Bad Laws Make Hard Cases: *Halifax* and the avoidance of inconsistent tax rules.

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Summary. 1. Scope of this paper. 2. The teleological element: an explicit or hidden requirement in every tax avoidance solution. 3. Applied and avoided provisions in *Halifax*. Is there any purpose in the limitation of the right to deduct? 4. Pure-revenue raising provisions and tax avoidance.

1. Scope of this paper.

On February 21st 2006 the European Court of Justice delivered its ruling in *Halifax*[1]. "Halifax day" has been considered as marking the beginning of a new stage of evolution of the European VAT system[2]. Therefore the facts, the opinion of Advocate General Mr. Miguel Poiares Maduro[3] and the ruling itself have generated a great amount of interest among European commentators[4]. These contributions focus on a very wide range of topics related to the case and, generally, to VAT avoidance. Nevertheless even though great progress has been made on these issues the time has come for a more detailed analysis of the case.

Leaving out other highly interesting topics, this paper will merely focus on one logical weakness of *Halifax* which has been already noted by some commentators[5], but not in our opinion resolved. We are referring, in fact, to one element of the "two-part test"

[1] ECJ judgment of 21 February 2006 in Case C-255/02 *Halifax plc v CC & E.*
[2] J. Swinkels, "Halifax day: Abuse of Law in European VAT" [2006] *International VAT Monitor*, May-June 173 at p.173.
[3] Opinion of Mr Advocate General Poiares Maduro delivered on 7 April 2005. **Halifax** plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v Commissioners of Customs & Excise. Case C-255/02. European Court reports 2006 Page I-01609.
[4] Both in critical and praiseworthy taste: M. Lang, "Rechtsmissbrauch und Gemeinschaftsrecht im Lichte von *Halifax* and *Cadbury Schweppes*" [2006] *Steuer und Wirtschaft International* 273. H.F. Lange, "Rechtsmissbrauch im Mehrwertsteuerrecht" [2006] *Der Betrieb* 519. R. De La Feria, "Giving themselves extra VAT? The ECJ Ruling in Halifax" [2006] BTR 119. B. Lask, "Banks, Universities and Hospitals: the limits to tax avoidance" (2006) 8, Issue 2, *The EC Tax Journal* 39. C. Piccolo, "Abuso del diritto ed Iva: tra interpretazione comunitaria ed applicazione nazionale" [2006] *Rassegna Tributaria* 1040. S. Douma; F. Engelen, "Halifax plc v Customs and Excise Commissioners: the ECJ Applies the Abuse of Rights Doctrine in Vat Cases" [2006] BTR 429. F. Vanistendael, "*Halifax* and *Cadbury Schweppes*: one single European theory of abuse in tax law? [2006] *EC Tax Review* 192. I. Massin, "Introduction of *Halifax* in the Belgian VAT Legislation" [2006] *International VAT Monitor,* September-October 336. H. McCarthy, "Abuse of rights: The Effect of the Doctrine on VAT Planning" [2007] BTR 160. M.P. Bonet Sánchez, "Abuso del derecho comunitario a deducir el IVA soportado en los asuntos «Halifax» y «Huddersfield» [2007], No 6 *Jurisprudencia Tributaria Aranzadi* 25. Even before deliverance of the ruling and/or opinion of the AG: P. Brennan, "Why the ECJ Should Not Follow Advocate General Maduro's Opinion in *Halifax*" [2005] *International VAT Monitor,* Juli-August 247. M. Ridsdale, "Abuse of rights, fiscal neutrality and VAT" [2005] *EC Tax Review* 82. R. Cordara, "*Halifax*: a conservative opinion" [2005] BTR 267. R. de la Feria, "The European Court of Justice's solution to aggressive VAT planning – further towards legal uncertainty?" [2006] *EC Tax Review* 27.
[5] See: Ridsdale, "Abuse of rights, fiscal neutrality and VAT" [2005] *EC Tax Review* 82 at 88 et seq. R. de la Feria, "The European Court of Justice's solution to aggressive VAT planning – further towards legal uncertainty?" [2006] *EC Tax Review* 27 at 32.

applied in order to determine the existence of abuse of law: the so called teleological or objective element. It has been described as follows in relation to *Halifax*: "*where there is no contradiction between recognition of the claim made by the taxable person and the* ***aims and results pursued by the legal provision invoked****, no abuse can be asserted*"[6]; and in the ECJ ruling: "*…an abusive practice can be found to exist only if, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage* ***the grant of which would be contrary to the purpose of those provisions***"[7]. Furthermore, in the second part of this article, we try to demonstrate that the teleological element is essential to any tax avoidance doctrine.

