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

Mr President,
Members of the Court,

1. This action against the United Kingdom for failure to fulfil its obligations concerns the criteria for the application of Article 28 (2) of the Sixth Council Directive of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes (77/388).[1] The essence of the claim is that the United Kingdom applies to a number of goods and services 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,[2] to which Article 28 (2) of the Sixth Directive refers.

2. That provision was adopted as part of a process initiated in 1967, when the first two directives on the harmonization of legislation concerning turnover taxes[3] were adopted; it should be noted that in the United Kingdom these taxes have never been as important as they were in the original Member States of the Community,[4] nor have they taken the same form, that of a cumulative multi-stage tax. Although 'the rates and exemptions [were] not harmonized at the same time'[5] the result was the establishment of a 'general tax on consumption'.[6] The Sixth Directive,[7] 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'.[8]

3. 'So that the Communities' own resources may be collected in a uniform manner in all the Member States'[9] 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 the last indent of Article 17 of the Second Directive (hereinafter referred to as 'Article 17'). That possibility was left open on the ground that it was '*vital* to provide for a *transitional period* to

* Translated from the French.

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

2 — Directive 67/228 — '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'.

3 — 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.

4 — J. C. Scholsem, 'La TVA, impôt européen' in Mélanges Fernand Dehousse, Vol. II, p. 305.

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

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

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

8 — Second recital in the preamble to the directive; my emphasis.

9 — Eleventh recital in the preamble to the directive.

allow national laws in *specified fields* to be *gradually adapted*'.[10]

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 earlier stages 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 35% of the private consumption of households is zero-rated in the United Kingdom and 33% in Ireland; Ireland disputes that percentage and states that the real figure is 25%. 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 certain categories of goods and services[11] in the list contained in the Value-added Tax Act 1983. It considers that those provisions do 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 and of the drive towards a standardization of the rate of VAT . . .' 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.'

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. The Commission 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. The United Kingdom disagrees with that definition, and submits that the final consumer is the person at the end of a production or distribution chain. Moreover,

10 — Nineteenth (last) recital in the preamble to the directive; my emphasis.

11 — Disputed zero rates:
Group 1 — Food (animal feedingstuffs, seeds, live animals of a kind generally used as, or yielding or producing, food for human consumption);
Group 2 — Sewerage services and water (supplies to industry);
Group 6 — News services (supplies to industry);
Group 7 — Fuel and power (supplies to industry);
Group 8 — Construction of buildings, etc. other than by or for the final consumer within a social policy;
Group 17 — Clothing and footwear (protective boots and helmets sold to employers).

it is not necessary that it should 'only' be the final consumer who benefits, or that he should benefit directly. It is sufficient if he gains an indirect benefit from the transaction, in particular by way of a lower end price. The United Kingdom points out that it enjoys considerable discretion in determining its own social policies and hence in deciding on the national measures to be taken for 'clearly defined social reasons'. The Commission does not deny that such a prerogative exists, but it submits that the Court, exercising its supervisory power, should hold that in this case those measures are unjustified or disproportionate in relation to the social reasons relied on, and that the meaning of that concept for Community purposes must be defined by the Court.

8. The United Kingdom complains more generally, however, that what the Commission is really doing is using an action against it for alleged failure to fulfil its obligations in an endeavour to evade 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. That analysis, it says, is illustrated by the terms used by the Commission, from which it appears that the application of zero rates constitutes one of the 'stumbling blocks' on the path towards a uniform rate of VAT. The United Kingdom considers that its assessment of the Commission's real motive is supported by the fact that the Commission accepts that the zero-rating in question has no bearing on own resources because of the mechanism established by the last sentence of the first subparagraph of Article 28 (2), which requires that 'taxable persons declare the data required to determine own resources' relating to exempted operations. The United Kingdom also argues that when it instituted these proceedings the Commission had not yet submitted to the Council a proposal for progressive abolition as provided for in that article. It may be noted in that regard that such a proposal was submitted while these proceedings were in progress. [12]

9. 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'. [13] 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 of them [the Community institutions] without adversely affecting its status as an institution under the Treaty'. [14]

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

12 — OJ C 250, 18.9.1987, p. 2.

