OPINION OF ADVOCATE GENERAL JACOBS

delivered on 13 December 2001 [1]

1. In this action brought under Article 226 EC the Commission seeks a declaration that, by exempting from value added tax research activities conducted by State universities, Germany has failed to fulfil its obligations under Article 2 of the Sixth VAT Directive. [2]

The Sixth Directive

2. Article 2(1) of the Sixth Directive provides that 'the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such' is to be subject to value added tax.

3. Article 4 provides in so far as is relevant:

'1. "Taxable person" shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.

2. The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity.

...

1 — Original language: English.

2 — 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.

5. 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.

...'

4. Article 13A(1)(i) of the Sixth Directive provides:

'Exemptions within the territory of the country

A. *Exemptions for certain activities in the public interest*

1. Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of such exemptions and of preventing any possible evasion, avoidance or abuse:

...

(i) children's or young people's education, school or university education, vocational training or retraining, including the supply of services and of goods closely related thereto, provided by bodies governed by public law having such as their aim or by other organisations defined by the Member State concerned as having similar objects'.

The national legislation

5. Paragraph 4(1)(21a) of the German law on value added tax (the Umsatzsteuerge-

setz, 'UStG') [3] exempts from VAT turnover of public-sector higher education establishments attributable to research activities.

6. Paragraph 48 of the Higher education framework law [4] provides that higher education establishments are as a general rule governed by public law.

7. I will refer to such establishments as State universities.

Procedure

8. On 6 November 1998 the Commission sent the German Government a letter of formal notice pursuant to Article 169 of the EC Treaty (now Article 226 EC) indicating that in the Commission's view it was contrary to Article 2(1) of the Sixth Directive for the research activities of State universities to be exempt from VAT. No response was received.

9. On 26 August 1999 the Commission sent Germany a reasoned opinion pursuant to Article 226 repeating its position and inviting Germany to take the necessary measures to bring the infringement to an end within two months.

10. In its response of 4 April 2000 the German Government referred to two provisions of the Sixth Directive which it considered justified the exemption. First, since activities related to research contracts were closely related to the teaching given in State universities, the exemption could be based on Article 13A(1)(i). Second, since the exemption did not entail serious distortions of competition, it could be based on Article 13A(2), which permits Member States to make the granting to bodies other than those governed by public law of certain exemptions, including that under Article 13A(1)(i), subject to one or more specified conditions including that exemption of the services concerned is not to be likely to create distortions of competition such as to place at a disadvantage commercial enterprises liable to VAT.

11. In July 2000 the Commission brought the present proceedings. In its application it sought a declaration by the Court that, by exempting from value added tax research

3 — Law of 27 April 1993, BGBl. I, p. 565, 1160 as amended by Paragraph 4(5) of the Umsatzsteuer-Änderungsgesetz (Law amending the legislation on turnover taxes) of 12 December 1996 (BGBl. I, p. 1851 et seq.).

4 — Hochschulrahmengesetz, version of 19 January 1999, BGBl. I, p. 18.

activities conducted by State universities, Germany has failed to fulfil its obligations under Article 2 of the Sixth VAT Directive. The application sets out the grounds for the Commission's view that the exemption is contrary to Article 2(1) of the Sixth Directive. It also explains why the Commission does not consider that the exemption is justified by virtue of Article 13A(1)(i) or 13A(2) of the Directive.

Admissibility

12. Germany submits that the Commission's action is inadmissible for two reasons.

13. First, Germany considers that the Commission did not observe the pre-litigation procedure prescribed by Article 226 EC: its reasoned opinion — comprising a mere seven sentences — did not fully set out the subject-matter of the procedure as required by the Court's case-law [5] but simply repeated the content of the letter of formal notice.

14. Second, Germany considers that the Commission has unacceptably broadened the scope of the proceedings contrary to the principle of continuity between the pre-litigation procedure and the action, which expresses the right to be heard: [6] whereas the reasoned opinion simply alleges infringement of Article 2 of the Sixth Directive, the application also invokes Article 13A of that directive. The Commission's argument concerning Article 13A is an essential aspect of its case. Article 2 simply defines the basis of assessment, laying down the various types of turnover which are in principle to be subject to VAT. It does not however follow directly from Article 2 that the activities there described are automatically taxable: that follows rather from the specific exemption criteria laid down in Article 13 et seq. Whether an activity is subject to VAT can accordingly be determined only by an assessment of those criteria.

