JUDGMENT OF THE COURT (Third Chamber)

28 June 2007 (*)

(Sixth VAT Directive – Article 13B(d)(6) – Exemption – Special investment funds – Meaning – Definition by the Member States – Discretion – Limits – Closed-ended funds)

In Case C-363/05,

REFERENCE for a preliminary ruling under Article 234 EC, from the VAT and Duties Tribunal, London (United Kingdom), made by decision of 19 September 2005, received at the Court on 26 September 2005, in the proceedings

JP Morgan Fleming Claverhouse Investment Trust plc,

The Association of Investment Trust Companies

v

The Commissioners of HM Revenue and Customs,

THE COURT (Third Chamber),

composed of A. Rosas (Rapporteur), President of the Chamber, J. Klučka, U. Lõhmus, A. Ó Caoimh and P. Lindh, Judges,

Advocate General: J. Kokott,

Registrar: L. Hewlett, Principal Administrator,

having regard to the written procedure and further to the hearing on 13 December 2006,

after considering the observations submitted on behalf of:

– JP Morgan Fleming Claverhouse Investment Trust plc, by K.P.E. Lasok QC and M. Angiolini, Barrister, instructed by A. Khan, Solicitor,

– the United Kingdom Government, by C. Gibbs and R. Hill, acting as Agents,

– the Commission of the European Communities, by R. Lyal and M. Afonso, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 1 March 2007,

gives the following

Judgment

1 This reference for a preliminary ruling relates to the interpretation of Article 13B(d)(6) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1; 'the Sixth Directive').

2 The reference was made in the course of proceedings brought by JP Morgan Fleming Claverhouse Investment Trust plc ('Claverhouse') and the Association of Investment Trust Companies, the applicants in the main proceedings, against the Commissioners of HM Revenue and Customs ('the Commissioners') regarding their refusal to exempt the management services supplied to an investment trust company ('ITC') from value added tax ('VAT').

Legal context

The Community legislation

3 Under Article 13B(d)(6) of the Sixth Directive Member States are to exempt the following from VAT under conditions which they are to lay down for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse:

'management of special investment funds as defined by Member States.'

4 Article 1 of Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ 1985 L 375, p. 3), as amended several times, inter alia by Directive 2001/108/EC of the European Parliament and of the Council of 21 January 2002 (OJ 2002 L 41, p. 35), and, most recently, by Directive 2005/1/EC of the European Parliament and of the Council of 9 March 2005 (OJ 2005 L 79, p. 9) ('the UCITS Directive') provides:

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

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

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

– the units of which are, at the request of holders, re-purchased or redeemed, directly or indirectly, out of those undertakings' assets. Action taken by a UCITS to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regarded as equivalent to such re-purchase or redemption.

…

3. Such undertakings may be constituted according to law, either under the law of contract (as common funds managed by management companies) or trust law (as unit trusts) or under statute (as investment companies).'

5 According to Article 2(1) of the UCITS Directive, undertakings for collective investment in transferable securities ('undertakings for collective investment') of the closed-ended type are not to be considered to be undertakings for collective investment subject to that directive.

6 The sixth recital of the preamble to the UCITS Directive reads as follows:

'Whereas the coordination of the laws of the Member States should be confined initially to collective investment undertakings other than of the closed-ended type which promote the sale of their units to the public in the Community and the sole object of which is investment in transferable securities (which are essentially transferable securities officially listed on stock exchanges or similar regulated markets); whereas regulation of the collective investment undertakings not covered by the Directive poses a variety of problems which must be dealt with by means of other provisions, and such undertakings will accordingly be the subject of coordination at a later stage; …'

National legislation

7 Article 13B(d)(6) of the Sixth Directive was implemented in the United Kingdom by the Value Added Tax Act 1994 ('the VAT Act 1994').

8 Items 9 and 10 of Group 5 of Schedule 9 to the VAT Act 1994 exempt the management of an authorised unit trust scheme ('AUT') and the management of the scheme property of an open-ended investment company ('OEIC') respectively.

