019, p.25

[19] Article 132(1)(f) of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

[20] Ibid

[21] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 35

order for a transaction to be exempt[22], it shall first be subject to VAT, should the exemption not be in place. Here it is necessary to go to the starting provisions of the VAT Directive.

Article 2 (1)(c) of the VAT Directive provides that VAT shall be applied on *"the supply of services for consideration within the territory of a Member State by a taxable person acting as such".*[23] Thus, it can be concluded that in order for a service to be subjected to the system of VAT, it must be provided by a taxable person, or by a person who is acting as a taxable person.[24] A taxable person is defines in Article 9 of the VAT Directive, explaining that a taxable person is "*any person who, independently, caries out in any place any economic activity, whatever the purpose or result of that activity".*[25]

Considering the aforementioned, it can be concluded that for the Cost Sharing Exemption to apply, the underlining services must be subject to VAT. That in itself entails, that these services must be provided by a taxable person acting as such.[26] As the wording of Article 132(1)(f) provides, the exemption shall apply on the *"Supplies of services by independent groups of persons [..]".*[27]

Since the condition requires that the IGP provides services, that in itself entail that the IGP shall be a taxable person acting as such, in accordance with Article 9 of the VAT Directive. By viewing Article 132(1)(f) in conjunction with Article 9 again, more conditions must be considered.

First, when providing services subject to the VAT exemption the IGP must act independently from its members. Whilst it might seem simple at first, one must bear in mind that the jurisprudence of the CJEU has established case-law dealing with the taxable person and the independence criteria. More specifically, this can be viewed in notable cases such as *Heerma*, where a partnership had the characteristic to be a distinct taxable person from its partners.[28] The CJEU had further established in cases such as *FCE Bank* and

[22] Also, clearly emphasized in European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015, page 5

[23] Article 2 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

[24] See judgement of 29 April 2004 in Case C-77/01, *Empresa de Desenvolvimento Mineiro SGPS SA (EDM),* EU:C:2004:243, paragraph 50

[25] Article 9 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

[26] See judgement of 29 April 2004 in Case C-77/01, *Empresa de Desenvolvimento Mineiro SGPS SA (EDM),* EU:C:2004:243, paragraph 50

[27] Article 132(1)(f) of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

[28] European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015 page 5

Skandia America that a branch office which does not bare any economic risks distinct form its head office, cannot be deemed to act independently and therefore is not a separate person.[29]

Besides the abovementioned case-law on taxable persons, another consideration may be drawn from the provisions of the Implementing Regulations. Article 5 of the Implementing Regulation, which related to Article 9 of the VAT Directive, explains that European Economic Interest Groups (EEIG) when supplying goods or services to its members shall be considered as a taxable person in the meaning of Article 9 of the VAT Directive.[30] Taking into consideration that in dealing with its members an EEIG shall be deemed as a taxable person, it seems that, an EEIG could be a perfect form of an IGP, referred to in Article 132(1)(f).This notion can be derived from the fact that EEIG is a taxable person, and services provided to members are treated as services for consideration, thus fulfilling the first criterion of the Cost Sharing Exemption.

However, the reality of the matter is that there is no specific form the IGP must take[31] and if preferred by the VAT Directive, other than the fact that it must be a taxable person in accordance with Article 9. This is also confirmed by the direct literal interpretation of Article 9, as it clearly states that a taxable person is any person, so far as it acts independently.

The next consideration from the taxable person criteria, is the pursuing of economic activity, whatever the purpose or result.[32] This is also confirmed by the CJEU in its settled case-law, that the existence of '*economic activity*' is essential in order to deem a taxable person to exist.[33] Considering that it is clearly stated in Article 9 that the economic activity pursued does not bare a mandatory profit measurement, it seems that there is no contradiction with Article 132(1)(f). Indeed, as will be discussed further, one of the conditions for applying the Cost Sharing Exemption is the non-profit element, that is that the members reimburse the exact part in their joint expenses.[34]

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[29] See judgment of 23 March 2006, Case C-210/04 *FCE Bank plc*, EU:C:2006:196 paragraph 35 and judgment 17 September 2014, Case C-7/13 *Scandia America*, EU:C:2014:2225, paragraph 25

[30] Article 5 of the Council Implementing Regulations (EU) 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, (OJ L77, 23.03.2011, p.1-22)

[31] See European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015 page 5

[32] Ibid

[33] See judgement of 15 September 2011 in joint Cases C-180/10 and C-181/10, *Słaby and Others*, EU:C:2011:589, paragraph 43

[34] Article 132(1)(f) of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

When considering that a taxable person must pursue an economic activity, of which profit is not a mandatory prerequisite, also confirmed in *IZNO*[35], and comparing with the non-profit criteria of Article 132(1)(f), a deeper view shows that there are some inconsistencies. For these reasons the pursuance of economic activity as well as the consideration received needs to be put under the microscope.

2.1.1.1 Economic activity

In order for, one to be considered as a taxable person within the meaning of Article 9(1) of the VAT Directive, economic activity must be pursued.[36] As has been stated by the CJEU in its settled case-law the '*economic activity*' is objective in its character in a sense, namely that it is an activity *per se,* and it does not take into consideration the purpose or result of it.[37]

'*Economic activity*' has been described in Article 9 of the VAT Directive, as *"exploitation of tangible or intangible property for the purpose of obtaining income therefore on a continuing basis [..]"*[38] Therefore, merely looking at the grammatical text of the provision, it might seem that in order for activity pursued by a person to be deemed as *'economic'* it should seek to gain income on a continuing basis. According to the case-law of the CJEU, there is a twofold test to be achieved, first there must be *'exploitation'*[39] and second, that exploitation must be carried out to obtain income on a continuing basis.[40]

In order to determine whether activity is performed to derive income on a continuing basis, the behaviour of that person must be considered. As a well-known example in this case would be the methods adapted by the CJEU in *Słaby and Others.* In the mentioned case, the CJEU has put it clearly, that a person shall be considered to be pursuing *'economic activity'*, thus acting as a taxable person,[41] if that person takes active steps similar to those pursued by a developer, trader or person supplying services.[42]

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[35] See judgment of 29 February 1996, C-110/94, *Intercommunale voor zeewaterontzilting (INZO)*, EU:C:1996:67 paragraphs 15-17

[36] Article 9(1) of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

[37] See judgement of 19 July 2012 in Case C-263/11, *Ainārs Rēdlihs*, EU:C:2012:497, para. 28.

[38] Article 9 (1) 2nd subparagraph of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, also emphasized in judgement of 19 July 2012 in Case C-263/11, *Ainārs Rēdlihs*, EU:C:2012:497, paragraph 30.

[39] Ibid para. 31

[40] Ibid para. 32

[41] See judgement of 15 September 2011 in joint Cases C-180/10 and C-181/10, *Słaby and Others*, EU:C:2011:589, para. 43

[42] Ibid para. 39

It is necessary to note that Article 9(1) 1st subparagraph includes in the scope "*any activity of producers, traders or persons supplying services [..]*"[43] Article 9(1) 1st subparagraph has been overtaken from Article 4(2) of the Sixth Directive[44], which included "*[..] all activities of producers, traders, and persons supplying services [..]*"[45] Importantly the CJEU had, when dealing with Article 4(2) of the Sixth Directive, stated that all activities of traders also includes activities before taxable supplies take place, namely preparatory activities.[46] Although a slight difference in the chosen wording, it is safe to say that '*any activity*' shall be analogous to '*all activities*'.

From the aforementioned it may be derived that in order for a person to be deemed as pursuing '*economic activity*' that person must actively take steps, which are reasonably and objectively expected from a person providing services. In the case of IGP, that in itself entails that that group must carry out such activities which are reasonably expected from a taxable person. This may be more complicated in circumstances where an IGP is established for the sole purpose to provide services only to its members.

2.1.1.2 Consideration at cost

Previously it was described that the settled CJEU case-law has defined that '*economic activity*' must be carried out consciously and has a certain behaviour which is objectively expectable. Yet in order to attribute Article 9 to an IGP, even more so, to attribute that the services provided by that group are subject to VAT, Article 9 needs to be interpreted in conjunction with Article 2 of the VAT Directive. A similar test was established by the CJEU in *EDM* case, where transactions potentially subject to a VAT exemption were first attributed to the VAT system as such.[47] That is, transactions must fulfil the criteria of Article 2 and Article 9,[48] that is a taxable person (performing economic activity) provides services for consideration.