15. There is abundant case-law on the procedure which must be observed before the Commission can bring proceedings under Article 226 EC. The purpose of that procedure is to give the Member State concerned an opportunity, on the one hand, to comply with its obligations under Community law and, on the other, to avail itself of its right to defend itself against the complaints made by the Commission. [7]

5 — Case C-96/95 *Commission* v *Germany* [1997] ECR I-1653, paragraphs 22 and 24 of the judgment; Case C-347/88 *Commission* v *Greece* [1990] ECR I-4747, paragraph 29.

6 — Case C-274/93 *Commission* v *Luxembourg* [1996] ECR I-2019, paragraph 11 of the judgment.

7 — See for example Case 293/85 *Commission* v *Belgium* [1988] ECR 305, paragraph 13 of the judgment.

16. First, the Commission must send the Member State concerned a letter of formal notice. That letter is intended to delimit the subject-matter of the dispute and to indicate to the Member State which is invited to submit its observations the factors enabling it to prepare its defence. [8]

17. In the present case the Commission's letter of formal notice of 6 November 1998 comprises three substantive paragraphs. The Commission notes first that German legislation exempts certain services from VAT and then specifies that pursuant to paragraph 4(21a) of the UStG research activities of State universities are exempt from VAT. Second, it states that (i) a public body such as a State university is unquestionably subject to VAT in so far as it is not acting as a public authority but carrying out activities for consideration and (ii) research activities carried out by a taxable person are taxable rather than tax exempt transactions under the Sixth Directive. Third, it notes that Article 2(1) of the Sixth Directive subjects to VAT 'the supply of goods or services for consideration within the territory of the country by a taxable person acting as such'; since research activities are not — in particular not by virtue of Article 13 of the Sixth Directive — exempt from VAT, the Commission concludes that, by exempting from VAT research activities of State universities, Germany has infringed Article 2(1) of the Sixth Directive.

18. The Court has ruled that the purpose of the requirement in Article 226 EC that the Commission deliver a reasoned opinion is 'to give the Member State an opportunity to justify its position and, as the case may be, to enable the Commission to persuade the Member State to comply of its own accord with the requirements of the Treaty. If this attempt to reach a settlement is unsuccessful, the function of the reasoned opinion is to define the subject-matter of the dispute.' [9]

19. The reasoned opinion sets out the Commission's case in four paragraphs. It notes, first, that German legislation exempts certain services from VAT and then specifies that pursuant to paragraph 4(21a) of the UStG research activities of public higher education establishments are exempt from VAT. Second, it notes that Article 2(1) of the Sixth Directive subjects to VAT 'the supply of goods or services for consideration within the territory of the country by a taxable person acting as such'. Third, it states that (i) a public body such as a State university is unquestionably subject to VAT in so far as it is not acting as a public authority but carrying out activities for consideration, (ii) research activities carried out by a taxable person are taxable

8 — See for example Case 211/81 *Commission* v *Denmark* [1982] ECR 4547, paragraph 8 of the judgment.

9 — Joined Cases 142/80 and 143/80 *Essevi and Salengo* [1981] ECR 1413, paragraph 15 of the judgment.

rather than tax exempt transactions under the Sixth Directive and (iii) it accordingly follows in the Commission's view that, by exempting from VAT research activities of State universities, Germany has infringed Article 2 of the Sixth Directive. Fourth the reasoned opinion notes that the Commission in November 1998 notified Germany pursuant to Article 226 EC of that infringement and that there was no response to that notification although Germany was granted an extension of time for its response.

20. Had Germany responded to the letter of formal notice, the Commission would have been entitled to reply to defences or arguments raised in its response. [10] In the absence of any response from Germany, the reasoned opinion simply repeated in substantially identical terms the content of the letter of formal notice. It was only in its response to the reasoned opinion that Germany sought to justify its position by invoking Article 13A as a defence.

21. The Court has ruled that in an infringement action against a Member State the Commission may plead Community legislation for the first time in the application where it is merely replying to a defence raised by the Member State concerned and in so doing alters neither the definition nor the basis of the alleged failure to fulfil an obligation. [11] In my view the Commission in submitting in its application that Article 13A is not applicable is simply replying to the defence raised by Germany and does not alter the definition or the basis of the alleged failure to fulfil an obligation: the principal allegation remains that Germany has infringed Article 2(1) of the Sixth Directive.

22. That provision states that the supply of goods or services for consideration by a taxable person acting as such shall be subject to VAT. Article 13A contains a list of mandatory and optional exemptions. It is clear from the scheme of the legislation that the basic imposition of VAT is effected by Article 2. [12] The Commission's case is that research activities carried out by State universities are supplies of services within the meaning of Article 2(1) and should accordingly be subject to VAT; since however German legislation exempts such activities, the Commission concludes that

10 — Case 74/82 *Commission* v *Ireland* [1984] ECR 317, paragraph 20 of the judgment.