9 The terms AUT and OEIC used in the VAT Act 1994 are defined by the Financial Services and Markets Act 2000 which implements part of the UCITS Directive in the United Kingdom.

10 According to the court-file ITCs are, in principle, defined according to the criteria appearing in section 842 of the Income and Corporation Taxes Act 1988. That section lays down the conditions which a company must meet in order to qualify, as an ITC, for exemption from capital gains tax.

The main proceedings and the questions referred for a preliminary ruling

11 Claverhouse is an ITC which used the management services of a third party, JP Morgan Fleming Asset Management (UK) Limited, to manage its investment portfolios.

12 Claverhouse is subject to VAT on the management services which it receives, since the Commissioners refuse to treat the supply of management services to an ITC as a service which is exempt from VAT. Thus, over a period of 10 years ending on 31 December 2003, Claverhouse paid GBP 2.7 million in non-recoverable VAT.

13 Against that background, Claverhouse and the Association of Investment Trust Companies, an association representing a number of ITCs operating within the United Kingdom market, lodged an appeal against the Commissioners before the referring court.

14 According to the order for reference, AUTs, which are constituted under trust law, and OEICs, which are constituted under statute, are collective special investment funds in which the respective number of units or shares held by investors varies in accordance with their investment. AUTs and OEICs are variable capital funds (or open-ended funds) which are obliged to buy back their units or shares from investors who wish to sell them. ITCs, which are constituted under statute, on the other hand, are fixed-capital funds (or closed-ended funds). ITCs are collective investment schemes constituted as limited liability companies quoted on the stock exchange. An investor who wishes to realise his investment in this type of fund generally sells his shares on a secondary market such as a stock exchange where the price is negotiated on the basis of supply and demand on the market.

15 The referring court explains that, unlike AUTs and OEICs, ITCs are not subject to authorisation by the Financial Services Authority under the Financial Services and Markets Act 2000. However, like listed companies, they are regulated by the Financial Services Authority in its capacity as Listing Authority.

16 The referring court points out, further, that the management of AUTs and OEICs must be entrusted to an external manager, while ITCs have a Board of Directors which is empowered to manage investments. However, 90% of ITCs entrust the management of investments to external fund managers.

17 Finally, according to the order for reference, in the United Kingdom, an OEIC, which has variable capital and which constitutes a collective investment undertaking within the meaning of the UCITS Directive and which is required to entrust the management of its funds to a third party, is exempt from VAT on the services supplied by its external manager, whereas closed-ended investment companies such as ITCs enjoy no such exemption.

18 In those circumstances, the VAT and Duties Tribunal, London, decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

‘1. Are the words “special investment funds” in Article 13B(d)(6) of the Sixth Directive capable of including closed-ended investment funds, such as ITCs?

2. If the answer to the first question is in the affirmative, does the phrase “as defined by Member States” in Article 13B(d)(6):

(a) allow Member States to select certain of the “special investment funds” within their jurisdiction to benefit from the exemption of the supply of management services and exclude others from the exemption, or

(b) does it mean that the Member States are to identify those funds within their jurisdiction which fall within the definition of “special investment funds” and that the benefit of exemption should extend to all such funds?

3. If the answer to the second question is that Member States can select which “special investment funds” benefit from the exemption, how do the principles of fiscal neutrality, equal treatment and the prevention of distortion of competition affect the exercise of that discretion?

4. Does Article 13B(d)(6) have direct effect?’

The questions referred for a preliminary ruling

Preliminary remarks

19 According to settled case-law, the exemptions provided for in Article 13 of the Sixth Directive have their own independent meaning in Community law which must be given a Community definition whose purpose is to avoid divergences in the application of the VAT system from one Member State to another (see, to that effect, Case C-428/02 *Fonden Marselisborg Lystbådehavn* [2005] ECR I-1527, paragraph 27; Case C-498/03 *Kingscrest Associates and Montecello* [2005] ECR I-4427, paragraph 22; Joined Cases C-394/04 and C-395/04 *Ygeia* [2005] ECR I-10373, paragraph 15; Case C-169/04 *Abbey National* [2006] ECR I-4027, paragraph 38; and Case C-401/05 *VDP Dental Laboratory* [2006] ECR I-0000, paragraph 26).

