OPINION OF MR ADVOCATE GENERAL DARMON
delivered on 2 December 1987 *

Mr President,
Members of the Court,

1. This action against Ireland for failure to fulfil its obligations concerns the criteria for the application of Article 28 (2) of the Sixth Council Directive 77/388 of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes [1] (hereinafter referred to as 'the directive'). The essence of the claim is that Ireland applies to certain categories of goods and services [2] contained in a list laid down by the Value-Added Tax Act 1972 [3] a 'zero rate' which is not justified for 'clearly defined social reasons and for the benefit of the final consumer', as required by the last indent of Article 17 of the Second Council Directive of 11 April 1967 [4] (hereinafter referred to as Article 17), to which Article 28 (2) of the Sixth Directive refers.

2. That provision was adopted as part of a process initiated in April 1967, when the first two directives on the harmonization of legislation concerning turnover taxes [5] were adopted. Although 'the rates and exemptions [were] not harmonized at the same time' [6] the result was the establishment of a 'general tax on consumption'. [7] The Sixth Directive, [8] adopted 10 years later, had as its aim an essential objective, the creation of 'own resources' for the Communities, which were to include 'those accruing from value-added tax and obtained by applying a common rate of tax on a *basis of assessment determined in a uniform manner* according to Community rules'. [9]

3. 'So that the Communities' own resources may be collected in a uniform manner in all the Member States' [10] Articles 13 to 16 of the directive lay down a list of exemptions common to all the Member States. However, on a transitional basis Article 28 of the directive allows them to retain, under certain conditions, *inter alia* the reduced rates and exemptions which were in force on 31 December 1975 and satisfy the criteria set out in Article 17. That possibility was left open on the ground that it was '*vital* to provide for a *transitional period* to allow national laws in *specified fields* to be *gradually adapted*'. [11]

* Translated from the French.

1 — 'Common system of value-added tax: uniform basis of assessment', OJ L 145, 13.6.1977, p. 1.

2 — The action concerns certain agricultural inputs (feeding-stuffs for animals other than domestic pets, certain fertilizers supplied in units of not less than 10 kg, medicines for the oral consumption of animals other than domestic pets, and seeds and other products used for sowing in order to produce food) and supplies of electricity other than to the final consumer.

3 — As amended most recently by the Finance Act 1985.

4 — Directive 67/228 on the harmonization of legislation of Member States concerning turnover taxes — 'Structure and procedures for application of the common system of value-added tax' (hereinafter referred to as VAT). Official Journal, English Special Edition 1967, p. 16; hereinafter referred to as 'the Second Directive'.

5 — First Council Directive of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes (67/227), Official Journal, English Special Edition 1967, p. 14; Second Directive, cited above.

6 — Eighth recital in the preamble to the First Directive.

7 — Article 2 (1) of the First Directive.

8 — The third, fourth and fifth directives merely delayed the introduction of the common VAT system.

9 — Second recital in the preamble to the Sixth Directive (my emphasis).

10 — Eleventh recital in the preamble to the Sixth Directive.

11 — Nineteenth (last) recital in the preamble to the Sixth Directive; my emphasis.

4. Although it was adopted on the basis of Article 28 (2), the system of zero-rating at issue differs from the exemption mechanism provided for in that article. That is to say, Article 28 provides for exemption 'with refund of the tax paid at the preceding stage' which takes effect at the retail stage. At the preceding stage every taxable person as defined in Article 4 of the directive must apply the tax. Only a retailer who sells an exempted product to a 'final consumer' does not pass on the VAT which he has paid but obtains a refund from the tax authorities. The zero-rating system takes a different approach. A list of goods and services designated by the national legislature is subject to purely notional taxation, under which no VAT is actually charged either on delivery or at earlier stages in the marketing chain. Naturally, there is nothing to refund to the retailer. According to the Commission, some 33% of the private consumption of households is zero-rated in Ireland. Ireland disputes that percentage and states that the real figure is 25%. The figure in the United Kingdom is 35%. The zero-rating technique exists in three other States, but they operate it only on a very small scale, largely in favour of the press.