11 — *Commission* v *Denmark*, cited in note 8, paragraph 16 of the judgment.

12 — Case C-149/97 *Institute of the Motor Industry* [1998] ECR I-7053, paragraph 18 of the judgment. See paragraph 29 below for further discussion of the effect of Article 2.

Germany has infringed Article 2(1). That case is in my view adequately stated in both the letter of formal notice and the reasoned opinion.

23. Moreover it follows from the fact that Germany responded to the reasoned opinion with detailed purported justification for the national legislation at issue that that opinion — and hence also the letter of formal notice, which as Germany states is in substantially identical terms — enabled the Member State concerned to prepare a defence.

24. The Commission's action is accordingly admissible.

Substance

25. The Commission notes that, by virtue of Article 4(2) of the Sixth Directive, a body governed by public law such as a State university is considered to be taxable in so far as it carries out an economic activity such as the supply of services. When carrying out research which is commissioned and remunerated pursuant to a contract, State universities consequently provide services and are accordingly taxable pursuant to Article 4 of the Sixth Directive. Since Article 2(1) provides for the supply of services effected for consideration by a taxable person to be subject to VAT, the national legislation at issue infringes Article 2(1) of the Sixth Directive.

26. Germany raises two principal arguments by way of defence.

27. First, it submits that the Commission's claim is not founded since Article 2 of the Sixth Directive is neither an obligation nor a prohibition but simply a definition of the basis of assessment and as such not susceptible of infringement.

28. Second, it submits that the exemption for research activities of State universities is justified pursuant to Article 13A(1)(i) of the Sixth Directive.

Article 2(1) of the Sixth Directive

29. I do not accept Germany's argument that no obligation to impose VAT follows

from Article 2. That argument finds no support in the case-law of the Court. The Court has ruled that Article 2 is infringed by national legislation exempting certain transactions from VAT [13] or by Member States which have omitted to charge VAT on certain transactions [14] and has explicitly stated that the 'fundamental principle which underlies the VAT system, and which follows from Article 2 of the First and Sixth Directives, is that VAT applies to each transaction by way of production or distribution ...' [15] and that 'a supply of services is effected "for consideration" within the meaning of Article 2(1) of the Sixth Directive, and hence is taxable ...'. [16]

Article 13A(1)(i) of the Sixth Directive

30. Germany submits that the research activities of State universities satisfy the criteria for the exemption provided for in Article 13A(1)(i) of the Sixth Directive. Services related to research are closely related to higher education. Research and teaching activities in universities cannot be separated.

31. Article 13A(1)(i) requires Member States to exempt from VAT 'university education ..., including the supply of services and of goods closely related thereto, provided by bodies governed by public law ...'.

32. As the Commission points out, that provision makes no mention of research activities of State universities. It is settled case-law that the terms used to specify the exemptions envisaged by Article 13 of the Directive are to be interpreted strictly, since they constitute exemptions to the general principle that turnover tax is levied on all services supplied for consideration by a taxable person, [17] that the aim of Article 13A is to exempt from VAT certain activities which are in the public interest and that that provision does not provide exemption for every activity performed in

13 — See for example Case 203/87 *Commission* v *Italy* [1989] ECR 371, paragraph 11 and operative part of the judgment; Case C-35/90 *Commission* v *Spain* [1991] ECR I-5073, paragraph 10 and operative part; Case C-331/94 *Commission* v *Greece* [1996] ECR I-2675, paragraph 19 and operative part.

14 — See for example the road toll cases: Case C-276/97 *Commission* v *France* [2000] ECR I-6251, paragraph 49 and operative part of the judgment; Case C-358/97 *Commission* v *Ireland* [2000] ECR I-6301, paragraph 58 and operative part; and Case C-359/97 *Commission* v *United Kingdom* [2000] ECR I-6355, paragraph 70 and operative part.

15 — Case C-62/93 *BP Supergas* v *Greek State* [1995] ECR I-1883, paragraph 16 of the judgment; see also paragraph 20 of my Opinion.

16 — Case C-16/93 *Tolsma* [1994] ECR I-743, paragraph 14 of the judgment.

17 — But see the points made by Advocate General Fennelly in his Opinion in Case C-76/99 *Commission* v *France* [2001] ECR I-249, paragraphs 21 to 23, and my Opinion in Case C-267/00 *London Zoological Society*, delivered today, paragraphs 17 to 19.

the public interest, but only for those which are listed and described in great detail.[18] Since research activities of State universities are not separately mentioned in Article 13A(1)(i), they will be exempt from VAT pursuant to that provision only if they are 'closely related' to university education.