20 However, the Community legislature may confer the task of defining certain terms of an exemption on the Member States (see, to that effect, Case C-468/93 *Gemeente Emmen* [1996] ECR I-1721, paragraph 25, and *Abbey National*, paragraph 39).

21 In such cases it is for each Member State to define the concepts in question in its own domestic law (see to that effect, Joined Cases C-443/04 and C-444/04 *Solleveld and van den Hout-van Eijsbergen* [2006] ECR I-3617, paragraph 29), subject to the terms of the exemption laid down by the Community legislature.

22 Moreover, it is clear from the case-law of the Court concerning VAT that, when the Member States come to define certain terms of an exemption, they may not prejudice the objectives pursued by the Sixth Directive or the general principles underlying it, in particular the principle of fiscal neutrality (see, to that effect, *Gemeente Emmen*, paragraph 25; and Case C-246/04 *Turn- und Sportunion Waldburg* [2006] ECR I-589, paragraph 31).

The first question

23 By its first question the referring court asks whether the term ‘special investment funds’ in Article 13B(d)(6) of the Sixth Directive is capable of including closed-ended investment funds, such as ITCs.

24 Taking issue with the contention of the United Kingdom Government, the applicants in the main proceedings and the Commission of the European Communities take the view that the words ‘special investment funds’ are capable of including closed-ended investment funds such as ITCs.

25 In that connection, it must be observed that Article 13B(d)(6) of the Sixth Directive lays down no definition of the words ‘special investment funds’.

26 In paragraph 53 of its judgment in *Abbey National* the Court held that Article 13B(d)(6) of the Sixth Directive covers special investment funds whatever their legal form. Undertakings for collective investment constituted under the law of contract or trust law, and those constituted under statute both come within the scope of that provision.

27 Consequently, if the legal form does not determine whether the term ‘special investment funds’ in Article 13B(d)(6) of the Sixth Directive applies, the relevance of the mode of operation must be examined in that connection.

28 It is not apparent from either the wording or the context of Article 13B(d)(6) of the Sixth Directive that it was the intention of the Community legislature to authorise Member States, when they define the terms of the exemption, to make a distinction according to the mode of operation used by special investment funds.

29 An interpretation of Article 13B(d)(6) of the Sixth Directive exempting from VAT the management of open-ended funds, and not the management of closed-ended funds, would be contrary to the principle of fiscal neutrality on which, in particular, the common system of VAT established by the Sixth Directive is based, and which precludes economic operators carrying out the same transactions being treated differently in relation to the levying of VAT (see, to that effect, Case C-382/02 *Cimber Air* [2004] ECR I-8379, paragraphs 23 and 24; Case C-280/04 *Jyske Finans* [2005] ECR I-10683, paragraph 39; and *Abbey National*, paragraph 56).

30 As the Advocate General observed in point 21 of her opinion, closed-ended funds present no relevant difference which would preclude, a priori, their classification as special investment funds within the meaning of Article 13B(d)(6) of the Sixth Directive, along with open-ended funds.

31 Contrary to the contention of the United Kingdom Government, the provisions of the UCITS Directive cannot be relied on to derive a restricted interpretation of the term ‘special investment funds’ from Article 13B(d)(6) of the Sixth Directive.

32 Although it follows from the recitals in the preamble to and the terms of the UCITS Directive that its objective is to coordinate national legislation governing collective investment undertakings, the fact remains, as the Advocate General observed in point 22 of her opinion, that, when the Sixth Directive was adopted, Community terminology in the field of special investment funds was not yet harmonised, since the UCITS Directive, Article 1(3) of which gives a Community definition of collective investment undertakings, was not adopted until 1985 (see *Abbey National*, paragraph 55).