The teleological analysis of this case could finish at this stage by stating that to allow taxable persons to deduct all input VAT even though, in the context of their normal commercial operations, no transactions conforming with the deduction rules of the Sixth Directive or of the national legislation transposing it would have enabled them to deduct such VAT, or would have allowed them to deduct only a part, would be contrary to the principle of fiscal neutrality and, therefore, contrary to the purpose of those rules[8]. This position seems to be shared by quite a lot of commentators[9].

Nevertheless, and this is in my opinion the crucial problem in *Halifax*, these contributions fail to recognise the purpose -or more precisely the lack of purpose- of the allegedly avoided rules. One should bear in mind that the whole VAT structure in *Halifax* was designed for the purpose of recovering a maximum percentage of the input tax on the construction of four call centres, avoiding a 5 per cent recovery limit of VAT under partial exemption rules arising because Halifax was a banking company whose supplies were predominantly exempt financial services. On the other hand, and this is perhaps frequently forgotten, the VAT rules limiting the right to deduct when exemptions apply, are considered normally inconsistent with principles governing the EU VAT system such as fiscal neutrality and VAT as consumption tax[10]. These facts give raise to a curious paradox: the avoidance of certain VAT rules might be the only way to adhere to the principles of the VAT system[11].

Therefore, the third and fourth parts of this paper will focus on these issues. In a first step we will try to prove how rules limiting the right to deduct may culminate in treating

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[6] Advocate's General's Opinión on *Halifax,* at para. 88.
[7] Paragraph 74 of the judgment.
[8] Paragraph 80 of the judgment.
[9] V. Ruiz Almendral, "Tax Avoidance and the European Court of Justice: What is at Stake for European General Anti-Avoidance Rules?" (2005) 33 *Intertax* 562 at 579 et seq. Cordara, "*Halifax*: a conservative opinion" [2005] BTR 267 at 260. C. Piccolo, "Abuso del diritto ed Iva: tra interpretazione comunitaria ed applicazione nazionale" [2006] *Rassegna Tributaria* 1040 at 1046. S. Douma; F. Engelen, "Halifax plc v Customs and Excise Commissioners: the ECJ Applies the Abuse of Rights Doctrine in Vat Cases" [2006] BTR 429 at 433 et seq. M.P. Bonet Sánchez, "Abuso del derecho comunitario a deducir el IVA soportado en los asuntos «Halifax» y «Huddersfield» [2007], No 6 *Jurisprudencia Tributaria Aranzadi* 25 at 27. And it has been also the position assumed by the AG: Advocate's General's Opinión on *Halifax,* at para. 93 et seq.
[10] R. de la Feria, "The European Court of Justice's solution to aggressive VAT planning – further towards legal uncertainty?" [2006] *EC Tax Review* 27 at 32.
[11] In fact, this is not an isolated problem. See for social grounded exemptions: A. Báez Moreno and D. Marín Barnuevo, "La tributación de las federaciones deportivas", in *Manual de Gestión de Federaciones Deportivas* (Alberto Palomar Olmeda (ed), Thomson-Aranzadi, Pamplona, 2006) at 254 et seq.

traders as *de facto* consumers, creating tax cascading and encouraging self-supplies[12]. Finally we will try to offer a solution for this and similar cases on VAT; we will demonstrate thereby that this problem is not that new in fact, since German scholars have been dealing with it –from a strict theoretical point of view- during the last decades.

2. The teleological element: an explicit or hidden requirement in every tax avoidance solution.

European (and non-European) countries have had different reactions to the tax avoidance phenomenon. Nevertheless, and despite the diversity of general tax avoidance "solutions"[13], there are common structural elements[14], among which the teleological element is worth noting. It has been stated, in fact, that the first and most important common element to all GAARs is that they provide an instrument for the tax administration to recharacterize a given arrangement by interpreting the tax legislation according to its purpose[15].

Briefly, tax avoidance comes up under two different schemes. Either the taxpayer avoids application of burdensome tax statutes or, on the other hand, accrues a tax advantage by causing application of beneficial tax provisions[16]. Regardless of which GAAR might be applied, the purpose of the avoided or applied provision will be decisive, as we will try to demonstrate next.

Most countries make a distinction between substance over form techniques and separate anti-avoidance rules[17]. The former, if applicable, require a purposive analysis of the avoided or applied legislation. Whatever the technique may be (*Wirtschaftliche Betrachtungsweise* in Germany[18], independent fiscal qualification in the Netherlands[19],

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[12] Which are the effects normally linked to rules limiting the right to deduct. See: R. de la Feria, "The European Court of Justice's solution to aggressive VAT planning – further towards legal uncertainty?" [2006] *EC Tax Review* 27 at 32.