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

14 — Judgment of 22 May 1985 in Case 13/83 [1985] ECR 1513, at p. 1556, paragraph 17.

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'. [15]

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 the United Kingdom. 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 that the Court can determine whether or not the United Kingdom 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.

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

10. 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'*

11. 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 that the Court should hold that in this case the measures adopted are not sufficiently well defined or are unjustified or disproportionate in relation to the reasons relied on.

12. 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'. [16]

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

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

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.

13. 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*

14. 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 must bear that tax 'unless there is a further transaction in which a price is paid'. [17] 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: [18]

'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,

(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*

15. 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

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

18 — OJ C 226, 28.8.1984, p. 2

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.

16. Can we go further and take into account the indirect benefit which, according to the United Kingdom, 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 a 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, albeit variable, for the final consumer, 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.

17. 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 — *Group 1 of the list set out in Schedule 5 to the Value-added Tax Act 1983 — Food*

18. At issue is the application of zero rates to animal feedingstuffs, seeds or other means of propagation of plants, and live animals used as, or yielding or producing, food for human consumption. These are all inputs used in the production of food for human consumption, and there is no dispute as to the application of zero rates to food. The United Kingdom argues that the application to them of zero rates is of direct benefit to final consumers who themselves use those inputs to produce food. It refers more generally to the reduced burden on farmers' cash-flow and its possible effects on food prices.

19. Although this last consideration must be approached with caution, as I have already stated, the negative effects of any taxation of those products on food prices, increases in which are particularly 'sensitive' at the level of the final consumer, cannot be

ignored. It should be observed that all the supplies referred to contribute directly and exclusively to the production of food for the final consumer. Moreover, persons using such supplies to produce their own food and farmers keeping part of their production for the use of their family receive a direct benefit from the application of the zero rates at issue. I therefore propose that the Court hold that the United Kingdom has not failed to fulfil its obligations in this respect.

B — *Group 2 — Sewerage services and water supplies*

20. Sewerage services (reception, disposal or treatment of sewage and emptying of cesspools, septic tanks, etc.) are normally financed by a rate which is not subject to VAT. Consequently, taxable commercial services are provided only in respect of cesspools or septic tanks which are made necessary by the absence of any main drainage system. The United Kingdom justifies the application of zero rates to such services essentially for reasons of equity between town-dwellers and isolated farmers, who are generally the beneficiaries of the measure in question. There are also, it maintains, domestic considerations justifying exemption. The Commission, in any event, disputes only the supply of such services to industry. Since the United Kingdom states that it is highly unlikely that industrial concerns would make use of such services, I agree with the Commission that the repeal of the disputed provision — since industrial concerns cannot be regarded as final consumers — should not present any difficulty.

21. With regard to the supply of water, only supplies to industry are in dispute; while the United Kingdom admits that the industrial sector is the largest consumer, it argues that in certain cases water is used principally for the benefit of the individual in the preparation of food and drink. In its view there is, moreover, no practical reason for attempting to identify the status of the final consumer, since water is connected in the public mind with food and should be treated in the same way by analogy.

22. That argument cannot be upheld. Industrial uses of water are important enough to preclude, so it seems to me, the application of zero rates, in the light of the fact that the users are taxable persons. All I would allow, following the Commission's view, is the application of a zero rate for the industrial production of finished food products. The United Kingdom did point out that there is an exemption for supplies of water in another Member State. The Commission observed that that exemption was based on Article 28 (3) (b) of the Sixth Directive, under which Member States may, during the transitional period, continue to exempt the activities set out in Annex F, *inter alia* 'the supply of water by public authorities'.[19] The United Kingdom, which based its contentions expressly on Article 28 (2), has not argued that it could rely on Article 28 (3) (which to my mind is strictly alternative to Article 28 (2)) or even asserted that it met the conditions laid down in the latter. I therefore think that the United Kingdom has failed to fulfil its obligations in this respect.

19 — Item 12 of the annex.