5. Let me state right away that the system itself is not challenged by the Commission, which considers it to be equivalent to the system of exemption and refund. However, the Commission disputes the application of zero-rating to the goods and services referred to above [12] on the ground that it does not comply with the criteria laid down in Article 17. While it admits that zero-rating has no effect on own resources, it states that 'in the context of the completion of the internal market, of the abolition of fiscal frontiers . . .' its aim is to 'limit the use of zero rates to those transactions which meet the criteria laid down in Article 28 (2) of the Sixth Directive and this as part of its overall fiscal policy of working towards the total phasing out of all zero rates or exemptions with refunds'. It considers that 'zero rates constitute one of the stumbling blocks on the path towards a uniform rate of VAT'.

6. According to the Commission, in determining how far up the commercial chain zero-rating may be applied if it is to benefit the final consumer, only stages corresponding to '*bona fide* inputs' in the production or distribution of a final product which may be exempted in accordance with the criteria laid down in Article 28 (2) may be taken into account. It submits that the agricultural inputs at issue are not intended for the final consumer and can be regarded only as indirect agricultural inputs. It further argues that only the person who acquires the goods or services without having any right of deduction may be regarded as the final consumer.

7. In its pleadings Ireland did not dispute the Commission's interpretation of the term 'final consumer', although in its letter of 23 July 1982, in the course of the administrative proceedings, it stated that that interpretation was too narrow and not 'necessarily correct'. It argues first of all that zero-rating is justified where, having regard to the commercial circumstances, there is a benefit, even an indirect one, for the final consumer. In any event, in so far as the agricultural inputs at issue are concerned,

12 — See note 2, above.

there is a direct benefit for producers who consume the produce of their farm. Secondly, Ireland argues that the determination of appropriate measures in response to clearly defined social reasons is a matter for its discretion. It observes that the exercise by the Court of supervisory power seems 'very difficult' in that respect. The Commission does not deny that Ireland has such a discretion. It argues, however, that it is for the Court to define the phrase 'clearly defined social reasons' for Community purposes and to determine whether national measures are compatible with that concept.

8. However, in its defence Ireland relies mainly on Article 27 (5) of the Sixth Directive (hereinafter referred to as Article 27). That provision allows Member States to retain special derogating measures of the kind referred to in Article 27 (1), provided that they were notified to the Commission before 1 January 1978, in order 'to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance'. Ireland argues that that provision is sufficient to justify zero rates on agricultural inputs and also, in an alternative submission, on supplies of electricity. The Commission considers in essence that from the point of view of their scope *ratione materiae*, the cumulative application of Articles 27 and 28 (2) is not possible. In particular, Article 27 cannot be used in order to escape the rules laid down in Article 28 (2).

9. Finally, in its rejoinder Ireland submitted generally that the Commission was improperly seeking to use an action against it for alleged failure to fulfil its obligations as a means of evading the provisions of Article 28 according to which it is for the Council, acting unanimously, to decide to abolish the exemptions permitted by that article. It observes that the Commission has stated that the Irish method of zero-rating 'impedes progress towards further harmonization in the VAT sphere'. It regards that argument as a political one. It also points out that when it instituted these proceedings the Commission had not submitted to the Council a proposal for progressive abolition. It may be noted in that regard that such a proposal was submitted while these proceedings were in progress. [13]

10. Let me say right away that these objections concerning the Commission's possible motives for bringing the action do not seem relevant to the role of the Court. It scarcely needs pointing out that the decision whether or not to bring an action against a Member State for failure to fulfil its obligations is in any event in the entire discretion of the Commission, as the custodian of the Treaties, and that it is for the Commission 'to judge at what time it shall bring an action before the Court'. [14] Moreover, the role of the Court in proceedings of this kind is to determine whether or not a Member State has failed to fulfil its obligations towards the Community as defined by the law in force. It should be recalled in that regard that in *Parliament* v *Council*, where the Council contended that the Parliament was using the action for failure to act as a means of furthering political objectives, the Court held that:

'It is not possible to restrict the exercise of that right [to bring an action for failure to act] by one them [the Community institutions] without adversely affecting its status as an institution under the Treaty'. [15]

13 — OJ C 250, 18.9.1987, p. 2.