33 Moreover, even if certain language versions, such as, in particular, the Spanish, French, Italian and Portuguese versions of Article 1(3) of the UCITS Directive, when they designate

undertakings for collective investment constituted under the law of contract, as opposed to funds constituted under trust law or under statute, use the same expression as that which appears in Article 13B(d)(6) of the Sixth Directive, that is not the case in other language versions, such as the English, Danish and German versions (see, to that effect, *Abbey National*, paragraph 55).

34 Finally, it cannot be argued that the harmonisation introduced by the UCITS Directive does not extend to closed-ended funds. In that connection, it must be observed that, as the Commission points out, closed-ended funds are not excluded definitively from the coordinating measures laid down by that directive. It is apparent from the sixth recital of the preamble to the directive that those funds are merely temporarily excluded from the coordinating measures laid down in the directive. Thus it is not ruled out that closed-ended funds might be harmonised at a later stage.

35 It follows from all the foregoing that a closed-ended investment company such as an ITC, which uses external management services, is liable to fall within the definition of 'special investment funds' in Article 13B(d)(6) of the Sixth Directive.

36 That interpretation is not undermined in any way by the fact that closed-ended funds are not required to use external management but can opt to manage themselves. The fact that, unlike OEICs, closed-ended funds such as ITCs have the option of self-management and are not required to have recourse to external management has no effect on the position of an ITC which decides to use external management. Where such a fund chooses to use external management, it is objectively in the same position as an open-ended fund such as an OEIC which is required to use external management.

37 Therefore, the answer to the first question must be that Article 13B(d)(6) of the Sixth Directive must be interpreted as meaning that the words 'special investment funds' in that provision are capable of including closed-ended investment funds, such as ITCs.

The second and third questions

38 By its second and third questions the referring court seeks essentially to ascertain the scope of the phrase 'as defined by Member States' in Article 13B(d)(6) of the Sixth Directive.

39 The applicants in the main proceedings and the Commission consider that the Member States alone are empowered to identify, amongst the funds on their territory, those which meet the definition of 'special investment funds'. According to the Commission, once a fund has been identified as a special investment fund, it must be eligible for the exemption from VAT provided for by Article 13B(d)(6) of the Sixth Directive. The discretion of the Member States does not, therefore, extend to the question whether the VAT scheme actually applies. The Commission adds that the funds have to be identified in the light of the provisions of the UCITS Directive.

40 The United Kingdom Government, for its part, argues that a wide interpretation of the words 'special investment funds' in Article 13B(d)(6) of the Sixth Directive must necessarily be combined with an interpretation of the phrase 'as defined by Member States' according to which Member States are given a wide discretion to select the funds eligible for the exemption.

41 At the outset it must be observed that the task of defining the meaning of the words 'special investment funds' does not in any way permit the Member States to select certain funds located on their territory and grant them exemption and exclude other funds from that exemption. It follows from paragraph 21 of this judgment that the terms 'special investment funds' must be the starting point for the discretion conferred on the Member States.

42 The interpretation according to which it is for the Member States to select the investment funds which are eligible for the exemption and exclude others would negate the significance of the terms 'special investment funds' in Article 13B(d)(6) whose objective is to prevent discrepancies in the application of VAT to such funds.

43 Article 13B(d)(6) of the Sixth Directive thus only grants the Member States the power to define, in their domestic law, the funds which meet the definition of 'special investment funds'. That power should, according to paragraph 22 of this judgment, be exercised subject to the objective pursued by the Sixth Directive and the principle of fiscal neutrality of the common system of VAT.

44 Accordingly it is necessary to consider whether the limits of the discretion allowed to the Member States by Article 13B(d)(6) of the Sixth Directive are respected where a taxable person seeks to have the management services supplied to him recognised as relating to the management of a special investment fund in order to enjoy the exemption from VAT provided for thereby .

45 In that regard it must be observed, first, that the purpose of the exemption, under Article 13B(d)(6) of the Sixth Directive, of transactions connected with the management of special investment funds is, particularly, to facilitate investment in securities by means of investment undertakings by excluding the cost of VAT. That provision is intended to ensure that the common system of VAT is fiscally neutral as regards the choice between direct investment in securities and investment through undertakings for collective investment (*Abbey National*, paragraph 62).

