JUDGMENT OF THE COURT (Third Chamber)

28 October 2010 *

In Case C-49/09,

ACTION under Article 226 EC for failure to fulfil obligations, brought on 2 February 2009,

European Commission, represented by D. Triantafyllou and K. Herrmann, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Republic of Poland, represented by M. Szpunar, M. Dowgielewicz, M. Jarosz and A. Rutkowska, acting as Agents,

defendant,

* Language of the case: Polish.

THE COURT (Third Chamber),

composed of K. Lenaerts, President of the Chamber, R. Silva de Lapuerta, E. Juhász, J. Malenovský and D. Šváby (Rapporteur), Judges,

Advocate General: J. Kokott,
Registrar: K. Malacek, Administrator,

having regard to the written procedure and further to the hearing on 22 April 2010,

after hearing the Opinion of the Advocate General at the sitting on 10 June 2010,

gives the following

Judgment

1 By its application, the Commission of the European Communities seeks a declaration from the Court that, by applying a reduced value added tax ('VAT') rate of 7 % to supplies, import and intra-Community acquisition of clothing and clothing accessories for babies and of children's footwear, the Republic of Poland has failed to fulfil its

obligations under Article 98 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1), in conjunction with Annex III thereto.

Legal context

European Union legislation

2 Directive 2006/112 repeals and replaces, from 1 January 2007, 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').

3 Article 96 of Directive 2006/112, corresponding to the first subparagraph of Article 12(3)(a) of the Sixth Directive, provides:

'Member States shall apply a standard rate of VAT, which shall be fixed by each Member State as a percentage of the taxable amount and which shall be the same for the supply of goods and for the supply of services.'

4 Under Article 97(1) of Directive 2006/112:

'From 1 January 2006 until 31 December 2010, the standard rate may not be less than 15 %.'

5 Article 98(1) and (2) of that directive is worded as follows:

'1. Member States may apply either one or two reduced rates.

2. The reduced rates shall apply only to supplies of goods or services in the categories set out in Annex III. …'

6 Pursuant to Article 99(1) of Directive 2006/112, the reduced rates are to be fixed as a percentage of the taxable amount, which may not be less than 5 %.

7 Articles 109 et seq. of Directive 2006/112 determine the circumstances in which, as long as definitive arrangements have not been introduced, given Member States may apply different measures in the field of reduced VAT rates. Those measures concern the application of reduced rates lower than 5 %, the retention of reduced rates on goods and services other than those set out in Annex III to Directive 2006/112 and the application of a reduced rate not lower than 12 %.

8 In accordance with Article 114(1) of Directive 2006/112:

> 'Member States which, on 1 January 1993, were obliged to increase their standard rate in force at 1 January 1991 by more than 2% may apply a reduced rate lower than the minimum laid down in Article 99 to the supply of goods and services in the categories set out in Annex III.
>
> The Member States referred to in the first subparagraph may also apply such a rate to restaurant services, children's clothing, children's footwear and housing.'

9 Under Article 115 of Directive 2006/112:

> 'Member States which, at 1 January 1991, were applying a reduced rate to restaurant services, children's clothing, children's footwear or housing may continue to apply such a rate to the supply of those goods or services.'

10 Under Title VIII of Directive 2006/112, entitled 'Temporary provisions', Chapter 5 contains, in Articles 123 to 130, provisions authorising certain Member States which joined the European Union on 1 May 2004 to grant an exemption with deductibility of VAT paid at the preceding stage in respect of the supply of certain goods and to apply a reduced rate of VAT to certain goods.

11 In relation to the Republic of Poland, Article 128 of Directive 2006/112 provides:

'1. Poland may, until 31 December 2007 grant an exemption with deductibility of VAT paid at the preceding stage in respect of the supply of certain books and specialist periodicals.

2. Poland may, until 31 December 2007 or until the introduction of definitive arrangements, as referred to in Article 402, whichever is the earlier, continue to apply a reduced rate of not less than 7 % to the supply of restaurant services.

3. Poland may, until 30 April 2008, continue to apply a reduced rate of not less than 3 % to the supply of foodstuffs as referred to in point (1) of Annex III.

4. Poland may, until 30 April 2008, continue to apply a reduced rate of not less than 3 % to the supply of goods and services of a kind normally intended for use in agricultural production, but excluding capital goods such as machinery or buildings, as referred to in point (11) of Annex III.