14 — Judgment of 10 December 1968 in Case 7/68 *Commission* v *Italy* [1968] ECR 423.

15 — Judgment of 22 May 1985 in Case 13/83 [1985] ECR 1513, at p. 1556.

Rejecting the objection of inadmissibility raised in that respect by the Council, the Court followed the Opinion of the Advocate General, who had stated:

'It is not for this Court to decide whether the action has political objectives. An action is being prosecuted before the Court according to the rules of procedure on a question of law, namely the scope of the duties of a Community institution. The action will be decided according to the relevant provisions, namely those of the Treaty establishing the European Economic Community of 25 March 1957. It is prosecuted in the interests of the Community and its legal system for the purpose of obtaining a binding ruling on the scope of the rights and obligations of the parties'. [16]

Such statements of principle, emphasizing the objective nature of actions brought before the Court, make possible a correct assessment of the weight of the arguments submitted in that respect by Ireland. Although the Commission did refer in rather general terms to the interests which it considered to be at issue in this case, the fact remains that its action is directed unambiguously at a failure to comply with Article 28 of the Sixth Directive in conjunction with Article 17 of the Second Directive. It is obviously on the basis of those provisions alone, subject to the possible application of Article 27, that the Court can determine whether or not Ireland has failed to fulfil its obligations, since although the Sixth Directive states expressly that it is for the Council to abolish the exemptions established under Article 28, their retention until such abolition depends on their conformity with that provision. The next step must therefore be to examine that issue.

16 — Opinion of Mr Advocate General Lenz delivered on 7 February 1985 in Case 13/83 [1985] ECR 1515, at p. 1518.

I — Measures taken for clearly defined social reasons and for the benefit of the final consumer

11. Let me emphasize right away that 'clearly defined social reasons' and 'benefit of the final consumer' are not alternative conditions. One of them concerns the objective of the measures in question, the other its beneficiaries. They are therefore cumulative. Moreover, a provision creating an exception to the rules on the uniform basis of assessment for VAT cannot be construed liberally.

A — *'Clearly defined social reasons'*

12. The parties are agreed that the determination of their own social policy is a matter for the discretion of the Member States. The Commission considers, however, that it is for the Court to lay down a definition for Community purposes of the phrase 'clearly defined social reasons' and, where necessary, to hold that the measures adopted are not sufficiently well defined or are unjustified or disproportionate in relation to the reasons relied on.

13. The application of zero-rating may result in a reduction of the tax burden on the least well-off segments of society. It is equally conceivable, however, that the Member States should also use fiscal instruments in order better to satisfy the needs of the great majority of the population. With regard to the concept at issue, moreover, I do not think that it is the role

of the Court to review the expediency of choices made by the Member States. With reference to the 'public morality' exception to the rules on the free movement of goods, the Court has held that:

'In principle, it is for each Member State to determine in accordance with its own scale of values and in the form selected by it the requirements of public morality in its territory'. [17]

I propose that the Court take the same approach in this case. That is to say, if it is accepted that the Member States can restrict that fundamental freedom in the manner described, it must be possible to accord them, without thereby endangering to any greater extent the consistency of the Community legal system, a similar latitude with regard to provisional exceptions to rules establishing a uniform basis of assessment for VAT.

14. However, compliance with the directive in question requires that the Court should be able to intervene in the event that the exercise by the Member States of their powers in the matter, where it has no relation to the field at issue, might frustrate the Community provision itself. I therefore suggest that the Court should declare measures contrary to Community law only where their objective is clearly unrelated to the satisfaction of the fundamental needs, be they individual or collective, of the population of the Member State.