While straying more away from the taxable person criteria, it might seem that the consideration analysis in the light of the Cost Sharing Exemption is no longer within the scope of the first criterion, it is worthwhile noting that

[43] Article 9(1) 1st subparagraph of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax
[44] Terra B.J.M. and Kajus J. *A guide to the European VAT Directive Volume 2 Integrated Texts of the VAT Directive and of the former Sixth VAT Directive*, (IBFD 2018) Annex XII
[45] Article 4(2) of the Sixth Council Directive 77/338/EEC of 17 May 1977 on the harmonization of the laws of the member states relating to turnover taxes – Common System of value added tax: uniform basis of assessment (OJ L145/1)
[46] See judgement of 14 February 1985 in Case C-268/83, *Rompelman*, EU:C:1985:74, paragraph 22
[47] See judgement of 29 April 2004 in Case C-77/01, *Empresa de Desenvolvimento Mineiro SGPS SA (EDM)*, EU:C:2004:243, paragraph 51
[48] Ibid paragraph 51 – consider that at the time the case dealt with the provisions of the Sixth Directive Article 4(1) and (2), now Article 9(1) of the VAT Directive

Article 9(1) concerns any (all) activities pursued by the taxable person.[49] These activities also include the request of remuneration for services carried out. Furthermore, settled case-law clearly finds a link between the legal relationship between the service provider and the remuneration. Namely, where there is absolutely no remuneration there is no supply for consideration[50] and where there is no reciprocal performance between the supply and payment there also is no supply.[51]

As for the purposes of clarifying the Cost Sharing Exemption, and if services (transactions) are at all subject to the VAT system the judgments of CJEU in case *EDM* can brings some more clarity to the question. The case at hand dealt with consortiums where EDM took the role of manager as well as one of the members. According to the *'consortia agreement'* the main purpose of the consortia was for the members to pool resources in order to achieve a common goal.[52] Each member had a specific obligation to be carried out to achieve the consortium objective, after which an invoice was issued to EDM, not for settlement purposes, but rather to help identify the involvement of the members to calculate their benefit.[53]

If a member's contribution exceeded or was less its share, a settlement between members was performed.[54] No payments are made, if the contribution of the member is equal to that members share in the consortium.[55] The question therefore what whether there is a supply for consideration for the part which exceeds the share of a member.[56]

Accordingly, the CJEU had emphasized that where there is no consideration, that is, that a service is performed free of charge, no taxable transaction can take place.[57] Whereas that part which reflects an excess of the involvement against the total share in the consortium, and where actual payments are made, does constitute a service for consideration and consequently is a transaction subject to VAT.[58]

A notable decision as a consortium agreement may have some similarities of an IGP, as there is (1) a common goal to benefit its members (2) members

[49] See judgement of 14 February 1985 in Case C-268/83, *Rompelman*, EU:C:1985:74, paragraph 22
[50] See judgement of 29 April 2004 in Case C-77/01, *Empresa de Desenvolvimento Mineiro SGPS SA (EDM)*, EU:C:2004:243, para. 86
[51] See judgement of 23 March 2006, Case C-210/04 *FCE Bank plc*, EU:C:2006:196 para. 34
[52] See judgement of 29 April 2004 in Case C-77/01, *Empresa de Desenvolvimento Mineiro SGPS SA (EDM)*, EU:C:2004:243, paragraph 83
[53] Ibid.
[54] Ibid para. 18 and 83
[55] Ibid para. 87
[56] Ibid. see 2nd question asked by the referring court
[57] Ibid para. 88
[58] Ibid para. 89

benefit exactly to their share from a joint involvement. The payments which are made, albeit to members not to the consortium, are not of a commercial nature, but rather to ensure all members have contributed an exact share in the joint efforts.

As was already described in chapter 2.1.1.1 Article 9(1) does not require a specific result to be achieved, namely profit is not mandatory. Therefore, since only services where no payments are made shall be seen as not creating taxable supplies, those activities which trigger payment on the contrary do. As was confirmed in *EDM* case, payments forming exact part of the excess constitute a supply for consideration, thus subject to VAT.

To strengthen the position that payments that do not generate profit still create consideration, CJEU case-law considering deduction rights may also be looked at. In *Gemeente Woreden* the CJEU stated that for deduction purposes there is no relevance that a transaction was supplied for a consideration which is lower than the costs associated to that supply.[59] Considering that the Court deemed the price irrelevant, but merely the fact whether the supply at question is itself subject to VAT, it is clear, that for the purposes of Article 2(1) and Article 9(1) of the VAT Directive, the amount of the consideration can have little to no effect, to state that a supply for consideration takes place.

Thus, it may be derived that such a payment which intend to settle an exact part, can constitute a consideration for a received service. As settled by the case-law of the CJEU the fact that a payment for the exact amount as the expenses born by the supplies, in other words costs are merely passed along, this activity can still be seen as a supply for consideration. Case at hand would be *BGZ Leasing* where the CJEU established that the re-invoicing party is seen as supplying the services if acting on his name an on his own behalf.[60] Therefore, there is no question whether the criterion of remunerated at cost can impact the application of Article 132(1)(f) as inapplicable on the basis that a supply for consideration has not taken place.

2.1.1.3 Conclusions

As can be understood, in order for the Cost Sharing Exemption to be applicable, the first condition which must be fulfilled is that an IGP provides services to its members. Additionally, as was explained above, in order for a service to qualify for a VAT exemption, that service must first fall within the scope of VAT. This entails that services must be supplied for consideration by a taxable person as such.

[59] See judgement of 22 June 2016 in Case C-267/15, *Gemeente Woerden*, EU:C:2016:466, paragraph 40
[60] See judgement of 17 January 2013, Case C-224/11, *BGŻ Leasing sp. z o.o.*, EU:C:2013:15 paras. 62-63

As a consequence, a conclusion can be derived, that in order for the services to be subject to the Cost Sharing Exemption, they must be provided by the IGP. This in itself entails that the IGP must be a taxable person, in accordance with Article 9 of the VAT directive and independent from its members. Whilst the IGP must be a separate taxable person, neither the provisions of the VAT Directive, nor any other explanatory source give guidance that that IGP must take a specific form.

2.1.2 Providing services which are exempt or to which they are not taxable persons

The second criterion of applying the Cost Sharing Exemption is that the services ae necessary to execute the downstream activity of IGP members exempt activity or to which the members are not taxable persons.[61] This has been expressed in all of its communications the VAT Committee that *"the members must be either taxable persons carrying on a downstream activity which is exempt from VAT or out of scope or non-taxable persons"*.[62]

It is therefore clear that for the purposes of applying the Cost Sharing Exemption, it is the activity of the members of the IGP that needs to be exempt from VAT. However, the scope of those activities was significantly limited by the judgments of the CJEU in *DNB Banka* and *AVIVA*, where the Court clearly stated that the IGP whose members pursue activities covered by Article 135 cannot rely on the Cost Sharing Exemption.[63]

Up until the 21st of September 2017 the questions which had been raised, yet dully *'resolved'* were the questions whether members of the group can carry out other activities which are subject to VAT[64] and whether the members can carry out activity which is exempt pursuant to Article 135.[65] Interestingly

[61] See European Commission, VAT Committee, Working Paper No 654, Scope of the exemption for cost-sharing arrangements, taxud.d.1(2010)123337, Brussels, 3 March 2010 page 3, reconfirmed in European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015 page 4 and European Commission, VAT Committee, Working Paper No 883, Scope of the exemption for cost-sharing arrangements: a further analysis (II), taxud.d.1(2015)4500631, Brussels, 30 September 2015 page 2

[62] See European Commission, VAT Committee, Working Paper No 654, Scope of the exemption for cost-sharing arrangements, taxud.d.1(2010)123337, Brussels, 3 March 2010 page 3, reconfirmed in European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015 page 4 and European Commission, VAT Committee, Working Paper No 883, Scope of the exemption for cost-sharing arrangements: a further analysis (II), taxud.d.1(2015)4500631, Brussels, 30 September 2015 page 2

[63] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 36 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 31

[64] Discussed in WP 856 and 883

[65] Discussed WP 654

enough, the CJEU did not agree with the statement which was claimed by the VAT Committee on March 3 2010.[66]

As of the time of creation if this thesis, the VAT exemption prescribed by Article 132(1)(f) of the VAT Directive, cannot be relied upon by IGP whose members pursue those activities which are exempt from VAT under Article 135.[67] More specifically, the Cost Sharing Exemption may be relied by those IGP which pursue activities in the public interest and exempt from VAT listed in Article 132.[68]

Furthermore, with regards to the question whether the members of the IGP are allowed to pursue activities which are also subject to VAT and still rely on the VAT exemption for that part of services which qualifies, the VAT Committee had tacked this question in its Working Paper No 856 and No 833. In both communications the VAT Committee pointed out that nowhere is it implied that Article 132(1)(f) is applicable where the members carry out exclusively VAT exempt activities.[69] The notion is confirmed in the CJEU judgment in *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing*, where the Court emphasized that there may be cases where the neds of the IGP members may differ in certain taxation periods.[70] It would go against the purposes of the exemption (to be discussed in Chapter 3) to limit the application of the Cost Sharing Exemption due to those differences.[71]

It was further clarified by the CJEU in the *Commission v Luxembourg* proceedings, that the Cost Sharing Exemption is not restricted to those IGP whose members pursue exclusively VAT exempt activities.[72] Therefore it may be concluded with some certainty, that in order for the second criterion to be fulfilled, it is not necessary for the members of the IGP to pursue exclusively VAT exempt activities, or activities to which they are not taxable persons.