5. Poland may, until 31 December 2007, continue to apply a reduced rate of not less than 7 % to the supply of services, not provided as part of a social policy, for construction, renovation and alteration of housing, excluding building materials, and to the supply before first occupation of residential buildings or parts of residential buildings, as referred to in point (a) of Article 12(1).'

12 Those derogations were established in negotiations which gave rise to the Act concerning the conditions of accession to the European Union of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded (OJ 2003 L 236, p. 33) ('the Act of Accession'). They appear in Chapter 9, point 1(a) to (c) of Annex XII to the Act of Accession.

13 Article 24 of the Act of Accession states:

'The measures listed in Annexes V, VI, VII, VIII, IX, X, XI, XII, XIII and XIV to this Act shall apply in respect of the new Member States under the conditions laid down in those Annexes.'

14 Annex XII to the Act of Accession is entitled 'List referred to in Article 24 of the Act of Accession: Poland'. Chapter 9 of that annex, entitled 'Taxation', contains Point 1 which states in the following terms that the rules on the common system of VAT are applicable:

'31977 L 0388: 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 L 145 …, p. 1), as last amended by:

— 32002 L 0038: Council Directive 2002/38/EC of 7.5.2002 (OJ L 128 …, p. 41).

(a) By way of derogation from Article 12(3)(a) of Directive 77/388/EEC, Poland may (i) apply an exemption with refund of tax paid at the preceding stage on the supply of certain books and specialist periodicals, until 31 December 2007, and (ii) maintain a reduced rate of value added tax of not less than 7 % on the supply of restaurant services until 31 December 2007 or until the end of the transitional period referred to in Article 28[l] of the Directive, whichever is the earlier.

(b) By way of derogation from Article 12(3)(a) of Directive 77/388/EEC, Poland may maintain (i) a reduced rate of value added tax of no less than 3 % on foodstuffs (including beverages but excluding alcoholic beverages) for human and animal consumption; live animals, seeds, plants and ingredients normally intended for use in preparation of foodstuffs; products normally intended to be used to supplement or substitute foodstuffs; and on the supply of goods and services of a kind normally intended for use in agricultural production, but excluding capital goods such as machinery or buildings, referred to in points 1 and 10 of annex H to the Directive, until 30 April 2008, and (ii) a reduced rate of value added tax of no less than 7 % on the supply of services, not provided as part of a social policy, for construction, renovation and alteration of housing, excluding building materials, and on the supply before first occupation of residential buildings or parts of residential buildings as referred to in Article 4(3)(a) of the Directive until 31 December 2007.

(c) For the purposes of applying Article 28(3)(b) of Directive 77/388/EEC, Poland may maintain an exemption from value added tax on international transport of passengers referred to in point 17 of Annex F to the Directive, until the condition set out in Article 28(4) of the Directive is fulfilled or for as long as the same exemption is applied by any of the present Member States, whichever is the earlier.'

National legislation

15 In accordance with Article 41 of the Law of 11 March 2004 on value added tax (Dz. U No 54, item 535), as amended ('the Law on VAT'), the standard rate of VAT is 22 %, with certain derogations. By contrast, Article 41(2) of that law provides that, for the goods and services listed in Annex III thereto, the VAT rate is 7 %.

16 Annex III to the Law on VAT lists, under item 45, 'clothing and clothing accessories for babies' and, under item 47,'children's footwear'.

Pre-litigation procedure

17 Considering that the application of a reduced VAT rate of 7 % to supplies, import and intra-Community acquisition of clothing and clothing accessories for babies and of children's footwear is contrary to Article 98 of Directive 2006/112, in conjunction with Annex III thereto, the Commission decided to initiate proceedings for failure to fulfil obligations under Article 226 EC. By letter of 23 March 2007 it invited the Republic of Poland to submit its observations.

18 In its reply of 22 May 2007, the Republic of Poland submitted that the application of a reduced VAT rate to the goods concerned forms part of the measures aimed at supporting families and increasing the birthrate in Poland, which are in line with the objectives of the 'Lisbon Strategy'. It also referred to the application of reduced VAT

rates on those goods in Ireland, Luxembourg and the United Kingdom. Finally, it considered that, in the light of the limited application in time of the reduced rate at issue, there could be no distortion of competition.

19 Since it was not convinced by that reply, the Commission issued a reasoned opinion on 1 February 2008 in which it called on the Republic of Poland to take the measures required to comply with it within two months of the date of receipt.

20 By letter of 31 May 2008, the Republic of Poland reiterated its position.

21 Since the Commission was not convinced by the arguments of the Republic of Poland, it decided to bring the present action.