B — *The final consumer*

15. In my view the final consumer must be defined as the person who acquires goods or services for his personal use, as opposed to an economic activity, which Article 4 of the directive uses as the criterion for determining who is a taxable person. The distinction between a taxable person and a final consumer lies in the fact that a taxable person carries out transactions for consideration, while a final consumer is one who acquires goods or services for his own use. That distinction has fundamental consequences for tax purposes: in principle a taxable person deducts VAT, whereas a final consumer bears that tax 'unless there is a further transaction in which a price is paid'. [18] That consequence cannot be ignored in the case of a zero rate. In such a case the final consumer is the person who would have to bear a positive tax and would not be able to deduct it. That definition is not, I think, based on a narrow approach; it corresponds strictly to a fiscal interpretation, the only one which, in the context of provisions on VAT, is appropriate to the categories relevant to such taxation. It is, moreover, that which appears in Article 3 of the proposal for a 16th VAT directive: [19]

'For the purposes of this directive:

(a) "final consumer" means:

(1) any person who, with regard to the importation of goods referred to in Article 2, is not deemed to be a taxable person within the meaning of Article 4 of Council Directive 77/388/EEC;

17 — Judgment of 14 December 1979 in Case 34/79 *Regina* v *Henn and Darby* [1979] ECR 3795.

18 — Judgment of 1 April 1982 in Case 89/81 *Staatssecretaris van Financiën* v *Hong Kong Trade Development Council* [1982] ECR 1277, at paragraph 9.

19 — OJ C 226, 28.8.1984, p. 2.

(2) a taxable person who was not entitled to deduct value-added tax when purchasing goods.'

C — *'For the benefit' of the final consumer: the concept of a benefit*

16. It remains for me to consider the concept of a 'benefit' as used in Article 17, where it speaks of exemptions 'for the benefit of the final consumer'. In the case of a 'normal' exemption, such a benefit results from the non-application of VAT at the retail stage. In essence, the benefit is entirely identical under the zero-rating system: the consumer pays no VAT. The application of zero-rating at earlier stages of distribution results in no additional fiscal benefit for the consumer since he does not pay the tax in any event. However, as the Commission says, zero-rating may be accepted higher in the commercial chain in so far as it is applied to the product itself which is zero-rated on purchase by the final consumer.

17. Can we go further and accept Ireland's submission that an indirect benefit results from the application of zero-rating to inputs used to produce goods which are themselves zero-rated? It should be emphasized that from the fiscal point of view such a benefit does not exist once a zero rate is applied on purchase by the final consumer. That is to say, the extension of zero-rating higher up the commercial chain has no effect on the fiscal burden on the consumer, who in any event benefits from a zero rate. The only benefit for him, therefore, lies in a possible reduction in the cost of the product resulting from a reduction in cash outlays and overheads in the absence of positive rates of tax on the inputs concerned. I think, however, that these consequences, which are revealed by an economic analysis, should be regarded with prudence in so far as they vary according to the time-limits for deductions, the size and structure of the producers or dealers in question, credit arrangements between them, etc. The complexity of such effects requires, in my opinion, a degree of caution in that respect in considering the notion of a 'benefit' for the final consumer for the purposes of Article 17. However, in so far as the very existence of a reduction in production costs is likely to result in a benefit for the final consumer, albeit a variable one, I propose that the Court should not reject, as a matter of principle, the zero-rating of inputs which are directly and exclusively used in a product which itself is properly zero-rated.

18. Now that the conditions laid down in the provision at issue have been defined, we may determine whether or not the contested measures comply with them.

II — The contested zero rates

A — *Agricultural inputs*

19. At issue, it should be remembered, are feedingstuffs for animals other than domestic pets, medicines for oral consumption by the same animals, most fertilizers supplied in units of not less than 10 kg, and seeds and other products intended to be sown in order to produce food.

20. There is no dispute with regard to the fact that food is zero-rated. Ireland states

that farm households account for as much as a quarter of the total population of the State, and that the zero-rated goods in question are direct inputs in the production of food which is in part consumed by the producers themselves. Such home consumption, estimated by Ireland at up to 9% of total output, seems all the more likely inasmuch as there are many small farms. It seems undeniable that positive taxation would have the effect of increasing costs in respect of that portion of final consumption. Ireland further submits that if a positive rate of VAT were imposed on the inputs in question producers might increase their prices in order in particular to make up for the cash-flow loss incurred as a result of having to wait to obtain flat-rate compensation. Such a consequence cannot be excluded out of hand. Furthermore, since these inputs are in my view used directly and exclusively for food, I suggest that the Court accept that zero-rating results in an indirect benefit for the final consumer, having regard to the 'sensitive' nature of retail food prices. I therefore propose that the Court dismiss the Commission's claim in this respect.