2.1.3 Directly necessary

An essential criterion for application of the Cost Sharing Exemption is that the services subject to exemption and provided by the IGP to it member must

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[66] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 36 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 31

[67] Ibid.

[68] Ibid.

[69] European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015 page 10

[70] See judgement of 11 December 2008, Case C-407/07, *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing*, EU:C:2008:713, paragraphs 34 - 35

[71] Ibid paragraphs 41- 42

[72] See judgment of 4 May 2017, Case C-274/15 *Commission v Grand Dutchy of Luxembourg*, EU:C:2017:333 para 53

be directly necessary for the VAT exempt activities of those members. It must be born in mind that not a lot of uncertainties are present with regards to this criterion.

From the 7 cases dealing with the exemption only 1 has actually tackled the *'directly necessary'* criterion, namely the *Commission v Luxembourg*. Yet this case came only after the VAT committee issued its working papers on Article 132(1)(f).[73]

Before the decision in *Commission v Luxembourg* it was indicated in one of the VAT Committee working papers, that from the settled case-law the best example was that of *Taksatorringen* where the services at question were essential for the members to carry out their exempt activities, namely, that without the services the future supplies would be either impossible or significantly hindered.[74] Furthermore, in its working papers the VAT Committee did not spend too much on explaining the criterion.[75]

As it has been emphasised, VAT exemptions are a derogation from the general VAT system and thus must be interpreted strictly.[76] It was followed up by the VAT Committee that the services which are to be subject to the exemption should form an indispensable part of the downstream supply, to ensure the exempt activities of the receiving member.[77] From this it seems to be rational to assume that there should be no issue, namely if services are directly necessary for the exempt supplies of the members of an IGP, those services can rely on the exemption, whereas if those services are used for taxed activates, the exemption cannot be relied upon.

The notion was confirmed by the CJEU in the *Commission v Luxembourg,* where the Court clearly stated that in the services are subject to the Cost Sharing Exemption where the IGP renders services *'directly necessary'* for carrying out services which are either exempt or to which the members are not taxable persons.[78] As a consequence the Court concluded that were the services provided by the IGP do not qualify for the aforementioned, namely

[73] Last VAT Committee working paper was issued in 2015 whereas *Commission v Luxembourg* was decided on 4 May 2017
[74] Ibid page 11
[75] Case at point would be VAT Committee Working Paper No 883 where the criterion was deemed resolved in VAT Committee Working Paper No 856
[76] See judgment of 20 November 2003, Case C-8/01 *Taksatorringen,* EU:C:2003:621, para. 61
[77] European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015 page 11
[78] See judgment of 4 May 2017, Case C-274/15 *Commission v Grand Dutchy of Luxembourg,* EU:C:2017:333 para 51

that the services are not directly necessary for the members VAT exempt services, they must be subject to VAT.[79]

The wording of Article 132(1)(f) does not place a limitation that the members of IGP must carry out exclusively VAT exempt activates. This was also confirmed by the VAT Committee in its working papers most notably in working papers 654 and 856. In both working papers the VAT committee acknowledged that a risk does exist that the exemption can be misused.[80] Therefore as a safeguarding measure it is suggested that Member States may, in the light of Article 131 of the VAT Directive, introduce rules which require that the members of IGP pursue exempt activates represent a significant part of that taxable person's business activities.[81]

Nevertheless, from the *Commission v Luxembourg* proceedings it is clear that such arguments that it would be difficult for the members to carry out invoicing which would represent the joint expenses related to purely exempt activities are invalid.[82] Therefore it is clear that, in order for services to be VAT exempt pursuant to Article 132(1)(f) of the VAT Directive, those services provided by the IGP must be directly necessary to the VAT exempt activity of the members of the IGP. Otherwise if the direct necessity link does not exist; no VAT exemption can be relied upon.

2.1.4 Remunerated at cost

As already can be understood from previous sections, each criterion that needs to be fulfilled in order to rely on the VAT exemption for IGP comes with its own difficulties and uncertainties. This is also true for the fourth criterion, which requires the members of IGP to cover their exact part from the joint expenses. Similarly, to the previous criterion *'direct necessity'*, the remuneration at cost has not been tackled in much depth by the VAT Committee. Yet some indications have been given.

Unfortunately, the Court did not clarify the criteria at hand even though an opportunity to do so was present. In case *DNB Banka* the national court referred a question whether the criterion has been satisfied if mark-up in accordance with transfer pricing rules has been applied.[83]

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[79] Ibid paras. 51 - 52

[80] See European Commission, VAT Committee, Working Paper No 654, Scope of the exemption for cost-sharing arrangements, taxud.d.1(2010)123337, Brussels, 3 March 2010 page 6, reconfirmed in European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015 page 10

[81] Ibid

[82] See judgment of 4 May 2017, Case C-274/15 *Commission v Grand Dutchy of Luxembourg,* EU:C:2017:333 para 54

[83] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 22 5th question

Even though the Court did not answer the question raised, it is worthwhile to look at this issue in more detail. To begin with, it should be acknowledged that, there seems to be no limitation that the IGP itself as a separate taxable person cannot make profit. The limitation only extends that profits should not be gained by the IGP from its members.[84]

Touching upon base once again, it must be reminded, that in order for the exemption to be applied the transaction should fall within the scope of the VAT Directive, that is to say, the service must be supplied for consideration by a taxable person.[85] In case the remuneration is performed at cost, that is to say that the supplier merely reinvoices the costs borne by him, that transactions still may fulfil the characteristics of providing services in his own name and on his own behalf, as was stablished by the CJEU in *BGZ Leasing*.[86] Therebefore it may be concluded that pure cost settlement can satisfy the criteria of the exemption. It was already concluded that for the purpose of applying the Cosy Sharing Exemption the reimbursement of costs also satisfies the criteria that services are supplied for consideration in Chapter 2.1.1.2.

In cases a transaction is carried out between two related parties some additional conditions may come into play. Accordingly, when turning to the OECD issued Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations it is inevitable that transactions between associated enterprises will deviate from the open market.[87] Therefore tax authorities may seek to perform adjustments for profit in such a way that would represent that which would have occurred in the open market.[88] However for the purpose of this thesis a more detailed analysis of transfer pricing requirements of the OECD will not be performed.

Inevitably, according to Transfer Pricing requirements there may be instances that for the transactions between related parties the transaction may require an additional price adjustment. This was well seen in the *DNB Banka* case, where on top of the costs a mark-up of 5% was included in the invoices, for services which were subjected to the VAT exemption. From this a question

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[84] See European Commission, VAT Committee, Working Paper No 654, Scope of the exemption for cost-sharing arrangements, taxud.d.1(2010)123337, Brussels, 3 March 2010 page 7 and European Commission, VAT Committee, Working Paper No 883, Scope of the exemption for cost-sharing arrangements: a further analysis (II), taxud.d.1(2015)4500631, Brussels, 30 September 2015 page 12

[85] Article 2(1) of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

[86] See judgement of 17 January 2013, Case C-224/11, *BGŻ Leasing sp. z o.o.*, EU:C:2013:15 paras. 62-63

[87] OECD (2017), OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris accessed http://dx.doi.org/10.1787/tpg-2017-en Para. 1.5

[88] Ibid para. 1.6

as to whether or not a taxable person, where in the light of the requirements of the national legislation it is required to perform price adjustments to reflect market value, can rely on the exemption arises.

In its working paper No 654, the VAT Committee had indicated that there may be cases where, *"[..] the group may become liable for direct tax by virtue of the transfer pricing rules of the Member State in which it is established."*[89] The VAT Committee continued that the direct tax requirements should not impact the indirect tax application.[90] Merely from this point alone, it could be perceived that the mere fact that a direct tax requirement exists, that is to say that the prices between related parties should be that of two independent operators, should not limit the right to apply the VAT exemption.