[13] Hereby we refer not only to statute-based but also to court-based general tax avoidance rules.

[14] In Spain Prof. PALAO has insisted on these structural elements minimizing the importance of specific legal conditions. See: C. Palao, "La norma anti-elusión del proyecto de nueva Ley General Tributaria" (2003) 248 *Estudios Financieros Revista de Contabilidad y Tributación* 71 at p. 83. See also the comparative study of the legislation of Belgium, Germany, France, the UK and the Netherlands carried out by de Kleer: M. de Kleer, "Towards a European Anti-Abuse Doctrine in Direct Taxation?" [1996] *Intertax* 137.

[15] See Ruiz Almendral (2005), fn. 9, at p. 567.

[16] These two schemes, known by German scholars as rule-avoidance (*Tatbestandvermeidung*) and rule-catch (*Tatbestanderschleichung*), are described in: K.D. Drüen, "§ 42. Miβbrauch von Gestaltungsmöglichkeiten", in K Tipke and H.W. Kruse (eds) *Abgabenordnung. Finanzgerichtsordnung. Kommentar zur AO un FGO* (Otto Schmidt, Köln, 1961/2007) at § 42, Rz. 47, Lfg. 88 September 1999. For more details and further literature see: L. Dong-Sik, *Methoden zur Verhinderung der Steuerumgehung und ihr Verhältnis zueinander* (GCA-Verlag, Herdecke, 2000) at 30 et seq.

[17] See: M. de Kleer, "Towards a European Anti-Abuse Doctrine in Direct Taxation?" [1996] *Intertax* 137 at 139.

[18] German literature about *Wirtschaftliche Betrachtungsweise* is huge. For a general analysis with many references: K.D. Drüen, "§ 4. Gesetz", in K Tipke and H.W. Kruse (eds) *Abgabenordnung. Finanzgerichtsordnung. Kommentar zur AO un FGO* (Otto Schmidt, Köln, 1961/2007) at § 4, Rz. 47320 et seq, Lfg. 111 Oktober 2006.

[19] M. de Kleer, "Towards a European Anti-Abuse Doctrine in Direct Taxation?" [1996] *Intertax* 137 at 141.

acte anormal de gestion in France[20] or simply teleological interpretation) the method is more or less homogenous. Taking into account that the wording of a legal provision might be attributed different meanings, an avoidance attempt might be rejected by choosing a meaning appropriate to the purpose of the very avoided or applied provision[21]. When dealing with general anti-avoidance rules the teleological element might not be so evident.

Some statute or court based general anti-avoidance rules include the teleological element as an explicit application requirement. In this understanding we could mention the old Spanish GAAR in force up to July 1st 2004 ("*To avoid fraus legis, there shall not be deemed to be an extension of the taxable event when the tax is claimed with respect to events, acts or legal contracts which have been performed with the intention of avoiding the payment of the tax,* ***relying on provisions enacted for a different purpose****, provided the result they produce shall be equivalent to that derived from the taxable event*"[22] or the Dutch court-based *fraus legis* doctrine which requires as a condition that the choice of legal form conflicts with the purpose and intent of the (tax) law[23]. Nevertheless, this is unusual at least with regard to statute-based general anti-avoidance rules. By way of example, let us analyze the Spanish and German GAAR, which have been considered to share many features.[24]

Section 15 of the Spanish *Ley General Tributaria* defines a "conflict" in the application of tax provisions as follows:

> "*When the taxpayer succeeds in totally or partially avoiding the tax, or obtains a tax benefit of any kind through acts or arrangements in which both the following circumstances occur: (a) Individually considered or, as a group such acts are clearly artificial or improper for attaining the pursued economic objective; (b) That no other substantial consequences arise from the adoption of this legal form of arrangement as would have arisen had the normal, proper form be used*"[25].

Paragraph 42 of the German *Abgabenordnung* reads:

> "*The tax laws cannot be avoided by the misuse of legal construction opportunities. Where such a misuse is found, the tax consequences shall be such*

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[20] H. Lehérissel, "France", in *Form and Substance in tax law* (Cahiers de droit fiscal international. Volume LXXXVIIa, Kluwer, The Hague, 2002) at 276 et seq.

[21] This construction as a logical limit to interpretation has been developed by German scholars: K. Larenz, *Methodenlehre der Rechtswissenschaft* (6th ed, Berlin, Springer, 1991), at 342. K. Engisch, *Einführung in das juristische Denken* (5th ed., Kohlhammer, Stuttgart, 1971), at 146.

