JUDGMENT OF THE COURT (Second Chamber)

3 April 2008 *

In Case C-442/05,

REFERENCE for a preliminary ruling under Article 234 EC from the Bundesfinanzhof (Germany), made by decision of 3 November 2005, received at the Court on 14 December 2005, in the proceedings

Finanzamt Oschatz

v

Zweckverband zur Trinkwasserversorgung und Abwasserbeseitigung Torgau-Westelbien,

intervener:

Bundesministerium der Finanzen,

* Language of the case: German.

THE COURT (Second Chamber),

composed of C.W.A. Timmermans, President of the Chamber, L. Bay Larsen, J. Makarczyk (Rapporteur), P. Kūris and J.-C. Bonichot, Judges,

Advocate General: J. Mazák,
Registrar: B. Fülöp, Administrator,

having regard to the written procedure and further to the hearing on 10 May 2007,

after considering the observations submitted on behalf of:

— Finanzamt Oschatz, by T. Martin, acting as Agent,

— Zweckverband zur Trinkwasserversorgung und Abwasserbeseitigung Torgau-Westelbien, by F. Schmidt, Steuerberater,

— the German Government, by M. Lumma and U. Forsthoff, acting as Agents,

— the Italian Government, by I.M. Braguglia, acting as Agent, assisted by G. Fiengo, avvocato dello Stato,

— the Commission of the European Communities, by D. Triantafyllou, acting as Agent,

after hearing the Opinion of the Advocate General at the sitting on 10 July 2007,

gives the following

Judgment

1 The reference for a preliminary ruling relates, essentially, to the interpretation of the concept of 'supply of water', or 'water supplies', in point 2 of Annex D and Category 2 of Annex H to 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), as amended by Council Directive 2001/4/EC of 19 January 2001 (OJ 2001 L 22, p. 17) ('the Sixth Directive').

2 The reference was made in proceedings between Finanzamt Oschatz (Tax Office, Oschatz) ('the Finanzamt') and Zweckverband zur Trinkwasserversorgung und Abwasserbeseitigung Torgau-Westelbien (municipal association for the supply of drinking water and sewage disposal in Torgau-Westelbien) ('the Zweckverband') regarding whether or not a reduced rate of value added tax ('VAT') should apply to the connection of a building's water system to the water supply network ('mains connection').

Legal context

Community legislation

3 Article 4(5) of the Sixth Directive states as follows:

‘States, regional and local government authorities and other bodies governed by public law shall not be considered taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with these activities or transactions.

However, when they engage in such activities or transactions, they shall be considered taxable persons in respect of these activities or transactions where treatment as non-taxable persons would lead to significant distortions of competition.

In any case, these bodies shall be considered taxable persons in relation to the activities listed in Annex D, provided they are not carried out on such a small scale as to be negligible.

…’

4 The supply of water, inter alia, is mentioned in point 2 of Annex D to the directive.

5 Article 12(3)(a) of the Sixth Directive states:

'The standard rate of value added tax shall be fixed by each Member State as a percentage of the taxable amount and shall be the same for the supply of goods and for the supply of services. …

…

Member States may also apply either one or two reduced rates. These rates shall be fixed as a percentage of the taxable amount, which may not be less than 5%, and shall apply only to supplies of the categories of goods and services specified in Annex H.

…'

6 In Annex H to the Sixth Directive, entitled 'List of supplies of goods and services which may be subject to reduced rates of VAT', water supplies are mentioned in Category 2.

National legislation

7 According to the first sentence of Paragraph 1(1) of the Umsatzsteuergesetz 1999 (Law on Turnover Tax 1999) ('the UStG'), in the version in force at the material time, turnover tax is chargeable on supplies of goods and services which a trader, in the course of his business, makes for consideration within Germany.

8 In accordance with the first sentence of Paragraph 2(3) of the UStG, legal persons governed by public law carry on a trade or profession only in the context of their operations of a commercial nature. Pursuant to Paragraph 4(3) of the Körperschaftsteuergesetz (Law on Corporation Tax) ('the KStG'), operations of a commercial nature include operations for the supply of water to the public.

