OPINION OF ADVOCATE GENERAL JACOBS
delivered on 25 September 1997 *

1. The issue in this case, referred to the Court by the Finanzgericht des Landes Brandenburg (Finance Court of the Land of Brandenburg), is whether by reducing his potato crop in return for a national subsidy a farmer provides a service for consideration within the meaning of the Sixth VAT Directive. [1]

Relevant Community provisions

2. Article 2(1) of the Sixth Directive provides:

'The following shall be subject to value added tax:

(1) the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such.'

3. Article 6(1) of the Directive provides:

'"Supply of services" shall mean any transaction which does not constitute a supply of goods within the meaning of Article 5.'

Such transactions may include *inter alia*:

'...

— obligations to refrain from an act or to tolerate an act or situation,

— the performance of services in pursuance of an order made by or in the name of a public authority or in pursuance of the law.'

* Original language: English.

1 — Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization 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.

4. At the material time, i. e. the year 1990, Article 12(3) of the Directive read as follows:

'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.'

5. Article 12(3) was amended by Council Directive 92/77/EEC, [2] which Member States were required to implement not later than 31 December 1992. In so far as is relevant Article 12(3)(a) of the Sixth Directive provides:

'From 1 January 1993 Member States shall apply a standard rate which, until 31 December 1996, may not be less than 15%. Member States may also apply either one or two reduced rates. The reduced rates may not be less than 5% and shall only apply to supplies of the categories of goods and services specified in Annex H.'

6. Annex H, inserted by Directive 92/77, includes:

'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'.

The facts and national court's questions

7. Landboden-Agrardienste GmbH & Co. KG (hereinafter 'Landboden'), the applicant in the main proceedings, is the successor in title to the concern Landwirtschaftliche Produktionsgenossenschaft (P) Bronkow (hereinafter 'Bronkow'). In 1990 Bronkow was granted compensation by the Amt für Ernährung, Landwirtschaft und Forsten

...

2 — Council Directive of 19 October 1992 supplementing the common system of value added tax and amending Directive 77/388/EEC (approximation of VAT rates), OJ 1992 L 316, p. 1.

(Food, Agriculture and Forestry Office) of the Calau local authority, pursuant to the Decree of 13 July 1990 promoting the extensification [3] of agricultural production. The compensation, totalling DM 348 660, was granted in return for a 20% reduction in Bronkow's annual potato production. In its turnover tax declaration for 1990 Bronkow did not include the compensation in its taxable turnover, with the result that a net refund of tax was due for that year. Following an investigation, the tax authorities concluded that the compensation should have been included in Bronkow's taxable turnover and issued an amended notice of assessment.

8. In the ensuing proceedings the Finanzgericht decided to seek a preliminary ruling on the following questions:

'(1) Must a taxable farmer, who in 1990 extensified his potato production in Brandenburg (Federal Republic of Germany) to such an extent that at least twenty per cent of his potato crop was not harvested by him, be regarded as having supplied to a specific recipient a service within the meaning of Article 6(1) of the Sixth Council Directive of 17 May 1977 (77/388/EEC) on the harmonization of the laws of the Member States relating to turnover taxes ("the Sixth Directive")?

(2) Does a subsidy paid for the extensification of potato production on the basis of the decree of 13 July 1990 promoting the extensification of agricultural production constitute a cash payment taxable pursuant to Article 11A(1)(a) of the Sixth Directive?

(3) If the answer to question (1) is in the affirmative:

Is the service supplied to be taxed at the reduced rate provided for by the fourth sentence of Article 12(3)(a) of the Sixth Directive in conjunction with Annex H thereto?'

3 — This somewhat misleading term, which does not appear in the Shorter Oxford Dictionary, is to be found in Community legislation as denoting a reduction in agricultural production: see, for example, Council Regulation (EEC) No 797/85, OJ 1985 L 93, p. 1 and Council Regulation (EEC) No 1760/87, OJ 1987 L 167, p. 1. According to *The Times* of 23 January 1989, 'Extensification is Euro-jargon for farming less intensively, balancing lower output by savings in expenditure on feed, fertilisers and pesticides'. Source: Oxford English Dictionary Word and Language Service (OWLS), Oxford University Press.