[22] Art 24 of the *Ley General Tributaria* as reworded by Law nº 25/1995 of July 20th. We take the translation from: M. Marín Arias and J.L. Pérez de Ayala, "Spain", in *Form and Substance in tax law* (Cahiers de droit fiscal international. Volume LXXXVIIa, Kluwer, The Hague, 2002) at 517.

[23] See: L.H. Ijzerman, "The Netherlands" in *Form and Substance in tax law* (Cahiers de droit fiscal international. Volume LXXXVIIa, Kluwer, The Hague, 2002) at 454.

[24] V. Ruiz Almendral and G. Seitz, "El fraude a la ley tributaria (Análisis de la normas española con ayuda de la experiencia alemana" (2004) 257-258 *Estudios Financieros. Revista de Contabilidad y Tributación* 7. Ruiz Almendral (2005), fn. 9, at p. 562. V. Ruiz Almendral, *El fraude a la ley tributaria a examen. Los problemas de aplicación práctica de la norma general anti-fraude del artículo 15 de la LGT a los ámbitos nacional y comunitario* (Pamplona, Aranzadi, 2006), at 79.

[25] We take the translation from: Ruiz Almendral (2005), fn. 9, at p. 563.

as would follow from a legal construction that is appropriate to the economic circumstances."[26].

As we stated before the teleological element does not appear as an explicit application requirement in these and similar GAARs. Nevertheless as we try to demonstrate it is a "hidden" element in every tax avoidance solution. It is a widespread opinion among European scholars that GAARs are nothing different from application by analogy or teleological reduction[27] of the avoided or applied provisions[28]. If this finding is correct, the existence of a teleological element seems to be evident taking into account that both analogy and teleological reduction require a purposive analysis. Nevertheless we do not think it is necessary to resort to these thoughts in order to prove the teleological element inherent to GAARs[29]. To reflect on the very nature of the tax avoidance phenomenon will be more than enough.

As has been stated, tax avoidance schemes make use of the relation between the words of a provision and its purpose (the ability to pay which is supposed to be taxed). In the case of avoided tax provisions, the letter of the statute is not fulfilled but the abusive act or arrangement falls within the purpose of the provision. Alternatively, in using beneficial tax provisions, the relation works the other way round: the letter of the statute is fulfilled but the abusive act or arrangement does not fall within the purpose of the beneficial provision[30]. Therefore, the teleological element is just a logical requirement. We might not detect any kind of avoidance if an arrangement falls within the purpose of a provision (*i.e.* according to the purpose of a beneficial statute the arrangement should be benefited or according to the purpose of a burdensome provision the arrangements should not be taxed).

For that reason one should agree with the *Halifax* ruling and the Opinion of Mr Advocate General Poiares Maduro, at least on the whole, when requiring a teleological element as a part of the avoidance test. Nevertheless, the question becomes more problematic if we analyze the facts and the "avoided/ applied provisions" in *Halifax.*

3. Applied and avoided provisions in *Halifax.* Is there any purpose in the limitation of the right to deduct?

The facts in *Halifax* match perfectly with the second avoidance structure defined above: the taxpayer accrues a tax advantage by causing application of beneficial tax provisions. Ordinarily Halifax would only have been able to recover a 5% of the VAT incurred on

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[26] We take the translation from: V. Thuronyi, "Rules in OECD Countries to Prevent Avoidance of Corporate Income Tax". Available at: http://www.mof.go.jp/english/soken/jst2002p3.pdf (last visit: July, 31, 2008).

[27] For an explanation of the concept of teleological reduction see: C.W. Canaris, "Die Festellung von Lücken im Gesetz" (2nd ed. Berlin, Duncker & Humblot, 1983), at 132 et seq.

[28] See with further references from German and Spanish commentators: K. Tipke, "Die Steuerrechtsordnung. Band III: Föderative Steuerverteilung , Rechtsanwendung und Rechtschutz, Gestalter der Steuerrechtsordnung (Köln, Dr. Otto Schmidt, 1993), at 1325 et seq. V. Ruiz Almendral and G. Seitz, "El fraude a la ley tributaria (Análisis de la normas española con ayuda de la experiencia alemana" (2004) 257-258 *Estudios Financieros. Revista de Contabilidad y Tributación* 20 et seq.