33. The Court recently considered the scope of activities 'closely related' to hospital and medical care within the meaning of Article 13A(1)(b) of the Sixth Directive, which requires Member States to exempt from VAT 'hospital and medical care and closely related activities undertaken by bodies governed by public law ...'. The Commission had submitted that it was contrary to that provision for France to levy VAT on fixed allowances for the taking of samples for medical analysis. The Court stated that the concept of activities 'closely related' to hospital and medical care did not 'call for an especially narrow interpretation since the exemption of activities closely related to hospital and medical care is designed to ensure that the benefits flowing from such care are not hindered by the increased costs of providing that would follow if it, or closely related activities, were subject to VAT'.[19] That proposition closely follows the suggestion of Advocate General Fennelly, who considered that 'all activities which are directly and intimately related to the provision of "hospital and medical care" should, regardless of their form, be regarded as covered by the exemption'.[20]

34. The Court accordingly gave weight to the purpose of the activities alleged to be closely related to the exempt activities. In particular, it must be ascertained whether the service at issue constitutes for the customer an aim in itself or a means of better enjoying the principal service supplied.[21]

35. Applying those principles to the present case leads to the conclusion in my view that commissioned and remunerated research activities of State universities are not within the scope of the exemption for university education in Article 13A(1)(i) of the Sixth Directive.

36. Germany states in its defence that research and teaching are inseparable. Universities — in contrast to other teaching establishments with a purely practical orientation — need research for the purposes of teaching since both activities enable them to develop and convey knowledge. The close connection between research and teaching in universities is reflected in both the German constitution,

18 — *Institute of the Motor Industry*, cited in note 12, paragraphs 17 and 18 of the judgment and cases there cited.

19 — Case C-76/99 *Commission* v *France*, cited in note 17, paragraph 23 of the judgment.

20 — Paragraph 23 of the Opinion.

21 — Paragraphs 24 and 27 of the judgment.

which states that research and teaching are independent [frei],[22] and the Higher education framework law,[23] which states that research in universities contributes to the acquisition of scientific knowledge and the development of teaching and study.[24] Germany concludes that, if research and teaching were to be distinguished for the purposes of VAT, it would be inefficient and bureaucratic to separate exempt and taxable activities.

37. I accept that in university life research and teaching are closely connected. It must however be borne in mind that, if the Commission succeeds in its application, that will not mean that all research activities must be distinguished for all purposes from all teaching activities. VAT must be imposed on the supply of services effected for consideration. Accordingly, where a university carries out research for remuneration, those research services are subject to VAT. Conversely, where research is carried out for no consideration, the question of VAT will not arise. I cannot see that it is particularly difficult to distinguish remunerated services — which will necessarily be the subject of contracts — from general educational activities including research undertaken without consideration by way of further study.

38. The Commission moreover states that to its knowledge all Member States other than Germany and Ireland[25] distinguish in the case of higher education establishments between educational activities exempted from VAT pursuant to Article 13A(1)(i) of the Sixth Directive and research activities subject to VAT. I cannot therefore accept that separating exempt and taxable activities would be as problematic as Germany alleges. In any event it is settled law that practical difficulties of implementation cannot justify failure to implement.

39. I would add that the definition of research activities in national law is irrelevant: it is clear that the subjection to, or exemption from, VAT of a specific transaction cannot depend on its classification in national law.[26]

22 — Paragraph 5(3) of the Grundgesetz.

23 — Cited in note 4.

24 — Paragraph 22.

25 — Also the subject of infringement proceedings, which when the Commission lodged the application in the present case were at the stage of the letter before action.

26 — *Commission* v *France*, cited in note 17, paragraph 26 of the judgment.

40. Since for the above reasons remunerated research activities of State universities do not fall within the scope of the exemption from VAT for university education in Article 13A(1)(i) of the Sixth Directive, it follows that Germany is in breach of Article 2 of the Directive. It is not therefore necessary to consider Germany's argument that exempting such activities from VAT contributes to fiscal simplification and avoids administrative costs: Germany accepts that that argument would be relevant only if the exemption in Article 13A(1)(i) were to apply.

Conclusion

41. Accordingly the Court should in my opinion:

(1) declare that the Federal Republic of Germany, by exempting from value added tax research activities conducted by public-sector higher education establishments, has failed to fulfil its obligations under Article 2 of the Sixth VAT Directive;

(2) order the Federal Republic of Germany to pay the costs.