The action

Arguments of the parties

22 The Commission complains that the Republic of Poland is applying a reduced VAT rate of 7% to supplies, import and intra-Community acquisition of clothing and clothing accessories for babies and of children's footwear, contrary to Article 98 of Directive 2006/112, in conjunction with Annex III thereto.

23 The Commission notes that the purpose of Directive 2006/112 is to harmonise VAT. Since the reduced rate of VAT constitutes an exception to the rule, its application should be limited to the concrete and specific situations clearly referred to in that directive.

24 The Commission points out that Article 98(2) of Directive 2006/112 states unequivocally that the reduced rates apply to supplies of goods only in the categories set out in Annex III thereto and that the directive does not refer to either 'clothing and clothing accessories for babies' or'children's footwear'.

25 The fact that certain Member States maintained a reduced VAT rate for the goods at issue pursuant to both Article 114 and Article 115 of Directive 2006/112 if they were applying that rate at 1 January 1991 does not constitute an argument which also authorises the Republic of Poland to apply a reduced VAT rate to those goods.

26 The Commission submits, primarily, that, by virtue of its ratio legis, Article 115 of Directive 2006/112, which corresponds to Article 28(2)(d) of the Sixth Directive, as amended by Directive 92/77/EEC of 19 October 1992 (OJ 1992 L 316, p. 1), is addressed only to the Member States which formed part of the European Community when Directive 92/77 was adopted, and authorises them, by derogation, to maintain the reduced VAT rates, provided that those rates were applicable in those Member States at 1 January 1991 (see, to that effect, Case C-267/99 *Adam* [2001] ECR I-7467, paragraph 34).

27 It points out that the Republic of Poland was not a Member State when Directive 92/77 was adopted and that the Act of Accession does not state that that Member State is entitled to benefit from the transitional provisions laid down in Articles 114 and 115 of Directive 2006/112 (see, by analogy, Case C-169/00 *Commission* v *Finland* [2002] ECR I-2433, paragraph 30).

28 In the alternative, the Commission submits that the conditions for the application of Article 115 of Directive 2006/112 are not satisfied in any event.

29 First, at 1 January 1991, the tax established by the Law of 16 December 1972 on turnover tax (consolidated text Dz. U of 1983, No 43, item 191), as amended ('the Law of 16 December 1972'), did not constitute VAT for the purposes of Article 115 of Directive 2006/112.

30 Second, the Republic of Poland was not applying a reduced rate to the goods at issue at 1 January 1991.

31 The Republic of Poland submits that, in accordance with European Union law and, in particular, Article 115 of Directive 2006/112, it is entitled to maintain a reduced VAT rate for the goods at issue and that that possibility is strengthened by social considerations which are in line with the general objectives of the European Union.

32 The Republic of Poland maintains that, although the political situation of a Member State during the negotiations of the conditions for its accession may cause that State to indicate *expressis verbis* in the Accession Treaty the categories of exemption which

are particularly sensitive from a social point of view or which give rise to significant debate prior to accession, that cannot, however, support the claim that a Member State which has not had them included in the conditions for the Act of Accession is not able to apply Article 115 of Directive 2006/112.

33 The Republic of Poland asserts that a reduced rate for the sale of goods, including clothing and footwear for children, was applied in Poland at 1 January 1991 in accordance with the Law of 16 December 1972. The VAT scheme in Poland, which was put in place following the entry into force of the Law of 8 January 1993 on the taxation of goods and services (Dz. U No 11, item 50), as amended, is very similar to that of the European Union since it was modelled on that system. The Republic of Poland has thus always applied a reduced rate of 7 % to those goods. It therefore satisfies the conditions for the application of Article 28(2)(d) of the Sixth Directive and, consequently, of Article 115 of Directive 2006/112, even if that provision was not adopted in the Act of Accession.

34 The Commission's argument that the Act of Accession does not contain any provisions corresponding to the wording of Article 115 of Directive 2006/112 for the goods at issue, whereas it contains provisions to that effect in relation to the application of a reduced rate to restaurant and housing services, constitutes an argument *a contrario*, which cannot be accepted. According to the Republic of Poland, it cannot be inferred from the fact that certain provisions, referring to goods and services covered by a reduced VAT rate on the basis of derogations from the provisions of the Sixth Directive, were adopted in the provisions of the Act of Accession that other goods and services, referred to exclusively in secondary legislation, cannot be made subject to that rate. The adoption of provisions of secondary legislation in the Act of Accession can only be of declaratory value.