[29] Specially being this a controversial issue. For the discussion in Germany between the followers of the *Innentheorie* and *Außentheorie* see: P. Fischer, "§ 42 Missbrauch von rechtlichen Gestaltungsmöglichkeiten" in Hübschmann, Hepp, Spitaler (eds.) *Kommentar zur Abgabenordnung und Finanzgerichtsordnung* (Otto Schmidt, Köln, 1951/2006) at § 42, Rz. 77 et seq, Lfg. 197 März 2008.

[30] K Tipke (1993), fn 28, at 1324.

the purchase of construction related supplies, since the majority of his services were exempt. The insertion of additional companies enabled Halifax to recover all the input VAT incurred[31]. In that context it was logical for the ECJ and the AG to analyze the purposes and the objectives of the Sixth Directive governing the right to deduction.

AG Poaires Maduro points out in his opinion:

> "*The right of a taxable person to deduct from the output VAT payable the input VAT incurred for making the taxable supplies constitutes a corollary of the principle of neutrality. Correspondingly the same principle requires that a taxable person must not be entitled to deduct or recover the input VAT paid on supplies received for its exempted transactions"*[32].

The ECJ indicates along the same line:

> "*It must be borne in mind that the deduction system under the Sixth Directive is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures complete neutrality of taxation of all economic activities.* […] *Article 2 of First Council Directive…and article 17 (2), (3) and (5) of the Sixth Directive must be interpreted as meaning that, in principle, the existence of a direct and immediate link between a particular input transaction and a particular output transaction…is necessary before the taxable person is entitled to deduct input VAT.* […] *To allow taxable persons to deduct all input VAT even though, in the context of their normal commercial operations, no transactions conforming with the deduction rules of the Sixth Directive or of the national legislation transposing it would have enabled the to deduct such VAT, or would have allowed the to deduct only a part, would be contrary to the principle of fiscal neutrality and, therefore, contrary to the purpose of these rules*".

Even if some of these arguments might be accepted, several logical weaknesses should be pointed out:

a) The exposed purposive analysis could be considered incomplete. By every rule-catch avoidance structure the teleological element must be analysed in relation to different provisions: firstly in relation to the applied provision (*i.e.,* in our case, the one regulating the right of a taxable person to deduct input VAT incurred) this analysis has been carried out by the ECJ and the AG; but secondly, and perhaps more important, the avoided provision should also to be considered. However, in *Halifax* we cannot find even a single reference to the purpose of the rules limiting the right to deduct when exemptions apply. As we might see later, this analysis could have been an arduous task[33], since these rules simply lack purpose.

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[31] The "catch-avoidance strategy" normally involves an ordinary avoidance behaviour. In Halifax, in order to recover all the input VAT incurred (VAT deduction rule caught) the rule limiting tax deduction for exempt activities must be avoided.

[32] Paragraph 93 of the Advocate General's opinion.

[33] As stated by some commentators: R. de la Feria, "The European Court of Justice's solution to aggressive VAT planning – further towards legal uncertainty?" [2006] *EC Tax Review* 27 at 32.

b) As stated before, the Sixth Directive ensures neutrality of taxation entitling taxable persons to deduct all input VAT incurred in the course of their economic activities, provided that they are themselves subject to VAT. But this does not mean that where economic activities are totally or partially VAT exempt, a right to deduct all input VAT would be contrary to the principle of fiscal neutrality. In fact, the ECJ and AG Poiares have not put forward a single argument for this supposed violation. The only grounds for the "neutrality argument" is to be found in the decision of the VAT and Duties Tribunal in *Halifax* when considering that as the appellant in that case enabled itself "*to build call centres more cheaply than any other bank or financial institution that did not adopt a comparable tax avoidance scheme which in turn, enabled it to provide services to its costumers more cheaply than its non-tax avoiding competitors*"[34]. Several arguments have been set out against this finding[35]. Nevertheless, we will focus on the most important one which is inextricably linked to the *leit motive* of this article: the purpose –more precisely the lack of it- of the rules limiting the right to deduct when exemptions apply.

As we have stated before, the ECJ and the AG Poiares focus on the neutrality principle as the only scope of the whole VAT system, in general, and the right to deduct in particular. This way of thinking ignores the fact that VAT is a tax on consumption[36] treating and constructing it, in a certain way, as a "tax on enterprises"; and, what is worse, it leads to the fallacy of "neutrality (equality) in unfairness". The reasoning, in short, might be the following: given that some taxable persons might not deduct the input VAT paid on supplies received for its exempted transactions, every taxable person performing VAT exempted transactions must be denied the right to deduct. And hence we arrive to the real key issue of the *Halifax* case *i.e.* the rule limiting the right to deduct when exemptions apply.