9 In accordance with Paragraph 12(1) of the UStG, the tax amounts, for each taxable transaction, to 16% of the basis of assessment.

10 However, Paragraph 12(2) of the UStG provides that the rate of tax is reduced to 7% for transactions related to the supply, importation and intra-Community acquisition of the items listed in Annex 2 to that Law, amongst which water is mentioned in point 34 of the annex.

The dispute in the main proceedings and the question referred for a preliminary ruling

11 The Zweckverband ensures the supply of drinking water and disposal of sewage on behalf of a number of towns and municipalities in the district of Torgau-Westelbien. Accordingly, the activities of the Zweckverband include, inter alia, the collection, piping, treatment and supply of drinking water to its customers, that is to say the owners of buildings connected to the water supply network. In that context, it lays mains connections at the request of its customers, for which it receives a single fee corresponding to the cost of that work. The connection remains the property of the Zweckverband.

12 Taking the view that the laying of a connection was distinct from the supply of water, the Finanzamt decided to apply to it the standard rate of VAT laid down by national legislation.

13 After an unsuccessful objection to the Finanzamt, the Zweckverband brought proceedings before the Finanzgericht Sachsen (Finance Court, Saxony), claiming that a mains connection should be subject to the same reduced rate of VAT as that applied to the supply of water.

14 The Finanzgericht Sachsen upheld the Zweckverband's action, considering that the supply of water and the laying of the mains connection constituted a single service of 'water supply', within the meaning of the national legislation which transposed the Sixth Directive.

15 The Finanzamt appealed against that decision to the Bundesfinanzhof (Federal Finance Court) on a point of law.

16 Like the parties, the Bundesfinanzhof proceeds on the basis that, in laying a mains connection, the Zweckverband acts as a trader in accordance with the national legislation. However, that court states that it is apparent from the parties' observations at the hearing in the main proceedings that the Zweckverband acts pursuant to its public law statutes and under public law, which argues against its being subject to VAT, having regard to the provisions of Article 4(5) of the Sixth Directive.

17 As regards the rate of VAT applicable, the Bundesfinanzhof points out that, before the issue of a letter by the Bundesministerium der Finanzen (Federal Ministry of Finance) of 4 July 2000, laying a mains connection was considered a service ancillary to water supplies.

18 The Bundesfinanzhof is also inclined to the view that laying mains connections forms part of water supplies, but considers that that question depends on the interpretation of Article 12(3)(a) of the Sixth Directive and of Category 2 of Annex H thereto.

19 In those circumstances the Bundesfinanzhof decided to stay the proceedings and to refer the following question to the Court for a preliminary ruling:

'Does connection of the water distribution network to a property owner's installation (the so-called "household connection") by a water supply undertaking for a separately calculated fee come under the heading of ["the supply of water"/"water supplies"] within the meaning of [the] Sixth … Directive … (Annex D, point 2, and Annex H, Category 2)?'

The question referred

Admissibility

20 In their observations, the Finanzamt and the German Government have expressed doubts regarding the relevance of the question referred for a preliminary ruling inasmuch as it relates to point 2 of Annex D to the Sixth Directive since the dispute in the main proceedings does not concern whether the Zweckverband is subject to VAT.

21 In that regard, it should be borne in mind that, according to settled case-law, the Court may refuse to rule on a question referred for a preliminary ruling by a national court only where it is quite obvious that the interpretation of Community law that is sought bears no relation to the facts of the main action or its purpose, where the problem is hypothetical, or where the Court does not have before it the factual or legal material necessary to give a useful answer to the questions submitted to it (see, inter alia, Case C-35/99 *Arduino* [2002] ECR I-1529, paragraph 25, and Case C-13/05 *Chacón Navas* [2006] ECR I-6467, paragraph 33).

22 However, none of those conditions is fulfilled in the present case.

23 In its order for reference the national court, which has a dispute in a VAT matter before it, describes in detail the factual and legal background to the main proceedings.