Furthermore, considering that Article 131 allows Member States some discretion to implement measures to ensure the correct application of the exemptions, it could be possible to extend the application of the VAT exemption also to circumstances such as in the *DNB Banka* case. An example here would be the Latvian VAT law, which explicitly allowed the application of mark-up.[91]

At this case perhaps, some guidance can be derived from the provisions in the VAT Directive dealing with the taxable amount. According to Article 73 of the VAT Directive, the consideration shall form all of what is to be obtained by the supplier.[92] Furthermore, Article 78 dealing with inclusions provides that also incidental expenses born by the supplier shall be included in the taxable amount.[93] This notion is also confirmed by the VAT Committee, namely that all what constitutes an expense by the IGP can be allocated to its members as the taxable amount, which would afterwards be subject to VAT exemption prescribed by Article 132(1)(f).[94]

Yet, Article 80 of the VAT Directive contains an anti-avoidance measure which allows Member States to adjust the taxable amount in accordance to open market value, in cases where the transactions are preformed between

[89] See European Commission, VAT Committee, Working Paper No 654, Scope of the exemption for cost-sharing arrangements, taxud.d.1(2010)123337, Brussels, 3 March 2010 page 7
[90] Ibid
[91] Latvijas PVN likums 52. pants (3^2)(3), English version accessible at https://likumi.lv/ta/en/en/id/253451-value-added-tax-law
[92] Article 73 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax
[93] Ibid Article 78(1) (a) and (b)
[94] See European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015 page 12

related parties.[95] No such measure exists for the taxable value for non-related parties.

Although not answered by the Court in *DNB Bank*, this issue was tackled by AG Kokott in her opinion. AG Kokott stated that the wording of the exemption requires the that the IGP merely claims from the joint expenses, therefore any inclusion of a mark-up (uplift), cannot satisfy this condition.[96] Also, from the purpose of the exemption, which will be discussed in more details in Chapter 3, it can be understood that it is intended to relieve smaller taxable persons from input VAT burden for those functions which due to their size and resources cannot be executed from their own resources.[97]

When considering the criterion, it is reasonable to raise a question whether related parties who are bound by additional direct tax requirements can at all rely on the exemption? It should be born in mind that although the VAT Committee stated that direct tax requirements should not impact indirect tax application,[98] it has been established by the CJEU in *FCE Bank plc* that OECD guidelines are irrelevant in interpreting VAT application, since they concern direct taxation and not VAT.[99]

In this sense a conclusion may be derived that in order to satisfy the fourth criterion the costs which must be reimbursed by the members of the IGP must represent an exact cost relating to that member. Furthermore, whether those costs borne by the IGP and passed to its members may contain a surplus, if that surplus is required by national direct tax requirements of the Member State is still open for interpretation.

2.1.5 Distortion of competition

The fifth and final criterion of application is that the VAT exemption at question should not distort competition. Until today, from the 7 cases, 2 cases raised direct questions to the CJEU with regards to the question on competition. In *Taksatorringen* the Court was asked whether the VAT exemption can be refused if there is but a mere possibility to distort competition.[100] The *AVIVA* proceedings saw the national court seeking

[95] Ibid. Article 80
[96] See opinion of AG Kokott delivered on 1 March 2017 in Case C-326/15 *DNB Banka*, EU:C:2017:145, paras. 49-50
[97] opinion of AG Kokott delivered on 1 March 2017 in Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:150, paras. 20-21
[98] See European Commission, VAT Committee, Working Paper No 654, Scope of the exemption for cost-sharing arrangements, taxud.d.1(2010)123337, Brussels, 3 March 2010 page 7
[99] See judgment of 23 March 2006, Case C-210/04, *FCE Bank plc*, EU:C:2006:196 para. 39
[100] See judgment of 20 November 2003, Case C-8/01 *Taksatorringen*, EU:C:2003:621, para. 25 2nd question

guidance on how the distortion of competition criteria should be assessed.[101] To no avail, the Court did not answer the Polish courts questions, therefore the only guidelines which are available come from the *Taksatorringen* decision.

When analysing the distortion of competition criteria, the Court in *Taksatorringen* was clear, that in order for there to be a right to refuse the application of the VAT exemption on the ground of distortion of competition, that grounds must constitute a real risk.[102] Furthermore, AG Mischo observed in his opinion that the exemption may not be refused on a mere hypothetical possibility of distortion.[103]

It is not the purposes of this thesis to go into an in-depth analysis of the distortion of competition criteria. A better insight in this criterion has already been given by authors Joep Swinkels as well as Nebojsa Jovanovic and Madeleine Merkx.[104]

Nevertheless, to put the criterion in easier terms, in order for the VAT exemption to be refused there must be a real risk that the application of it can distort competition. And as best put by AG Mischo, to determine whether there is distortion it must be looked at whether the circumstances where an exemption is granted for party and VAT is applied to another result in that latter party to be excluded from the market.[105] Namely, the distortion of competition must be assessed on a case by case bases.

3 The purpose of the Cost Sharing Exemption

3.1 Overview

On the 21st of September 2017 the CJEU in its judgements in *DNB Banka* and *AVIVA* stated that besides grammatical interpretation it is also necessary to consider the context and purpose sought by EU legislation under question.[106]

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[101] See judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 17 2nd question.
[102] See judgment of 20 November 2003, Case C-8/01 *Taksatorringen,* EU:C:2003:621, para. 63
[103] See opinion of AG Mischo delivered on 3 October 2002 in Case C-8/01 *Assurandør-Societetet v Skatteministeriet,* EU:C: 2002:562, para 133
[104] Joep Swinkels *The EU VAT Exemption for Cost-Sharing Associations* International VAT Monitor January/February 2008 (accessed on IBFD 2019) and Nebosja Jovanovic and Madeleine Merkx, *The Cost Sharing Exemption under Debate – Part I*, International VAT Monitor, September/October 2016 (accessed on IBFD 2019)
[105] See opinion of AG Mischo delivered on 3 October 2002 in Case C-8/01 *Assurandør-Societetet v Skatteministeriet,* EU:C: 2002:562, para 134
[106] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 29 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 24

Interestingly in both mentioned judgments the Court admitted that the wording of the VAT exemption prescribed in Article 132(1)(f) does not preclude the exemption to be applied for members of the group pursuing economic activity on the field of financial or insurance services.[107]

At this point it would be essential to note as to what are the interpretation methods used and order followed by the Court. The methods of interpretation may be derived from Article 31 of the Vienna Convention. According to Article 31(1):*" A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."*[108] The Article gives some guidance as to the methods which should be applied in interpreting treaty provisions.

Furthermore, a good overview as to the order of interpretation was given by Christian Amand, listing that the ordinary course by the Court would be (1) the analysis of the text, (2) context, (3) the purpose.[109] The sequence of methods has also been confirmed by other scholars however, noting additionally that in absence of specific provisions as to the sequence the Court is free to choose which interpretation method best serves the legal order of the EU.[110]

As whas stated earlier, the Court acknowledged that form a grammatic perspective, there seem to be no limitations to those IGP who pursue activities listed in Article 135 of the VAT Directive. The Court went on further stating: *"when interpreting a provision of EU law, to consider not only its wording but also the context in which it occurs and the objectives pursued by the rule of which it is part."*[111] Thus the Court followed the textual interpretation with going into the context of Article 132(1)(f) of the VAT Directive.

However, the Court did not fully exhaust the grammatical interpretations nor did it go into a deeper look in to the purpose of the Cost Sharing Exemption. Which is peculiar considering that the CJEU had previously stated the purpose of the Cost Sharing Exemption in its judgement in *Stichting Centraal*

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[107] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 28 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 23

[108] United Nations, Vienna Convention on the Law of Treaties, 23 May 1969, United Nations, Treaty Series, vol. 1155, p. 331, available at: https://www.refworld.org/docid/3ae6b3a10.html [accessed 5 June 2019]

[109] Christian Amand, *DNB Banka and AVIVA: Has the ECJ Followed Its Own Interpretation Methods and Respected the Objectives Pursued by the EU Legislature?* International VAT Monitor November/December 2017 (accessed on IBFD 2019)

[110] Koen Lenaerts and José A. Gutiérrez-Fons, *To Say What the Law of the EU Is: Methods of Interpretation and the European Court of Justice*, European University Institute, EUI Working Paper AEL 2013/9, p. 4

[111] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 29 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 24

Begeleidingsorgaan voor de Intercollegiale Toetsing. In the said case the Court noted that the purpose of the Cost Sharing Exemption is to alleviate the burden of VAT for those taxable persons who have decided to pursue certain services by cooperating with other persons in a common structure.[112] That is to say, lessen the VAT burden for those taxable persons who need to acquire certain services from the market due to the fact that they cannot be ensured form their own resources.

While the CJEU stated the purpose of the Cost Sharing Exemption in *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing,* it was not followed in the *DNB Banka* and *AVIVA* judgments. In both cases the Court found that form the context of Article 132(1)(f) only those IGP whose members pursue activities laid down in Article 132 can rely on the said VAT exemption.[113] That is to say, the Cost Sharing Exemption is limited only to the activities pursued in the public interest.