B — *Electricity*

21. At issue is the application of a zero rate to electricity supplied to persons other than the final consumer.

22. Ireland argues in essence that the rating for VAT purposes of domestic supplies of electricity, which account for 41% of electricity consumption in Ireland, is inseparable from the rating of non-domestic supplies. The domestic use of electricity is significant enough to justify a zero-rating of all such supplies. It goes on to argue that the application of different rates to the same product would be impractical from a taxation viewpoint, and that there is little point in taxing consumers who are registered for VAT whether electricity is subject to a positive rate or a zero rate. The latter assertion no doubt relates to Ireland's statement that even if a positive rate of tax were applied to the supplies at issue, 80% of electricity consumption would be either zero-rated or entitled to a tax credit.

23. That argument is unconvincing. The industrial and commercial sectors cannot be regarded as 'final consumers'. Because of the zero-rating of supplies for industrial use the final consumer will not, of course, bear the VAT on the electricity used in the manufacture of finished products taxed at the normal rate. However, quite apart from the fact that it is difficult to see what social reasons might account for the zero-rating in question, I think the benefit is too indirect and remote. Moreover, while the Commission may be correct to say that zero-rating remains permissible where it only incidentally benefits a category of goods or users which are not, in principle, entitled to such a measure, that proposition cannot be accepted in respect of supplies of electricity to the entire industrial sector of a Member State. It does not appear impossible, moreover, to distinguish among categories of users of a product and apply different rates of VAT to them depending on their status. I do not think, therefore, that the criteria for the application of Article 28 (2) are fulfilled in this respect.

However, since Ireland has argued, in an alternative submission, that the zero-rating of all supplies of electricity may be justified under Article 27, it is necessary to consider that provision.

III — Article 27 of the Sixth Directive

24. It must be observed first of all that Article 27, which comes under the heading 'simplification procedures', is a permanent provision which does not appear to provide for an exemption. That is to say, a common and exhaustive list of permanent exemptions is laid down in Articles 13 to 16, and the second sentence of Article 27 (1) expressly provides that simplification measures must not, 'except to a negligible extent, ... *affect the amount of tax due at the final consumption* stage'.[20] Although that condition does not seem to apply in respect of measures intended to prevent tax evasion, it may be observed that Ireland also emphasized the simplifying role of the offending measures. Consequently, it cannot be accepted that a permanent measure which does not permit the adoption of a permanent exemption should, as a matter of principle, permit a provisional exemption. That would appear to preclude the zero-rating of supplies of electricity to industry, where the result is that no VAT on such supplies is reflected in the price paid on the purchase by the final consumer of finished products.

25. Furthermore, the provisions of Article 28 with regard to provisional exemptions are exhaustive. Consequently, it would be contrary to Article 28 to establish a provisional exemption not provided for in that article, relying improperly on Article 27. I therefore think that supplies of electricity to the industrial sector cannot be zero-rated on the basis of Article 27. Let me add that if the Court considers that the agricultural inputs at issue do not satisfy the criteria of Article 28 (2), it should hold that they cannot, having regard to the exhaustive nature of that provision, be justified under Article 27 either, it being borne in mind that the application of a zero rate has the effect of eliminating all taxation of products consumed by their producers.

26. I therefore propose that the Court hold that by applying a zero rate to supplies of electricity to users other than final consumers, Ireland has failed to fulfil its obligations under the EEC Treaty and under Article 28 (2) of the Sixth Council Directive of 17 May 1977 (77/388), and that it dismiss the remainder of the action. In view of the latter proposal I suggest that the parties be ordered to bear their own costs.

20 — My emphasis.