46 Second, the principle of fiscal neutrality, on which the common system of VAT established by the Sixth Directive is based, precludes economic operators carrying out the same transactions from being treated differently in relation to the levying of VAT. That principle does not require the transactions to be identical. According to settled case-law that principle precludes, in particular, treating similar goods and supplies of services, which are thus in competition with each other, differently for VAT purposes (see Case C-109/02 *Commission* v *Germany* [2003] ECR I-12691, paragraph 20; Joined Cases C-453/02 and C-462/02 *Linneweber and Akritidis* [2005] ECR I-1131, paragraph 24; *Kingscrest, Associates and Montecello*, paragraph 54; Case C-106/05 *L.u.p*. [2006] ECR I-5123, paragraph 32; *Turn- und Sportunion Waldburg*, paragraph 33; and *Solleveld and van den Hout-van Eijnsbergen*, paragraph 39).

47 The principle of fiscal neutrality includes the principle of elimination of distortion in competition as a result of differing treatment for VAT purposes (see, to that effect, Case C-481/98 *Commission* v *France* [2001] ECR I-3369, paragraph 22). Therefore, distortion is established once it is found that supplies of services are in competition and are treated unequally for the purposes of VAT (see, to that effect, Case C-404/99 *Commission* v *France* [2001] ECR I-2667, paragraphs 45 to 47). It is irrelevant, in that connection, whether the distortion is substantial.

48 It follows from the foregoing that any application of national legislation which excludes the management of special closed-ended investment funds from the exemption provided for by Article 13B(d)(6) of the Sixth Directive is contrary to the objective of that provision and to the principle of fiscal neutrality where those closed-ended funds are collective investment undertakings which allow investors to invest in securities and where those funds are in competition with funds exempt from VAT.

49 It is for the national court to verify whether the application of the national legislation at issue in the main proceedings is consistent with the objective of Article 13B(d)(6) of the Sixth Directive and with the principle of fiscal neutrality in the light of the guidelines given in this judgment.

50 In that regard, it is possible to provide the referring court with some further guidelines in the light of the information it sent to the Court. Thus, it must be held that, in any event, the management of AUTs and OEICs, which are collective investment undertakings as defined in the UCITS Directive, is exempt from VAT in the United Kingdom. Although, at present, ITCs are not collective investment undertakings within the meaning of the UCITS Directive, the fact remains that, as the referring court observes, AUTs, OEICs and ITCs are three forms of special investment which spread risk. In addition, the referring court considers that ITCs, like AUTs and OEICs, involve investment in securities through the intermediary of a collective investment undertaking which allows private investors to invest in wide-ranging investment portfolios and thus reduce the stock market risk.

51 Thus, according to the statements put before the court, the management of ITCs falls within the objective of the Sixth Directive and ITCs constitute investment funds comparable to AUTs and OEICs which fall within the definition of 'special investment funds'. In those circumstances, the exclusion of ITCs from the exemption provided for by Article 13B(d)(6) does not appear justified in the light of the objective of that provision and the principle of fiscal neutrality.

52 As the Commission argues, the question whether that interpretation results in the exemption provided for by Article 13B(d)(6) of the Sixth Directive being extended to cover funds other than those at issue in the main proceedings is not one of the questions referred to the Court for a preliminary ruling.

53 It must be added that the classification in national law of special investment funds cannot suffice to justify their qualifying for a Community exemption such as that at issue in the main proceedings. They must also be funds covered by the notion of 'special investment funds' within the meaning of Article 13B(d)(6) of the Sixth Directive and liable to be exempt in the light of the objective of that directive and the principle of fiscal neutrality.

54 In the light of the foregoing considerations, the answer to the second and third questions must be that Article 13B(d)(6) of the Sixth Directive must be interpreted as meaning that it allows Member States a discretion in defining the funds located on their territory which are covered by the notion of 'special investment funds' for the purposes of the exemption provided for by that provision. However, in the exercise of that power, the Member States must respect the objective pursued by that provision, which is to facilitate investment in securities for investors through investment undertakings, while guaranteeing the principle of fiscal neutrality from the point of view of the levying of VAT on the management of special investment funds which are in competition with other special investment funds such as funds falling within the scope of the UCITS Directive.