Interestingly enough the Court came to the conclusion by analogy from the *TMD* case.[114] It should be noted that in the *TDM* case the Court dealt with the supplies of plasma obtained from human blood. By comparing other paragraphs of Article 132 (in this case (b), (c) and (e)) the Court concluded that the exemption for supplies of human blood and plasma can be exempt only if supplied for the necessity of public activity.[115] At this point, at some level it can be observed how from the conclusions in case *TMD* the Court extended its views also to the exemption laid down in Article 132(1)(f). Evidently the analogy applied was that where other provisions of that Article clearly have a limit which cannot exceed that of public interest, this limitation should apply to all exemptions listed in Article 132 without exception.

Nevertheless, it should be emphasised that there is a significant difference when comparing paragraphs (b), (c), (d) and (e) with other paragraphs of Article 132, such as paragraph (f). This essential difference was also emphasised by the Court in *TMD* case, that is, that *"Article 3(2)(c) of the Charter of Fundamental Rights of the European Union prohibits making the human body and its parts as such a source of financial gain."*[116]

Thus, in its reasoning the Court had little room to broaden the application of the VAT exemption, which has a direct relation to the human body. Here, the

[112] See judgement of 11 December 2008, Case C-407/07, *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing*, EU:C:2008:713, para. 34
[113] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 34 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 29
[114] See Ibid para. 29 and 34
[115] See judgment of 5 October 2016, Case C-412/15, *TMD Gesellschaft für transfusionsmedizinische Dienste mbH*, EU:C:2016:738 paras. 31 - 33
[116] Ibid. para 29

strict limitation derived from the Charter of Fundamental Rights of the European Union relates only to financial gains from the human body. The question thus is whether these limitations which stem from the Charter of Fundamental Rights of the European Union can also impact the application of other VAT exemptions laid down in Article 132?

It should be born in mind that Article 132(1) provides for a total of 17 exemptions, of which only 4 relate to healthcare. Furthermore, when considering the scope of Article 132(1) the Court had ruled in its judgement in *Hoffmann* that "*the heading of Article 13(A) of the Sixth Directive* (now Article 132(1) in VAT Directive) *the wording of which is "Exemptions for certain activities in the public interest" does not of itself, entail restrictions on the possibilities of exemption provided for by that provision."*[117]

Granted, the *Hoffmann* case did deal with the exemption for cultural services, nevertheless it must be recognized that in this specific case the Court did allow for a broader application. This raises the question as to why in the case of the VAT exemption enshrined in Article 132(1)(f) the Court decided to apply by analogy the limitations derived from the reasoning of provisions concerning healthcare in Article 132 and rather the reasoning from *Hoffmann*? It should be noted that the *Hoffmann* decisions was also used by the VAT Working Group in its reasoning why the VAT exemption provided by Article 132(1)(f) should be extended to those activities pursued by members of IGP in the field covered by Article 135.[118]

Therefore, a deeper look into the purpose of the VAT exemption laid down in Article 132(1)(f) should be performed. To this extent there have been multiple works which have looked at the purpose of the exemption, and as a rule all have stated with the document where the exemption has first appeared, that is the Proposal for the Sixth Directive.[119] It is inevitable that in order to find the purpose of the exemption the first mention of it shall be viewed. Yet, before turning to the *genesis*, it can be worthwhile to take a different path, and start with the opinions expressed by AGs who have touched upon this issue.

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[117] See judgment of 3 April 2003, Case C-144/00, *Matthias Hoffmann*, EU:C:2003:192 para. 37

[118] See European Commission, VAT Committee, Working Paper No 654, Scope of the exemption for cost-sharing arrangements, taxud.d.1(2010)123337, Brussels, 3 March 2010 page 5

[119] Joep Swinkels *The EU VAT Exemption for Cost-Sharing Associations* International VAT Monitor January/February 2008 (accessed on IBFD 2019), Christian Amand *DNB Banka and AVIVA: Has the ECJ Followed Its Own Interpretation Methods and Respected the Objectives Pursued by the EU Legislature?* International VAT Monitor November/December 2017 (accessed on IBFD 2019)

3.2 Purpose according to AG

3.2.1 Early opinions of AG Mischo and AG Sharpston

As mentioned earlier up until today only 7 cases dealing with Article 132(1)(f) of the VAT Directive have been delivered by the CJEU. Within those 7 cases opinions were delivered by four AGs. AG Mischo delivered his opinions in cases *SUFA* and *Taksatorringen* which were followed by AG Sharpstons opinion in case *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing.* Most opinions were delivered by AG Kokott, a total of 3 in cases *Commission v Luxembourg, DNB Banka* and *AVIVA.* Whereas the final opinion in *Commission v Germany* was delivered by AG Wathelet.

The first reference to the purpose of the exemption was briefly mentioned by AG Mischo in *SUFA* where the AG pointed out that the exemptions provided in Article 13(A)(1) of the Sixth Directive, now Article 132(1) of the VAT Directive, are granted for those activities pursuing specific objectives.[120] Whilst not a lot can be derived from the opinion it does give some indications that the exemptions in Article 13(A)(1) of the Sixth Directive are intended for a specific objective. However, no reference is made that that objective shall be in the public interest only.

A much broader analysis was given by AG Mischo in his opinion in *Taksatorringen.* It should be noted that the opinion of AG Mischo in *Taksatorringen* is referred to by the VAT Committee as well as authors when trying to determine the purpose of the exemption.[121] AG Mischo pointed out that the exemption at question was intended to relieve the burden of non-deductible VAT, which is placed on taxable persons pursuing exempt activities in obtaining services necessary for their business.[122] Or as was well put by the VAT Committee interpreting the opinion of AG Mischo, the

[120] See opinion of AG Mischo delivered on 20 April 1989 in Case 348/87 *Stichting Uitvoering Financiële Acties v Staatssecretaris van Financiën,* EU:C:1989:163, para. 15

[121] See European Commission, VAT Committee, Working Paper No 654, Scope of the exemption for cost-sharing arrangements, taxud.d.1(2010)123337, Brussels, 3 March 2010 page 4, reconfirmed in European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015 page 3 and European Commission, VAT Committee, Working Paper No 883, Scope of the exemption for cost-sharing arrangements: a further analysis (II), taxud.d.1(2015)4500631, Brussels, 30 September 2015 page 11 and Joep Swinkels *The EU VAT Exemption for Cost-Sharing Associations* International VAT Monitor January/February 2008 (accessed on IBFD 2019)

[122] See opinion of AG Mischo delivered on 3 October 2002 in Case C-8/01 *Assurandør-Societetet v Skatteministeriet,* EU:C: 2002:562, para 118

purpose of the exemption is to achieve economies of scale for smaller taxable persons to put them in a level playing field with larger competitors.[123]

The relief of the VAT burden is a plausible explanation for the exemption, it in itself does not place limitations that certain objectives shall be achieved. It is possible that taxable persons pursuing economic activities laid down in Article 135 bare VAT costs which are not born by their larger counterparts. Where a good example was given by the Commission when discussing the necessity to harmonize the rules of the VAT Directive for insurance and financial services, that the most frequent users of the Cost Sharing Exemptions are small insurance companies.[124]

Furthermore, when analyzing the purpose of the Cost Sharing Exemption in his opinion AG Mischo does go into explaining that at first the said exemption was intended for members of IGP pursuing medical activities, yet it was afterwards broadened.[125] Still no mention on the limitation in favor of activities pursued in the public interest can be clearly identified. Even more so, the only limitation placed, as explained by the Commission and observed by the AG was that the exemption must not distort competition.[126] Granted, the CJEU did mention in its judgments in both *DNB Banka* and *AVIVA* that although *Taksatorringen* dealt with insurance services, the Court assessed merely the distortion of competition criteria, therefore omitting the criteria that the members of IGP must perform activities in the public interest.[127]

In any rate, from AG Mischos opinions it may be clearly derived that one of the purposes, if not the principal purpose, of the VAT exemption enshrined in Article 132(1)(f) of the VAT Directive is to lessen the VAT burden for those taxable persons who are limited in their internal resources as compared to their larger competitors. Still, a clear limitation in the public interest is yet to be clearly identified.

The same notion was later expressed by AG Sharpston in *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing*. In her opinion AG Sharpston repeated what was already stated by AG Mischo in *Taksatorringen*,

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[123] European Commission, VAT Committee, Working Paper No 883, Scope of the exemption for cost-sharing arrangements: a further analysis (II), taxud.d.1(2015)4500631, Brussels, 30 September 2015 page 11

[124] Commission staff working document, Accompanying document to the Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services, Impact Assessment SEC(2007) 1554, 28 November 2008 page 42

[125] See opinion of AG Mischo delivered on 3 October 2002 in Case C-8/01 *Assurandør-Societetet v Skatteministeriet*, EU:C: 2002:562, paras. 108 - 110

[126] Ibid. para 111

[127] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 38 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 33

namely that the purpose of the exemption is to lessen the VAT burden placed for services supplied by a group to its members in comparison if those services were to be provided internally.[128] Whilst directly confirming the viewpoint of AG Mischo, AG Sharpston also did not directly tackle the problem of whether or not the exemption prescribed in Article 132(1)(f) of the VAT Directive (at that time Article 13(A)(1)(f) of the Sixth Directive) has a certain limitation for activities pursued in the public interest.