When a taxable person performing exempt transactions is legally denied the right to deduct input VAT paid, two things might occur:

a) The taxable person might not be able to charge non-deductible VAT in price, turning thereby into *de facto* final consumer and frustrating the very nature of VAT[37].

b) The taxable person might be able to charge non-deductible VAT in the price. In this case we would also have a range of possibilities.

If the exempt transaction is located in the last stage of production or distribution, with non-deductible VAT charged in price, the final consumer is taxed with "silent VAT". This frustrates the scope of exemptions that become, as have been named by German

[34] Quoted by: Ridsdale, "Abuse of rights, fiscal neutrality and VAT" [2005] *EC Tax Review* 82 at 90.
[35] Ridsdale, "Abuse of rights, fiscal neutrality and VAT" [2005] *EC Tax Review* 82 at 88 *et seq.* R. de la Feria, "The European Court of Justice's solution to aggressive VAT planning – further towards legal uncertainty?" [2006] *EC Tax Review* 27 at 32.
[36] See the excelent ECJ case law summary about this issue in: L. Dobratz, *Leistung und Entgelt im Europäischen Umsatzsteuerrecht* (Otto Schmidt, Köln, 2005) at 22 et seq.
[37] Nevertheless, as German scholars have indicated, this is an unlikely case: H.G. Ruppe, "Unechte Umsatzsteuerbefreiung", in Die Steuerrechtsordnung in der Diskussion. Festschrift für Klaus Tipke zum 70. Geburtstag (Otto Schmidt, Köln, 1995) at 461. W. Reiβ, "Einführung UStG", in Reiβ, Kraeusel, Langer (eds.) *Umsatzsteuergesetz. Kommentar* (Stollfuβ, Stuttgart, 1995) at Band I, Rz. 46, Erg.-Lfg./Dezember 2007. H. Stadie, "Einführung zum Umsatzsteuer", in Rau, Dürrwachter, Flick, Geist (eds.) Umsatzsteuergesetz Kommentar (Otto Schmidt, Köln, 2007) at Band I, Rz. 133, Lfg. 129 Februar 2007.

scholars, false exemptions (*unechte Steuerbefreiungen*)[38]. In fact the exemption is just limited to the value added by the taxable person who performs the exempt transaction[39].

If, on the other hand, the exempt transaction is located in an intermediate stage of production or distribution it may generate a tax cascading effect. If a taxable person performs a taxed supply to another taxable person who performs exempt transactions, this will charge non-deductible VAT in price to the next trader. In the next stage (subject to tax and last in the chain) a taxable person will charge VAT to the final consumer calculating the tax base proportionally to the price which includes VAT charged by the previous trader[40]. This might generate a "tax on tax effect" whose avoidance was one of the basic reasons behind the introduction of a Community VAT system[41].

Therefore, whatever the behaviour of the taxpayer performing exempt transactions may be, the limitation of the right to deduct will lead to consequences that conflict with well established VAT tax principles. This limitation of the right to deduct has been consequently considered contrary to the very purpose of the VAT-system (*systemwidrig*)[42]. And these inconsistencies might be even worse in the *Halifax* case, taking into account the common idea that exemptions for financial services are due to the lack of consumption by which they are characterized[43].

Thus arises the difficulty in applying the teleological element to the *Halifax* case. Which is the goal of the rules limiting the right to deduct when exemptions apply? The search will be unsuccessful[44], unless we assume that this limit has been stated with a view to raising revenue or, in other words, with a view to recovering the loss of revenue associated normally to any tax exemption. And the question is: is the pure revenue-raising goal appropriate for a teleological analysis? This will be considered in the next paragraph.

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[38] Using this term: : H.G. Ruppe, "Unechte Umsatzsteuerbefreiung", in Die Steuerrechtsordnung in der Diskussion. Festschrift für Klaus Tipke zum 70. Geburtstag (Otto Schmidt, Köln, 1995) 457.

[39] H. Stadie, "Einführung zum Umsatzsteuer", in Rau, Dürrwachter, Flick, Geist (eds.) Umsatzsteuergesetz Kommentar (Otto Schmidt, Köln, 2007) at Band I, Rz. 133, Lfg. 129 Februar 2007.

[40] A graphic example might be found in: W. Reiβ, in Tipke, Lang (eds.) *Steuerrecht.* 18th ed. (Otto Schmidt, Köln, 2005), at 599.

[41] R. de la Feria, "The European Court of Justice's solution to aggressive VAT planning – further towards legal uncertainty?" [2006] *EC Tax Review* 27 at 32.