35 Refusing the 'new' Member States the possibility of applying Article 115 of Directive 2006/112 favours the 'old' Member States. Significant differences in the level of taxation – in the region of 10 % in terms of the VAT rate applied – leads to different prices for the same goods in different Member States which, in accordance with recitals 4 and 7 in the preamble to that directive, distorts intra-Community competition.

36 The Republic of Poland submits that it must be permitted to maintain a reduced VAT rate for social reasons which are consistent with the objectives of the European Union, which not only target economic growth but also social progress.

37 As is apparent from recital 6 in the preamble to Directive 2006/112 and the case-law, the objective of the derogations from the provisions of that directive is to reduce as far as possible the negative effects for the economy and for society of harmonisation which is too restrictive (see, by analogy, Case C-251/05 *Talacre Beach Caravan Sales* [2006] ECR I-6269, paragraph 22, and Case C-309/06 *Marks & Spencer* [2008] ECR I-2283, paragraph 24).

38 In that regard, the Republic of Poland points out that, from the stage of the administrative procedure, it has made clear that maintaining a reduced VAT rate for the goods at issue is extremely important from the point of view of economic growth, but especially from the point of view of solutions to increase the birthrate in Poland in an effective way.

Findings of the Court

39 It is not disputed that, on expiry of the deadline laid down in the reasoned opinion, the Republic of Poland was applying a reduced VAT rate of 7 % to the goods at issue and that those goods do not fall within the categories of goods and services listed in Annex III to Directive 2006/112, which, pursuant to Article 98 of that directive, are the only ones to which reduced rates may be applied. It is also not disputed that the Act of Accession does not provide for a derogation in that regard.

40 The Republic of Poland claims, however, that that reduced rate of taxation may be allowed under Article 115 of Directive 2006/112. The Commission submits, primarily, that that provision applies only to States which were members of the Community at the time Directive 92/77 was adopted and, in the alternative, that the conditions for the application of Article 115 of the directive are not met in the present case.

41 It should be noted, at the outset, that Article 115 of Directive 2006/112 is a transitional provision and was initially introduced into the Sixth Directive as Article 28(2)(d) by Directive 92/77 which, by derogation, authorises the Member States, which were required to adapt their VAT systems to the harmonised number and level of VAT rates, to maintain the reduced rates of VAT which they applied to certain goods and services provided that those rates were applicable in those Member States at 1 January 1991. As it is a case of derogating and transitional arrangements, Article 115 of Directive 2006/112 must be strictly interpreted (see, by analogy, Case C-462/05 *Commission* v *Portugal* [2008] ECR I-4183, paragraph 54).

42 In that regard, it is sufficient to note that the derogation provided for in Article 115 is subject to the fulfilment of two cumulative conditions for its application. The first requires that the Member State concerned was applying, at 1 January 1991, VAT within the meaning of Directive 2006/112 or, at the very least, a taxation system with similar

characteristics to the common system of VAT. The second requires that, in the context of that taxation, supplies of the goods and services referred to in Article 115 were subject to a reduced rate at 1 January 1991.

43 As regards the first condition, the Republic of Poland stated that it first introduced the common system of VAT into its national legislation by means of the Law on VAT. It must therefore be assessed whether the Polish tax provided for in the Law of 16 December 1972, as in force at 1 January 1991, may, at the very least, be regarded as a tax equivalent to VAT.

44 It should be noted, in that regard, that the principle of the common system of VAT is the application to goods and services, up to and including the retail trade stage, of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged. However, VAT is chargeable on each transaction only after deduction of the amount of VAT borne directly by the costs of the various price components. The procedure for deduction is so arranged that taxable persons are authorised to deduct from the VAT for which they are liable the input VAT already charged on the goods or services and that the tax is charged, at each stage, only on the added value and is ultimately borne by the final consumer (see Case C-475/03 *Banca popolare di Cremona* [2006] ECR I-9373, paragraphs 21 and 22).

45 The Court has established the essential characteristics of VAT. Notwithstanding certain differences of wording, it is apparent from the case-law that there are four such characteristics: (i) the tax applies generally to transactions relating to goods or services; (ii) it is proportional to the price charged by the taxable person in return for the goods and services which he has supplied; (iii) the tax is charged at each stage of the production and distribution process, including that of retail sale, irrespective of the number of transactions which have previously taken place; and (iv) the amounts

paid during the preceding stages of the process are deducted from the tax payable by a taxable person, with the result that that tax applies, at any given stage, only to the value added at that stage and the final burden of that tax rests ultimately on the consumer (see *Banca popolare di Cremona*, paragraph 28, and Joined Cases C-283/06 and C-312/06 *KÖGÁZ and Others* [2007] ECR I-8463, paragraph 37).