However, there might be some indirect indication regarding the public interest purpose. Namely, in the examples and observations submitted by the parties in the proceedings, only those necessary for the public interest were discussed. First it must be noted that the case *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing* dealt with a foundation, members of which are bodies related to healthcare.[129] Also, the Netherlands Government expressed examples in the hearing regarding services necessary for schools.[130] Considering that both medical services and educational services are exempted in accordance with Article 132 (1) it seems that there could be a reason to assume that the VAT exemption prescribed in Article 132(1)(f) could relate only to those exemptions pursued solely by Article 132(1).[131] However there is a possibility that both examples are merely incidental and hold no bearing in the purposive assessment made by AG Sharpston.

Looking at the opinions delivered by both AGs, there seems to be no clear indication that there may be limitations for the activities pursued by the members of IGP. Accordingly, this could be the reason why up until AG Kokott delivered her opinions, there did not seem to be any question that the VAT exemption prescribed in Article 132(1)(f) could be extended to activities covered by Article 135 of the VAT Directive.

3.2.2 Detectives and limitations by AG Kokott

It is sufficiently safe to say that from the three judgements and opinions delivered by AG Mischo and AG Sharpston the question that Article 132(1)(f) of the VAT Directive would be limited only to those IGP whose members pursue VAT exempt activities in the public interest was not looked at in greater detail. This however all changed, when opinions were delivered by AG Kokott.

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[128] See opinion of AG Sharpston delivered on 9 October 2008 in case C-407/07, *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing,* EU:C:2008:554, para. 19
[129] Ibid para. 5
[130] Ibid paras. 21 -22
[131] VAT exemptions for healthcare are listed in sections (b), (c), (d) and (e) whilst education in sections (i) and (j) of Article 132(1) of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

First the way the Grand Dutchy of Luxembourg implemented Article 132(1)(f) of the VAT Directive in its national legislation was put to the test. However extensive and detailed the opinion was, not a lot in the way of the purpose of the exemption was touched upon.

In her opinion AG Kokott firstly noted that the exemption at question requires the members of an IGP to pursue activities which are exempt from VAT or to which they are not taxable persons.[132] Furthermore, it was followed by the statement that *there is no reason to depart from the clear wording of Article 132(1)(f) of the VAT Directive when interpreting it.*[133] As a mere reminder the CJEU stated that the terms of the exemption do not prelude that the members of an IGP are eligible to pursue exemptions laid down in Article 135.[134]

It should be born in mind that in delivering her opinion in *Commission v Luxembourg* almost a year prior to the *DNB Banka* and *AVIVA* judgments, AG Kokott did not go into deeper context of the exemption at question. Therefore, still no indication as to the limitations in scope could be drawn from it. However, in these proceedings, the scope of the exemption was never questioned.

This all changed in the 1st of March 2017, when AG Kokott delivered her opinions in both *DNB Banka* and *AVIVA.* AG Kokott emphasized that both cases are significant from both the material as well as the territorial scope.[135] In comparison with how AG Mischo explained the way taxable persons bare input VAT expenses, AG Kokott gave a much more visual, and one might say, a more reader friendly example, of private detectives.[136] This visualization does give a better insight as to the extent to the burden of input VAT which is born by taxable persons who have the means to employ the necessary resources inhouse opposed to that of which is outsourced. In the latter case taxable persons incur both personnel expenses along with VAT associated to those expenses.

While both cases dealt with the personal scope of the VAT exemption laid down on Article 132(1)(f) AG Kokott gave a more detailed analysis of the personal scope in her opinion in *AVIVA*, this was also explained by in her

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[132] See opinion of AG Kokott delivered on 6 October 2016 in Case C-274/15 *Commission v Grand Dutchy of Luxembourg*, EU:C:2016:750, para. 39

[133] Ibid para. 41

[134] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 28 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 23

[135] See opinion of AG Kokott delivered on 1 March 2017 in Case C-326/15 *DNB Banka*, EU:C:2017:145, para. 2 and opinion of AG Kokott delivered on 1 March 2017 in Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:150, para. 2

[136] See opinion of AG Kokott delivered on 1 March 2017 in Case C-326/15 *DNB Banka*, EU:C:2017:145, para. 4

opinion delivered for *DNB Banka.*[137] For this reason more emphasis will be given to her opinion in *AVIVA.*

Considering that the wording of Article 132(1)(f) of the VAT Directive does not express a clear limitation in scope, AG Kokott rightfully observed that further analysis from the point of view of purpose should be ventured upon. When performing schematic interpretation of the provision AG Kokott observed the following:

(1) the legislature chose to place the said article under Chapter 2 with the heading *'Exemptions for certain activities in the public interest'*;[138]
(2) VAT grouping mechanism is not frequently used in the public-interest sector;[139]
(3) The fact that historically the legislator broadened the prosed exemption from only groups of doctors, clearly indicates that it was the intention to include also educational establishments and not necessarily banks and insurance companies;[140]
(4) Considering that the scope was not extended for financial and insurance sector by the legislature, cannot mean that the scope of Article 132(1)(f) can be broadened;[141]
(5) While *Taksatorringen* judgment involved taxable persons pursuing insurance services, the Court dealt with the question regarding the distortion of competition criterion.[142]

All of the aforementioned observations lead to the conclusion clearly expressed in paragraph 35 of the *AVIVA* opinion that "*the schematic position and the purpose of Article 132(1)(f) of the VAT Directive that the provision must be interpreted strictly and is not applicable to the group of insurance undertakings."*[143] On 21st of September 2017, the CJEU followed the reasoning and forever changed the scope of Article 132(1)(f).

3.2.3 A different perspective by AG Wathelet

A different perspective when looking on the purpose of the exemption at question was given in the final opinion given by an AG. And perhaps with good reason. When comparing the cases which were raised to the CJEU for which AG Kokott gave her opinion, it must be acknowledged that they dealt with a broad scope of application. Whereas the final case was an infringement

[137] Ibid para. 47
[138] See opinion of AG Kokott delivered on 1 March 2017 in Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:150, para. 26
[139] Ibid para. 27
[140] Ibid paras. 28 - 29
[141] Ibid para. 30
[142] Ibid para. 31
[143] Ibid para. 35

procedure against the Republic of Germany regarding a restrictively narrow scope. Here AG Wathelet gave his opinion regarding the scope of the exemption.

It should be pointed out that the Republic of Germany implemented the said exemption in its national legislation in such a way that it could only be relied upon by professionals in the health sector.[144] At this point since the proceedings brought before the court actually had to deal with the *ratione personae* scope of Article 132(1)(f). Here AG Wathelet gave a detailed and comprehensive analysis of the scope of application, going through schematic analysis, teleological approach and textual approach of Article 132(1)(f).

First it should be noted that AG Wathelet fully agreed with his predecessor's opinion in the sense that the main objective of the exemption would be to alleviate the burden of non-deductible input VAT which taxable persons pursuing exempt activities would encounter.[145] At this point though it seems that it is the only similarity as AG Wathelet offered a completely different solution.

As was concluded in Chapter 2.1.1, emphasised by the VAT Committee[146] as well as AG Kokott,[147] the IGP should be a taxable person within the meaning of Article 9 of the VAT Directive. However, AG Wathelet did not concur with this notion and expressed the opinion that the Article 132(1)(f) does not require the taxable status of an IGP.[148] More importantly in his opinion the AG expressed the notion that the IGP can be created on a contractual bases and even went to compare the exemption with the VAT grouping mechanism.[149] Notably AG Wathelet put forward the notion that the provision should not have been expressed as an exemption, but rather as an out of scope transaction, tying similarities to the *EDM* judgement.[150] Yet, the status of the IGP is not essential for determining the purpose of the Cost Sharing Exemption.