The judgment in *Mohr*

9. During the proceedings in this case the Court gave judgment in *Mohr* [4] in which it held that an undertaking given by a farmer to discontinue milk production pursuant to a Community regulation did not constitute a supply of services. The compensation received by the farmer pursuant to the regulation was therefore not subject to VAT. The Court reached that conclusion on the following grounds:

'... by compensating farmers who undertake to cease their milk production, the Community does not acquire goods or services for its own use but acts in the common interest of promoting the proper functioning of the Community milk market.

In those circumstances, the undertaking given by a farmer that he will discontinue his milk production does not entail either for the Community or for the competent national authorities any benefit which would enable them to be considered consumers of a service. The undertaking in question does not therefore constitute a supply of services within the meaning of Article 6(1) of the Directive.'

4 — Case C-215/94 *Mohr* v *Finanzamt Bad Segeberg* [1996] ECR I-959.

10. The Commission considers that the Court's reasoning in *Mohr* is equally applicable to the subsidy in issue in the present case, that is to say, compensation granted by the public authorities in return for a reduction in production under national intervention arrangements. I share that view.

11. However, as I shall explain below, the Finanzamt and the German Government criticize the ruling in *Mohr* and contend that the Court should not extend it to the present case.

Appraisal of the issues

12. One might, with some justification, take the view that there is little, if any, point in imposing VAT on subsidies. By doing so a public authority simply claws back money which has been granted by itself or by another public authority; in the latter case taxation of subsidies amounts to a rather circuitous — and costly — way of reallocating revenue between public authorities. National taxation of Community subsidies would, for example, represent no more than a diversion of resources from the Community budget to that of a Member State (except of course for the element of the VAT which forms part of the Community's own resources, which

would fall to be refunded to the Community).

13. Moreover, unless the amount clawed back in tax is offset by a corresponding increase in the amount of the subsidy, taxation will reduce the economic effects which the subsidy is designed to attain. Where the recipient has a choice between selling his produce and accepting a subsidy in return for not marketing it, taxation of the subsidy will make it less attractive.

14. The Sixth Directive makes only limited provision for taxation of subsidies. Article 11A(1)(a) includes in the taxable amount 'subsidies directly linked to the price' of supplies. Thus, a subsidy will be included in the taxable amount if it is paid subject to the condition that the recipient makes a supply of goods or services. For example, a support measure whereby a farmer receives a certain sum for each product sold forms part of the consideration for the supply. On the other hand, subsidies that are more remote from particular supplies and intended more generally to improve the undertaking's economic position do not form part of the basis of assessment. Examples of such subsidies include subsidies for the purchase of assets, for covering losses and for the restructuring of an undertaking.

15. The distinction made by the Sixth Directive is not without its difficulties. As the Commission noted in its First Report: [5]

'Article 11(A)(1)(a) of the Directive stipulates that subsidies received by a taxable person which are "directly linked to the price" of the supplies made by that person must be included in the taxable amount as components of the prices paid by third parties. While it is relatively easy to decide straight away that subsidies are "directly linked to the price" when their amount is determined either by reference to the selling price of the goods or services supplied, or in relation to the quantities sold, or again in relation to the cost of goods or services supplied to the public free of charge, it is extremely difficult to decide in the case of other types of subsidy such as deficit subsidies or operating subsidies, which are paid with the aim of improving a firm's economic position and which are granted without specific reference to any price. The absence of any substantial difference between these two types of subsidy (those "directly linked to the price" are usually also aimed at improving a firm's position), together with the fact that a Member State can convert a subsidy of the first type into a subsidy of the second type, illustrate the fragility of a distinction based on purely formal criteria (the manner in which the subsidy is granted) and thus the inadequacy of the Directive in this respect.'

5 — First Report from the Commission to the Council on the application of the common system of value added tax, submitted in accordance with Article 34 of the Sixth Council Directive (77/388/EEC) of 17 May 1977, COM(83) 426 final, 14 September 1983, p. 37.

16. Nevertheless the treatment of subsidies in the Directive may be seen to conform to the general rule that there should be a direct link between a supply and the consideration given. [6] It might also be justified on the ground that subsidies granted with reference to specific supplies are likely to have a more direct impact on competition. Superficially at least, there seems to be a greater case for treating such subsidies as part of the price paid by (or on behalf of) the consumer.