24 Furthermore, it seeks the opinion of the Court on Community law applicable to VAT, notably on the concept of water supply mentioned in both Annex D and Annex H to the Sixth Directive, in order to be in a position to determine whether connecting a building to the water supply network should be held to constitute part of such supply.

25 Although the dispute in the main proceedings relates principally to the application of a reduced rate of VAT to that operation, by way of exception to the application of the standard rate of VAT, it is apparent from the order for reference that the national court also has doubts regarding whether the Zweckverband is subject to VAT, which is a prerequisite for the application of a rate of VAT to the transaction.

26 The interpretation of Community law that is sought thus has a bearing on the facts and purpose of the main action and is not hypothetical.

27 Consequently, the question referred for a preliminary ruling is admissible.

Substance

28 It is appropriate to answer the question referred for a preliminary ruling, firstly, in so far as it relates to Article 4(5) of the Sixth Directive and to point 2 of Annex D thereto, then, secondly, in so far as it concerns application of one of the reduced rates of VAT referred to in Article 12(3)(a) of that directive, read in conjunction with Category 2 of Annex H thereto.

Article 4(5) of the Sixth Directive and point 2 of Annex D

29 By its question, the national court asks, inter alia, whether laying a mains connection forms part of the supply of water referred to in point 2 of Annex D to the Sixth Directive.

30 In the absence of a definition in the Sixth Directive, it should be borne in mind that in interpreting a provision of Community law, such as point 2 of Annex D to that directive, it is necessary to consider not only its wording, but also the context in which it occurs and the objective pursued by the rules of which it is part (see inter alia, to this effect, Case C-156/98 *Germany* v *Commission* [2000] ECR I-6857, paragraph 50, and Case C-53/05 *Commission* v *Portugal* [2006] ECR I-6215, paragraph 20).

31 It is clear from the third subparagraph of Article 4(5) of the Sixth Directive that, by providing that bodies governed by public law are in any case to be regarded as taxable persons in respect of the activities listed in Annex D provided they are not on such a small scale as to be negligible, that provision makes the rule that such bodies are not to be regarded as taxable persons subject to a limitation which must be added to those resulting from the condition laid down in the first subparagraph, namely that they must engage in activities as public authorities, and from the derogation laid down in the second subparagraph in cases where treatment as non-taxable persons would lead to significant distortions of competition. The third subparagraph of Article 4(5) thus seeks to ensure that certain categories of economic activity the importance of which derives from their subject-matter are not exempted from VAT on the ground that they are carried out by bodies governed by public law as public authorities (see Joined Cases 231/87 and 129/88 *Comune di Carpaneto Piacentino and Others* [1989] ECR 3233, paragraph 26).

32 In the present case, it should be noted that the supply of water is characterised by making water available to the public and that, as the Advocate General observes in point 43 of his Opinion, that supply is carried out by means of fixed networks intended to provide a service to the public.

33 Moreover, it is apparent from the order for reference and from the observations submitted to the Court that laying a mains connection consists in the installation, by the Zweckverband, of piping permitting the connection of a building's water system to the fixed water supply network.

34 It is common ground that, if that connection is not made, it is impossible to make water available to the owner or occupier of the building. Accordingly, that connection is essential for making the water available.

35 Since, firstly, the objective of the third subparagraph of Article 4(5) of the Sixth Directive, referred to in paragraph 31 of this judgment, is to ensure that the categories of economic activity of a certain importance that are listed in Annex D, which include the supply of water, are not exempted from VAT on the ground that the service is rendered by a public body, secondly, the supply of water is characterised by making water available to the public and, finally, a mains connection is essential for making it available, it must be held that that connection forms part of the supply of water referred to in point 2 of the annex.

36 It follows that, even if the Zweckverband were to lay the mains connection as a public body within the meaning of the first subparagraph of Article 4(5) of the Sixth Directive, pursuant to the third subparagraph of Article 4(5) it would be considered a taxable person in respect of that connection.