The fourth question

55 By its fourth question the referring court asks whether Article 13B(d)(6) of the Sixth Directive has direct effect.

56 The applicants in the main proceedings consider that they are entitled to rely on that provision. The mere fact that it appears to allow Member States a certain discretion in their definition of special investment funds cannot preclude the possibility of reliance on it where the

national measures implementing it exceed the limits of that discretion in that they are contrary to the principle of fiscal neutrality and/or the objective pursued by the exemption provided for by that provision. The Commission shares that view and adds that Article 13B(d)(6) of the Sixth Directive can be relied on directly since the limits imposed on the discretion of the Member States are clear, precise and sufficiently unconditional.

57 The United Kingdom Government, on the other hand, takes the view that Article 13B(d)(6) of the Sixth Directive does not have direct effect in that it requires further implementation by the Member States.

58 On that point, it is clear from settled case-law that wherever the provisions of a directive appear, so far as their subject-matter is concerned, to be unconditional and sufficiently precise, they may, in the absence of implementing measures adopted within the prescribed period, be relied on against any national provision which is incompatible with the directive or in so far as they define rights which individuals are able to assert against the State (see, inter alia, Case 8/81 *Becker* [1982] ECR 53, paragraph 25; Case C-141/00 *Kügler* [2002] ECR I-6833, paragraph 51; Joined Cases C-465/00, C-138/01 and C-139/01 *Österreichischer Rundfunk and Others* [2003] ECR I-4989, paragraph 98; and *Linneweber and Akritidis*, paragraph 33).

59 As regards the subject-matter of Article 13B(d)(6) of the Sixth Directive, it must be held that it indicates sufficiently precisely and unconditionally that the management of special investment funds must be exempted.

60 The fact that that provision confirms the existence of a discretion for Member States is not such as to call that interpretation into question if, according to objective evidence, the supply at issue meets the criteria for that exemption (see, by analogy, Case C-45/01 *Dornier* [2003] ECR I-12911, paragraph 81).

61 Consequently, the fact that Article 13B(d)(6) of the Sixth Directive allows Member States a discretion, indicating that they are responsible for defining special investment funds, does not prevent the persons concerned from relying directly on that provision (see, by analogy, *Dornier*, paragraph 81), where a Member State exercising that discretion has adopted national measures which are incompatible with that directive (see, to that effect, *Linneweber and Akritidis*, paragraphs 36 and 37).

62 The answer to the fourth question must, therefore, be that Article 13B(d)(6) of the Sixth Directive has direct effect, in that it can be relied on by a taxable person before a national court in order to challenge the application of national legislation alleged to be incompatible with that provision.

Costs

63 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Third Chamber) hereby rules:

1. **Article 13B(d)(6) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment must be interpreted as meaning that the words 'special investment funds' in that provision are capable of including closed-ended investment funds, such as Investment Trust Companies.**

2. **Article 13B(d)(6) of Sixth Directive 77/388 must be interpreted as meaning that it allows Member States a discretion in defining the funds located on their territory which are covered by the notion of 'special investment funds' for the purposes of the exemption provided for by that provision. However, in the exercise of that power, the Member States must respect the objective pursued by that provision, which is to facilitate investment in securities for investors through investment undertakings, while guaranteeing the principle of fiscal neutrality from the point of view of the levying of VAT on the management of special investment funds which are in competition with other special investment funds such as funds falling within the scope of Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), as amended by Directive 2005/1/EC of the European Parliament and of the Council of 9 March 2005.**

3. **Article 13B(d)(6) of Sixth Directive 77/388 has direct effect, in that it can be relied on by a taxable person before a national court in order to challenge the application of national legislation alleged to be incompatible with that provision.**

[Signatures]

* Language of the case: English.