[42] This is a common assumption among German scholars: W. Reiβ, in Tipke, Lang (eds.) *Steuerrecht.* 18th ed. (Otto Schmidt, Köln, 2005), at 598. W. Reiβ, "Einführung UStG", in Reiβ, Kraeusel, Langer (eds.) *Umsatzsteuergesetz. Kommentar* (Stollfuβ, Stuttgart, 1995) at Band I, Rz. 26, Erg.-Lfg./Dezember 2007. . H. Stadie, "Einführung zum Umsatzsteuer", in Rau, Dürrwachter, Flick, Geist (eds.) Umsatzsteuergesetz Kommentar (Otto Schmidt, Köln, 2007) at Band I, Rz. 200, Lfg. 129 Februar 2007 (and literature quoted there). P. Kirchhof , "40 Jahre Umsatzsteuergesetz – Eine Steuer im Umbruch" [2008] *Deutsches Steuerrecht* 1 at 8.

[43] This is a highly disputed issue but several financial services are considered not to be consumptive but just a preparation for consumption. See: H. Friedrich-Vache, "Plädoyer für die Abschaffung unechter Befreiungen im Finanzdienstleistungsbereich – Mit Ausnahme der Verwahrung im Einlagengeschäft" [2006] *Umsatzsteuer-Rundschau* 207 at 208 et seq.

[44] See in fact the "ground" offered by the German legislator in *Umsatzsteuergesetz 1967*: "*The exempt taxable person cannot be granted the right to deduct, appart from exceptions, because it seems inappropriate recovering VAT incurred in previous production stages, in sectors which do not perform taxable transactions*" (quoted according to: H.G. Ruppe, "Unechte Umsatzsteuerbefreiung", in Die Steuerrechtsordnung in der Diskussion. Festschrift für Klaus Tipke zum 70. Geburtstag (Otto Schmidt, Köln, 1995) at 458). The tautology seems evident.

4. Pure-revenue raising provisions and tax avoidance.

It is unusual for a tax provision to lack purpose. Therefore, tax scholars have not dealt with this problem very often. A general construction on this issue is not to be found among tax literature.

One option could be to consider the crude revenue raising purpose and come to the conclusion that the proper interpretation is that which leads to a highest tax collection. This reasoning, similar to the classical *in dubio pro fisco*, seems totally unacceptable under logical and legal consideration[45]. Another option must be sought.

In the late 1970s some German scholars developed a tax application theory which might be useful, if correctly understood, for the purposes of the *Halifax* case. The foundation upon which this theory is based seems easy: tax law provisions, save for regulatory and procedural ones, lack purpose apart from raising revenue. In this context, teleological interpretation seems to be excluded for tax law purposes[46]. The key issue is then to understand the consequences of this lack of purpose for the application of tax law provisions.

Even if there is no unanimous consensus among scholars on the consequences of this particular view of tax provisions, most of them point out that a lack of purpose must lead to a special significance of "written law" in their interpretation[47]. It is far from clear

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[45] It has been in fact a common criticism to teleological interpretation of tax laws: K. Vogel, "Die Besonderheit des Steuerrechts" in [1977] *Deutsche Steuer Zeitung* 5 at 9. G. Crezelius, *Steuerrechtliche Rechtsanwendung und allgemeine Rechtsordnung. Grundlagen für eine liberale Besteurungspraxis* (Neue Wirtschafts-Briefe, Berlin, 1983) at 128. K. Vogel, „Grundzüge des Finanzrechts des Grundgesetzes*"* in *Handbuch des Staatsrechts der Bundesrepublik Deutschland. Band IV Finanzverfassung – Bundestaatliche Ordnung* (J. Isensee and P. Kirchhof (eds.), 2nd ed., Müller, Heidelberg, 1999) at 51. K.D. Drüen, "Zur Rechtsnatur des Steuerrechts und ihrem Einfluß auf die Rechtsanwendung" in *Festschrift für Heinrich Wilhelm Kruse zum 70. Geburtstag* (Otto Schmidt, Köln, 2001) at 200.