46 It is sufficient that a tax does not display one of those essential characteristics for it not to be regarded as equivalent to VAT (see, to that effect, the order of 5 February 2009 in Case C-119/08 *UAB Mechel Nemunas*, paragraph 37).

47 In the present case, as regards the second essential characteristic of VAT, it must be observed that, whereas VAT is levied on individual transactions at the marketing stage and its amount must be proportional to the price of the goods or services supplied (*KÖGÁZ and Others*, paragraph 39), it is apparent from Articles 4 and 5 of the Law of 16 December 1972 that the Polish tax in force at 1 January 1991 was, by contrast, based on the gross turnover made by the taxable person during a given period.

48 Since the Polish tax is thus calculated on the basis of periodic turnover, it was not possible to determine the precise amount of that charge which may be being passed on to the customer when each sale of goods is effected, and thus the condition that this amount should be proportional to the price charged by the taxable person was not satisfied (see *KÖGÁZ and Others*, paragraph 40).

49 Next, concerning the fourth essential characteristic of VAT, it must be observed that, whereas the Community VAT scheme provides for the deduction of the tax due or paid in respect of any goods or services used for the purposes of taxed transactions

so that the tax is charged solely on the value added at a given stage of the production or distribution process, it is apparent from the information supplied by the parties in response to the written questions addressed to them by the Court and the discussion at the hearing that the Law of 16 December 1972 did not provide for the right to deduct the tax paid at an earlier stage, but authorised only the deduction of general tax on turnover incurred at a later stage on certain materials. That tax thus did not apply to the value added to the goods and services, but to the total income received.

50 The Republic of Poland submits nevertheless that Article 9 of the Regulation of the Finance Minister of 17 April 1990 (Dz. U No 27, item 156), exempted, in principle, from turnover tax the sale of provisions, capital goods and finishing goods.

51 However, although it is correct to state that the existence of differences in the method for calculating the deduction of tax already paid does not deprive a tax of an essential characteristic of VAT if such differences are in fact technical in nature and do not prevent that tax from operating in essentially the same way as VAT, the same is not true of a tax levied on production in such a way that it is not certain that it will ultimately be borne, like a tax on consumption such as VAT, by the final consumer (*Banca popolare di Cremona*, paragraph 31).

52 In the present case, by reason, in particular, of the opaque interplay between the various forms of exemption or cascade taxation systems, it cannot be certain that the Polish turnover tax was ultimately born by the final consumer in a way similar to a tax on consumption such as VAT nor that it led to the same result as that tax.

53 It is apparent from the above considerations that the turnover tax applicable in Poland at 1 January 1991 did not display the essential characteristics of VAT.

54 Since the Republic of Poland was not applying, at 1 January 1991, VAT within the meaning of Directive 2006/112, nor a taxation system displaying the essential characteristics of VAT, the conditions for the application of Article 115 of Directive 2006/112 are not satisfied.

55 Consequently, the Republic of Poland should have applied the normal rate of VAT to the goods at issue.

56 Finally, in so far as the Republic of Poland seeks to raise an independent ground of defence, arguing that the application of a reduced rate of VAT to the goods at issue aims to bring about an increase in birthrate in Poland and contribute to accelerating the rhythm of economic growth within the spirit of the Lisbon Strategy, it is sufficient to note that such an argument of a socio-political nature, although it may possibly justify the grant by the Council of the European Union of a derogation in the form of an amendment to Directive 2006/112, cannot, by contrast, justify, from a legal point of view, that Member State's infringement of Article 98(2) of Directive 2006/112 in the context of these infringement proceedings.

57 In those circumstances, it must be found that, by applying a reduced VAT rate of 7 % to supplies, import and intra-Community acquisition of clothing and clothing accessories for babies and of children's footwear, the Republic of Poland has failed to fulfil its obligations under Article 98 of Directive 2006/112, in conjunction with Annex III thereto.

Costs

58 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Commission has applied for costs to be awarded against the Republic of Poland and the latter has been unsuccessful, the Republic of Poland must be ordered to pay the costs.

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

1. **Declares that, by applying a reduced value added tax rate of 7 % to supplies, import and intra-Community acquisition of clothing and clothing accessories for babies and of children's footwear, the Republic of Poland has failed to fulfil its obligations under Article 98 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, in conjunction with Annex III thereto;**

2. **Orders the Republic of Poland to pay the costs.**

[Signatures]