It was followed by the AG in his opinion that it is true that in the initial proposal for the Sixth Directive the exemption at question was listed under

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[144] See judgment of 21 September 2017, Case C-616/15, *Commission v Federal Republic of Germany*, EU:C:2017:721, para.14
[145] See opinion of AG Wathelet delivered on 5 April 2017 in Case C-616/15 *Commission v Federal Republic of Germany*, EU:C:2017:272 para. 84
[146] See European Commission, VAT Committee, Working Paper No 856, Scope of the exemption for cost-sharing arrangements: a further analysis, taxud.d.1(2015)2162037, Brussels, 6 May 2015 page 5
[147] See opinion of AG Kokott delivered on 1 March 2017 in Case C-326/15 *DNB Banka*, EU:C:2017:145, para. 44
[148] See opinion of AG Wathelet delivered on 5 April 2017 in Case C-616/15 *Commission v Federal Republic of Germany*, EU:C:2017:272 para. 82
[149] Ibid paras. 73-75
[150] Ibid para. 79

Article 14(1)(f) and was at first limited to healthcare professionals.[151] However, coming into force, the scope was widened to IGP whose members pursue exempt activities, thus it must apply to all sectors.[152] Still it should be pointed out that AG Kokott also pointed out that the precise wording of Article 132(1)(f) does not set limitations in the scope of application.[153]

The main difference between the opinions of AG Kokott and AG Wathelet was regarding the placement of the provision. Where AG Kokott saw this as a conscious decision,[154] AG Wathelet did not see this as a clear intention by the legislature.[155] It was put forth that the name of the chapter in itself is of an indicative nature and cannot prevail over the actual wording of the exemption.[156]

As a consequence, AG Wathelet went a different way and proposed that the VAT exemption prescribed in Article 132(1)(f) of the VAT Directive should not be limited in its scope. This entails that the said exemption can be relied upon also by financial institutions as well as insure service providers. However, the course taken by the CJEU is well known.

3.3 A look in history

However different opinions were delivered by AG Kokott and AG Wathelet, both were concurrent that it is necessary to understand the history as to how the exemption come into existence to better understand the intention of the legislature. For these reasons it is necessary to take a long step back, as the history of the EU VAT system has changed significantly until the one we know today.

The 11th of April 1967 can be described as the *genesis* of the EU VAT system with two directives, the First VAT Directive and the Second VAT Directive. The First VAT Directive was the one to set the scene for the Member States to move away from their turnover taxes and implement a common system of VAT.[157] The Second VAT Directive in turn set out the common system of VAT.[158]

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[151] Ibid para. 91
[152] Ibid para. 96
[153] See opinion of AG Kokott delivered on 1 March 2017 in Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:150, para. 19
[154] Ibid para. 26
[155] See opinion of AG Wathelet delivered on 5 April 2017 in Case C-616/15 *Commission v Federal Republic of Germany*, EU:C:2017:272 para. 105
[156] Ibid para. 110
[157] Terra B.J.M. and Kajus J. *A guide to the European VAT Directives Volume 1 Introduction to European VAT*, (IBFD 2018) p 147
[158] Ibid p 148

It is important to point out that the First VAT Directive has been incorporated in the current VAT Directive.[159] Point at hand Article 2 of the First VAT Directive is now Article 1 of the VAT Directive.[160] This cannot be extended to the Second VAT Directive.

The Second VAT Directive did not go so far as to create a common list of exemption to be implemented by Member States. However, the Second VAT Directive did have references to VAT exemptions. While the intention was to create a common VAT system, Member States were free to implement exemptions after consulting the Commission, as prescribed by Article 10(3) of the Second VAT Directive.[161] Respectively this would inevitably lead to a situation where the exemptions are different between Member States.

Further harmonization of the VAT system was sought with the Sixth Directive.[162] Here for the first time a common list of exemptions was given in Article 13 of the Sixth Directive. The VAT exemption for IGP was enshrined in Article 13(A)(f). However, as was correctly observed by AG Wathelet the first ever notice of the VAT exemption of IGP as we know it, was limited to professionals in healthcare and was listed in Article 14(A)(f) of the proposal for the Sixth Directive.[163]

Some light might be shed when observing from the explanatory memorandum regarding the proposal for the Sixth Directive. In the explanation for Article 14, which at the proposal stage was the one contain exemptions, the Commission pointed out that where the purpose of the directive is to ensure equal treatment for collecting tax, this entails the unification of exemptions as well.[164]

As emphasized earlier, Article 10(3) of the Second VAT Directive created a situation where Member States had free will to implement different exemptions. This was sought to be remedied by Article 14 (later implemented as Article 13). Interestingly, in creating the list under section A with the heading 'Exemption for certain activities in the public interest' the Commission explained that the list contained exemptions which already were

[159] Ibid p 148 see footnote 383
[160] Ibid p 147
[161] See Article 10(3) and Article 16 of Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes - Structure and procedures for application of the common system of value added tax
[162] Terra B.J.M. and Kajus J. *A guide to the European VAT Directives Volume 1 Introduction to European VAT*, (IBFD 2018) p 148
[163] See opinion of AG Wathelet delivered on 5 April 2017 in Case C-616/15 *Commission v Federal Republic of Germany*, EU:C:2017:272 para. 96
[164] Commission Proposal for a sixth Council Directive on the harmonisation of Member States concerning turnover taxes — Common system of value added tax: Uniform basis of assessment, COM(73) 950 final, 20 June 1973 (Bulletin of the European Communities, Supplement 11/73, p. 15)

implemented in some of the Member States.[165] This this leads to the conclusion that the legislature merely was seeking a way to gather a combined list of already existing exemptions rather than creating new ones. Furthermore, the exemptions in section B which included insurance and financial services were justified under general policy of Member States.[166]

Another indication which might support the position of AG Wathelet that the placement is merely indicative, is the fact that at first try to list the exemptions already present in Member State, the exemption at question indeed was intended for medical professionals. This is supported by the explanatory memorandum where the Commission states - *They relate to postal services –(a), to medical services –(b), (c), (d), (e) and (f), to welfare services –(g) [..].*[167] Bearing this in mind, at the time the VAT exemption had a logical placement in section A. However, that exemption never took the form as proposed.

Another remark should be that the exemptions in section B could also bare an importance for the public interest. Article 135 of the VAT Directive, which is not included in the scope of Article 132(1)(f) of the VAT Directive also provides for an exemption for immovable property.[168] Although included in Article 135 of the VAT Directive and initially included under section B titled *'other exemptions'*, the explanatory memorandum indicates that the necessity of the VAT exemption for immovable property can be explained by technical, economic as well as social ground.[169] Considering the fact that the VAT exemption for immovable property can be founded on social ground, it is unclear as to why that exemption is not placed under section A, but rather under section B. It thereof raises the question, whether the structure as to how VAT exemptions are listed, justify the conclusion, that the legislature truly had intended to set limitations for the VAT exemption for IGP, to pursue only those activities listed in section A of the Sixth directive and now Article 132?

Both the opinions of AG Kokott and AG Wathelet ventured a similar trail to come to their conclusions as to what is the purpose for the VAT exemption for IGP. While the scope of the Cost Sharing Exemption is cloudy, the fact that exemptions intended to lessen the burden of non-deductible VAT for smaller entities in compared to their larger competitors is undisputed.

[165] Ibid p. 15
[166] Ibid p. 15
[167] Ibid p.15
[168] See Article 135 (j), (k) and (l) of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax
[169] Ibid p. 15

3.4 Could DNB Banka and AVIVA outcomes be predicted

It might be safe to say, that the resolution from the *DNB Banka* and *AVIVA* judgments came as a surprise. It is well established that financial and insurance operators often rely on the VAT exemption provided by Article 132(1)(f).[170] Case at point would be that out of the 7 cases 3 dealt with the exemption being applied by a financial or insurance operators. Additionally, the Court recognized this in its judgments in *DNB Banka* and *AVIVA.*[171]

The aftermath of both judgments did bring a shock wave around the EU. Primarily, the impact on financial and insurance sectors needed to be understood and was the main topic of the 19th VAT Expert Group meeting, reacting to the recent case-law with 4 potential policy options.[172] Another topic which was raised by tax experts was the question on the methods of interpretation which was followed by the CJEU. There seems to be a consensus that the contextual interpretations should have been followed by the court only after it had exhausted the textual interpretation.[173] As a reminder, the Court did acknowledge in both *DNB Banka* and *AVIVA* that the wording of the provision did not place limitations on sector,[174] afterwards immediately applying the contextual interpretation.

It seems in line with human nature to seek explanations and understand why the Court has ruled in the way it has. In this instance it would also be beneficial to understand whether there were some indications beforehand. Before the CJEU came forth with its controversial decisions, the only indication came from AG Kokkot in her opinion in *DNB Banka* and *AVIVA.*

As has been emphasized numerous times, there did not seem to be any indications that the VAT exemption provided in Article 132(1)(f) of the VAT Directive can to extended to cover those taxable persons operating in the financial and insurance sectors. Most notably the VAT Committee observed this it its Working paper No 654 referring to the CJEU case-law in *Hoffmann.*

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[170] European Commission, VAT Expert Group, VEG No 075, Implications of the CJEU judgements on cost-sharing for the financial and insurance sectors, taxud.c.1(2018)1016383, Brussels, 16 February 2018 page 2

[171] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 39 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 34

[172] European Commission, VAT Expert Group, VEG No 075, Implications of the CJEU judgements on cost-sharing for the financial and insurance sectors, taxud.c.1(2018)1016383, Brussels, 16 February 2018 page 6

[173] Christian Amand *DNB Banka and AVIVA: Has the ECJ Followed Its Own Interpretation Methods and Respected the Objectives Pursued by the EU Legislature?* International VAT Monitor November/December 2017 (accessed on IBFD 2019) afterwards reconfirmed by Herman van Kesteren and Vishal Sharma, *Cost sharing exemption,* ERA Forum (2018) 19: 229. https://doi.org/10.1007/s12027-018-0520-9 (accessed 2019)

[174] See judgment of 21 September 2017, Case C-326/15, *DNB Banka*, EU:C:2017:719 paragraph 28 and judgment of 21 September 2017, Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:718 paragraph 23

[175] However, it would be unreasonable merely to rely on the *Hoffmann* decision to deem that the Article 132(1)(f) of the VAT Directive can be extended to those exemptions conferred by Article 135 of the VAT Directive.