[46] H.W. Kruse, "*Steuerzpezifische Gründe und Grenzen der Gesetzesbindung*" in *Grenzen der Rechtsfortbildung durch Rechtsprechung und Verwaltungsvorschriften im Steuerrecht* (K. Tipke ed., Otto Schmidt, Köln, 1982) at 73. K. Vogel, "Die Besonderheit des Steuerrechts" in [1977] *Deutsche Steuer Zeitung* 5 at 8 et seq. G. Crezelius, *Steuerrechtliche Rechtsanwendung und allgemeine Rechtsordnung. Grundlagen für eine liberale Besteurungspraxis* (Neue Wirtschafts-Briefe, Berlin, 1983) at 128. K, Vogel, "Das ungeschriebene Finanzrecht des Grundgesetzes" in *Gedächnisschrift für Wolfgang Martens*. (De Gruyter, Berlin, 1987) at 268 et seq. K. Vogel, "Vergleich und Gesetzmäβigkeit der Verwaltung im Steuerrecht" in *Handelsrecht und Steuerrecht. Festschrift für Dr. Dr. h.c. Georg Döllerer.* (IDW, Düsseldorf, 1988) at 683 et seq. K. Vogel, „Grundzüge des Finanzrechts des Grundgesetzes*"* in *Handbuch des Staatsrechts der Bundesrepublik Deutschland. Band IV Finanzverfassung – Bundestaatliche Ordnung* (J. Isensee and P. Kirchhof (eds.), 2nd ed., Müller, Heidelberg, 1999) at 48 et seq. K.D. Drüen, "Zur Rechtsnatur des Steuerrechts und ihrem Einfluß auf die Rechtsanwendung" in *Festschrift für Heinrich Wilhelm Kruse zum 70. Geburtstag* (Otto Schmidt, Köln, 2001) at 200.

[47] K, Vogel, "Das ungeschriebene Finanzrecht des Grundgesetzes" in *Gedächnisschrift für Wolfgang Martens*. (De Gruyter, Berlin, 1987) at 270. K. Vogel, "Vergleich und Gesetzmäβigkeit der Verwaltung im Steuerrecht" in *Handelsrecht und Steuerrecht. Festschrift für Dr. Dr. h.c. Georg Döllerer.* (IDW, Düsseldorf, 1988) at 684. K. Vogel, „Grundzüge des Finanzrechts des Grundgesetzes*"* in *Handbuch des Staatsrechts der Bundesrepublik Deutschland. Band IV Finanzverfassung – Bundestaatliche Ordnung* (J. Isensee and P. Kirchhof (eds.), 2nd ed., Müller, Heidelberg, 1999) at 49. In relation to the *Halifax* case: P. Brennan, "Why the ECJ Should Not Follow Advocate General Maduro's Opinion in *Halifax*" [2005] *International VAT Monitor,* Juli-August 247 at 248.

what "written law" or "wording" means in a legal context[48], but I think we should consider these expressions equivalent to private law concepts and formal structures in contrast to autonomous tax law concepts and material (economic) constructions.

We cannot share this construction and its consequences in layman's terms. The purpose of tax provisions is not just raising revenue but doing it in a certain way. And hence "secondary goals" come into play. As stated before, VAT is based upon several principles, among which its legal character as tax on consumption might play a significant role. Even in taxes whose relation to the ability to pay principle must be considered remote, secondary goals exist. They indicate the way in which tax legislators intend to distribute the tax burden and, consequently, provide operators with purposes that are suitable for a teleological interpretation. But, for the above mentioned reasons, rules limiting the right to deduct when exemptions apply lack these secondary goals and are even inconsistent with established VAT principles. If this is true, there is only one remaining solution: the avoided and applied provisions must be interpreted formally. This solution, which entails the impossibility of correcting the operations carried out in *Halifax* and similar cases, must be considered both logical and unsatisfactory.

"Unsatisfactory" because only a few taxpayers might be enabled to resort to knowledge and skills necessary to set up complicated tax avoidance schemes. This gives rise to inequalities, distortions and, in a nutshell, to the well known phenomenon of "silly taxes" (*Dummensteuern*) *i.e.* taxes that are only paid by misinformed or non advised taxpayers[49]. Nevertheless, in cases involving rules limiting the right to deduct when exemptions apply, the ECJ's approach does not seem well-founded and, as it has been stated, it shifts the burden of the problem from the legislator to the tax payer, deterring Member States from taking appropriate measures against the causes of aggressive VAT planning[50].

In short, we should finish this contribution as we started it: bad laws make hard cases.

[48] We do not think a literal interpretation criterion exists. The words of a single provision represent the starting point for its interpretation. At most cases words might be polysemous, so a single provision might be attributed different meanings. Which of those is to be considered "literal" or "written"?

[49] About the concept of "silla taxes" see: G. Rose, "Über die Enstehung von "Dummensteuern" un ihre Vermeidung" in Die Steuerrechtsordnung in der Diskussion. Festschrift für Klaus Tipke zum 70. Geburtstag (Otto Schmidt, Köln, 1995) at 153 et seq.

[50] Feria, "The European Court of Justice's solution to aggressive VAT planning – further towards legal uncertainty?" [2006] *EC Tax Review* 27 at 34.