37 In the light of the foregoing, the answer to the question referred for a preliminary ruling must be that Article 4(5) of the Sixth Directive and point 2 of Annex D thereto must be interpreted as meaning that the laying of a mains connection which consists, as in the main proceedings, in the installation of piping permitting the connection of a building's water system to the fixed water supply network forms part of the supply of water, listed in that annex, so that a body governed by public law acting as a public authority is a taxable person in respect of that transaction.

Article 12(3)(a) of the Sixth Directive and Category 2 of Annex H thereto

38 By its question, the national court also asks whether laying a mains connection forms part of the water supplies covered by Category 2 of Annex H to the Sixth Directive.

39 It follows from Article 12(3)(a) of the Sixth Directive that the application of either one or two reduced rates of VAT is an option accorded to the Member States as an exception to the principle that the standard rate applies. Moreover, according to that provision, the reduced rates of VAT may be applied only to supplies of the goods and services specified in Annex H.

40 While the Sixth Directive does not define the concept of water supply, it is also not apparent from its provisions that that term should be interpreted differently according to the annex in which it is mentioned. Since a mains connection is essential in order to make water available to the public, as is clear from paragraph 34 of this judgment, the view should accordingly be taken that such a connection also forms part of the water supplies referred to in Category 2 of Annex H to the Sixth Directive.

41 However, it should also be pointed out that there is nothing in the text of Article 12(3)(a) of the Sixth Directive which requires that provision to be interpreted as meaning that the reduced rate can be charged only if it is applied to all aspects of the water supplies covered by Annex H to that directive, so that a selective application of the reduced rate cannot be excluded provided that no risk of distortion of competition results (see, by analogy, Case C-384/01 *Commission* v *France* [2003] ECR I-4395, paragraph 27).

42 The introduction and maintenance of reduced rates of VAT lower than the standard rate fixed in Article 12(3)(a) of the Sixth Directive are permissible only if they do not infringe the principle of fiscal neutrality, inherent in the common system of VAT, which precludes treating similar goods and supplies of services, which are thus in competition with each other, differently for VAT purposes (see, inter alia, Case C-481/98 *Commission* v *France* [2001] ECR I-3369, paragraphs 21 and 22, and Case C-109/02 *Commission* v *Germany* [2003] ECR I-12691, paragraph 20).

43 Accordingly, subject to compliance with the principle of fiscal neutrality inherent in the common system of VAT, Member States may apply a reduced rate of VAT to concrete and specific aspects of water supplies covered by Category 2 of Annex H of the Sixth Directive, such as mains connections.

44 In those circumstances, the answer to the question referred for a preliminary ruling must also be that Article 12(3)(a) of the Sixth Directive and Category 2 of Annex H thereto must be interpreted as meaning that the laying of a mains connection which consists, as in the main proceedings, in the installation of piping permitting the connection of a building's water system to the fixed water supply network forms part

of water supplies. Furthermore, Member States may apply a reduced rate of VAT to concrete and specific aspects of water supplies, such as the laying of mains connections at issue in the main proceedings, provided that they comply with the principle of fiscal neutrality inherent in the common system of VAT.

Costs

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

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

1. **Article 4(5) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment and point 2 of Annex D thereto must be interpreted as meaning that the laying of a mains connection which consists, as in the main proceedings, in the installation of piping permitting the connection of a building's water system to the fixed water supply network forms part of the supply of water, listed in that annex, so that a body governed by public law acting as a public authority is a taxable person in respect of that transaction.**

2. Article 12(3)(a) of Sixth Directive 77/388 and Category 2 of Annex H thereto must be interpreted as meaning that the laying of a mains connection which consists, as in the main proceedings, in the installation of piping permitting the connection of a building's water system to the fixed water supply network forms part of water supplies. Furthermore, Member States may apply a reduced rate of value added tax to concrete and specific aspects of water supplies, such as the laying of mains connections at issue in the main proceedings, provided that they comply with the principle of fiscal neutrality inherent in the common system of value added tax.

[Signatures]