One of the first indication pointing towards the current result, could be observed already in the *SUFA* and *Taksatorringen* cases. Firstly, in *SUFA,* the Court noted that it is true that exemption from VAT are granted in favour of specific objectives.[176]The CJEU followed that Article 13 of the Sixth Directive does not provide exemptions for every activity pursued in the public interest, but only those which are described.[177]

From the *SUFA* judgment first indications can be seen that the public interest exemptions are emphasised. Yet, the Court did not refer to Section A of Article 13 but towards Article 13 as a whole. As has been already discussed in the historical development of the exemption, Article 13 contained section A titled 'Exemption for certain activities in the public' and section B titled 'other exemptions'. Thus, the statement from *SUFA*, would not yet place any limitations on the scope of the exemption for IGP.

A further development could be drawn from *Taksatorringen,* where citing the settled case-law the Court stated, *"[..] the aim of Article 13A of the Sixth Directive is to exempt from VAT certain activities which are in the public interest."*[178] Here the CJEU specifies that the list of exemptions with the objective of public interest are specifically listed in section A of Article 13. Thus, although an indirect, still a reference towards the purpose of objectives pursued in favour of public interest has been expressed in *SUFA* and *Taksatorringen.*

Finally, the VAT exemptions for the financial and insurance industry have always been a difficult topic for EU VAT. In order to clarify and unify the application, a proposal to amend the VAT Directive regarding the treatment of insurance and financial services was proposed by the Commission in 2007.[179] In the proposal an Article 137b was put forward, which would create

[175] See European Commission, VAT Committee, Working Paper No 654, Scope of the exemption for cost-sharing arrangements, taxud.d.1(2010)123337, Brussels, 3 March 2010 page 5

[176] See judgment of 15 June 1989, Case 348/87, *Stichting Uitvoering Financiële Acties v Staatssecretaris van Financiën,* EU:C:1989:246, para. 12

[177] Ibid para. 12

[178] See judgment of 20 November 2003, Case C-8/01 *Taksatorringen,* EU:C:2003:621, para. 60

[179] Commission Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services, COM(2007) 747 final/2, 20 February 2008

an analogue exemption for IGP to that of Article 132(1)(f), yet exclusively for those IGP operating in the insurance and financial sectors.[180]

The necessity to include an exemption for IGP pursuing activities in the insurance and financial sector was not reasoned on the basis that the exemption of Article 132(1)(f) does not extend to said activities. Rather the necessity for a new provision was explained on the basis that the already existing exemption varies between Member States and in some cases has not even been implemented.[181] It was even noted in the impact assessment by the Commission that the application of the exemption is not limited to the insurance and financial sector.[182] Going even further the Commission explained that the most frequent users of the exemption for IGP since 1977 are small insurance companies.[183] This statement by the Commission merely confirms, that until the 21st of September 2017, there was no question, whether the exemption in Article 132(1)(f) can be relied upon by IGP operating in the insurance and financial sector.

However, the proposal never passed and the EU VAT system was left with the Cost Sharing Exemption as it stands in Article 132(1)(f). Yet, the mere fact that the proposal did not pass, did not impact application of the said exemption. Even more so, the proposal was used as an argument in *DNB Banka* proceedings by the Commission that Article 132(1)(f) can apply to financial sector.[184]

Considering that the proposal was never adopted, it is worthwhile mentioning the example of the *Aspiro* judgment. In *Aspiro* the case dealt with claim settlement services, which under Polish law due to a more lenient implementation that of the VAT Directive, where VAT exempt as insurance services. It was put forwards by *Aspiro* and the Polish Government, that there is some merit in the proposal to amend the VAT Directive as regards the treatment of insurance and financial services and that it could favour the favourable interpretation of application of the exemption in Article 135(1)(a) of the VAT Directive.[185] The Court in turn was strict and clearly stated that

[180] Ibid see Article 137b
[181] Commission staff working document, Accompanying document to the Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services, Impact Assessment SEC(2007) 1554, 28 November 2008 page 42
[182] Ibid
[183] Ibid
[184] See opinion of AG Wathelet delivered on 5 April 2017 in Case C-616/15 *Commission v Federal Republic of Germany*, EU:C:2017:272 Para 109
[185] See judgment of 17 March 2016, Case C-40/15, *Minister Finansów v Aspiro SA*, EU:C:2016:172, para. 27

since the proposal at question was never adopted, it is irrelevant and in no way, can be used to interpret a provision in force.[186]

From the *Aspiro* judgment a clear red flag could be drawn, that is, that an argument based on the proposal for the amendments of the VAT Directive with regards to insurance and financial services would most likely be deemed as irrelevant to argue in favour for a more broader application of Article 132(1)(f). Therefore, the conclusion of AG Kokott in *AVIVA* must be concurred. Namely that the decision of the legislature not to adopt the proposed VAT Directive amendments, can be reversed by broadening the scope of Article 132(1)(f).[187]

Therefore, whilst indirectly, some indications could have been made that limitations for Article 132(1)(f) could follow. However, these indications were overshadowed by the already established practice as well as the position expressed by the Commission and the VAT Committee.

4 Conclusions

The VAT exemption for IGP provided in Article 132(1)(f) of the VAT Directive deserves the distinction as one of the most complicated exemptions. The 2017 CJEU judgments had a significant impact on the application of the exemption and has raised many questions. While currently most of the questions relate to the future of the financial and insurance sectors, there are also questions as to whether the interpretation methods applied by the Court can have impact on future judgements.

It is clear that taxable persons operating in the insurance and financial sector will need to reassess their operations and new mechanisms to alleviate non-deductible input VAT burden will need to be found. However, on a positive note, the recent developments may force to reopen the negotiations to clarify the VAT treatment of the insurance and financial sectors.

While the wording of Article 132(1)(f) of the VAT Directive did not place explicit limitations for members of IGP to pursue activities in the public interest, some indications could have been derived from previous case-law as well as the structure of the Sixth Directive. However, at the same time, when looking at the historic development as to how the Cost Sharing Exemption came into existence, it is not so straight forward that the intention of the legislature would have been to limit the scope of the said exemption.

[186] Ibid para. 30

[187] See opinion of AG Kokott delivered on 1 March 2017 in Case C-605/15, *Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, EU:C:2017:150, para. 30

When considering the way, the CJEU came to the conclusion in the *DNB Banka* and *AVIVA* cases it is not clear as to why the court choose to pursue the contextual interpretation and not to consider the purpose it has confirmed in the *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing* case. Therefore, it is not clear whether the Court would have come to the same conclusion should the purpose and history would have been looked at in addition to the contextual interpretation. According to AG Wathelet the purpose of the exemption should not place such limitations.

Although the Court is free to choose the interpretation methods as appropriate to best serves the legal order of the EU, some criticism has been raised by scholars that the textual and purposive methods had not been fully exhausted. Furthermore, it should be considered that the Court had in previous cases emphasised that while the interpretation of VAT exemptions should be strict but not as strict as to limit the application of the exemptions in practice and the main purpose was given in *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing.* These considerations however were not takine into account in *DNB Banka* and *AVIVA.* Therefore, it is unclear as to why the Court deemed it necessary to choose the contextual method.

The application of the Cost Sharing Exemption has forever changed based on the judgments of 21st of September 2017. However, it will be interesting to see further development as the CJEU will be forced to answer more unsettled questions in two pending cases - C-400/18 *Infohos*[188] and C-77/19 *Kaplan International colleges UK Ltd*[189].

However different opinions of the purpose of the scope of the Cost Sharing Exemption may be at this point two notions may be derived. First, that the intention of the legislature in broadening the scope of the Cost Sharing Exemption from its first form in Article 14(1)(f) of the proposal of the Sixth Directive is still unclear. And second, the Cost Sharing Exemption was put in place to help smaller taxable persons to achieve economies of scale, by reducing their input VAT burden in comparison with their larger competitors.

[188] Application of the case: OJ C 301 from 27.8.2018, p.17
[189] Application of the case: OJ C 131 from 08.04.2019, p.25

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