C — *Group 6 — News services*

23. Since the Commission has accepted that zero rates may be applied in respect of the supply of information directly to the public or to undertakings which use that information in the production of products such as newspapers, it seems that it is only the application of zero rates to the supply of information — essentially by electronic means — for other business uses that remains at issue. Such beneficiaries of zero-rating (banks, insurance companies, etc.) cannot be regarded as final consumers.

D — *Group 7 — Fuel and power*

24. The Commission contests the exemption of supplies other than to final consumers. The United Kingdom argues first of all that in the case of mixed users it is difficult to distinguish between business uses and private uses. Such an objection is unconvincing, and it is for the Member States to find appropriate technical solutions to what does not appear to be an insurmountable difficulty. Secondly, it argues that the taxation of such supplies in the education and health sectors would have undesirable social effects. Having regard to the very large energy consumption of the industrial sector it is clear that zero rates do not benefit the final consumer in this area; the Commission's claim must therefore, in my opinion, be upheld in this respect.

E — *Group 8 — Construction of buildings, etc.*

25. This is certainly the most important group of exemptions from the economic point of view since it covers the housing sector, industrial and commercial buildings, and the community and civil engineering sector. The Commission considers that the failure to distinguish according to the type of housing concerned is disproportionate having regard to the objectives pursued. The United Kingdom argues that it is very difficult to distinguish, as the Commission suggests, between housing constructed by local authorities, which unquestionably qualify for exemption, and other housing, especially since it is now the private sector which, because of the steps taken to encourage home ownership, provides an increasing proportion of housing for the most disadvantaged segments of the community.

26. If it was for the Court to consider whether or not the decision to apply a zero rate in respect of the construction of all private housing was well founded, it could undoubtedly hold that measures of such an indiscriminate nature reflect a very wide view of the social reasons relied on. As I have already said, however, the exercise of such a supervisory role would impinge on the powers of the Member States. In any event, the approach adopted by the United Kingdom, that is to say, facilitating home ownership for the whole population, clearly does not go beyond the discretion which it undoubtedly retains in this field.

27. In the industrial and commercial sector zero-rating is used by the United Kingdom as a means of encouraging renewal of infra-

structure and construction, especially from the point of view of employment. I do not share the Commission's reservations with regard to the social reasons put forward. The improvement of industrial infrastructure, the development of residential areas and, above all, the quantitative and qualitative effects of such development for employment are clearly important social reasons. However, I must propose that the Court hold that the United Kingdom has failed to fulfil its obligations in so far as the zero rates at issue, although undoubtedly benefiting workers, users and citizens, cannot be regarded as benefiting the final consumer as defined in the directive. To treat the entire population as the final consumer does not seem to me to be compatible with a provision which clearly concerns a person who acquires goods or services for his own use. Moreover, such a wide interpretation of the term 'final consumer' would amount to the *de facto* removal of the condition laid down in that respect by the relevant provision, and allow any exemption based on social reasons.

28. With regard to community works and civil engineering, I am inclined, for reasons similar to those I have just set out, to adopt the same approach. Here again, despite the social aspect of the reasons put forward, it is hard to see any distinction between the final consumer and the population as a whole.

F — *Group 17 — Clothing and footwear*

29. The zero-rating of purchases of such supplies by employers is said to be justified by the fear that taxation would discourage them from providing such equipment for their staff. I need simply point out that the beneficiary cannot be regarded as a final consumer according to the definition I have adopted. It may be added that it appears from the United Kingdom's pleadings themselves that many employers should be able to recover the tax on such supplies.

30. I therefore propose that the Court:

(1) hold that by applying zero rates of VAT:

to supplies to industry of water and sewerage services,

to information services other than those intended directly for the public or for the production of zero-rated products such as newspapers,

to the construction of buildings for industrial and commercial use and in the community and civil engineering sector,

to supplies of fuel and power and of protective boots and helmets in so far as they are not supplied to the final consumer,

the United Kingdom 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);

(2) dismiss the remainder of the application;

(3) order the United Kingdom to pay the costs.