17. Whatever the merits of the requirement laid down by the Directive, it seems clear that it is not met by the subsidy in issue here.

18. It is first of all clear that the subsidy is not directly linked to supplies of produce to consumers. It does not therefore form part of the consideration for a supply of goods within the meaning of Article 11A(1)(a) of the Directive. On the contrary, its purpose is to stabilize markets by limiting the supply of produce. It seeks to improve the position of the farmer partly by compensating him for lost production and partly by bringing about an increase in the price of produce sold to consumers. The subsidy may therefore be distinguished from a price support subsidy such as that described above, which seeks to improve the financial position of the farmer by subsidizing particular supplies of produce.

19. The Finanzamt and the German Government argue however that, although the subsidy in issue here cannot be regarded as part of the consideration for a supply of goods under Article 11A(1)(a), it is caught by the Directive as consideration for the supply of a service. The farmer's act of limiting production or refraining from marketing certain produce is a service in its own right, separate from the supply of produce to consumers and with its own consideration. It is argued that, by requiring that the public authority must receive a supply for its own use, the Court has added a condition not provided for in the Directive. The German Government supports that conclusion with the — rather exotic — example of an individual who purchases a south seas island; the sale of the island would constitute a supply of goods within the meaning of the Directive regardless of whether the person actually used the island. The German Government adds that a subsidy may constitute the consideration for a supply of services even though it is paid in the general interest.

20. The German Government considers that the Court's ruling in *Mohr* results in a distortion of competition. It gives the example

6 — See, most recently, the judgments in Case C-288/94 *Argos Distributors* v *Commissioners of Customs and Excise* [1996] ECR I-5311 and Case C-317/94 *Gibbs* v *Commissioners of Customs and Excise* [1996] ECR I-5339.

of a farmer who grows certain produce for a cost of DM 100. However, market conditions are such that he would only be able to sell it for DM 1. To offset the losses he receives DM 99 from the Community. Under Article 11A(1)(a) the taxable amount would be DM 100. If, on the other hand, the Community had bought the produce for DM 100 in order to stabilize the market, the German Government considers that the subsidy would not be subject to VAT by virtue of the ruling in *Mohr*. It points out that the taxable person acts in the same way and receives the same income; yet in one case he makes a supply subject to VAT but in the other does not.

21. The German Government's example is not wholly apposite because, as I shall explain, in the second example there would in my view be a supply of goods within the meaning of the Directive. There is however a more basic flaw in the German Government's argument: it fails to recognize that VAT is not a tax on income but a tax on consumption. A taxable person's income is relevant for VAT purposes only if it constitutes the consideration for a supply of goods or services to a consumer. If there is no consumption then there should be no VAT.

22. In that regard it is necessary to distinguish between supplies of goods and supplies of services. As the German Government illustrates with its south seas island example, a supply of goods by a taxable person always entails consumption regardless of the use, if any, to which the goods are put. Consumption in the context of VAT does not mean actual use but merely the acquisition of the right to dispose of the goods as owner. Where goods pass down the commercial chain they must be subject to VAT — it would be unworkable if tax authorities had to inquire whether there was actual enjoyment of the goods.

23. Thus, if a public authority acquires land with a view to the construction of a motorway but in the event does nothing with it, there is still a supply of goods. Moreover, the fact that the purchase is made in the public interest of a sound transport policy does not remove it from the scope of VAT. As already mentioned, in the German Government's example of a purchase of goods by the Commission or by an intervention agency, there is undoubtedly a supply of goods.

24. The position regarding services is however more complex. Services are defined residually in the Directive as 'any transaction which does not constitute a supply of goods'. The acquisition of a service is more difficult to verify than the acquisition of goods. Any payment, except perhaps a gift,

will have conditions attached to it whose performance might, by creative use of language, be described as a service.

25. In order to determine whether a service has been provided within the meaning of the Directive, however, it is necessary to examine the transaction in the light of the aims and characteristics of the common VAT system. Article 2 of the First Directive provides:

'The principle of the common system of Value Added Tax involves the application to goods and services 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.

On each transaction, Value Added Tax, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of Value Added Tax borne directly by the various cost components.

... .'

26. The transaction in the present case does not fit in with that definition. There is no consumption. The farmer does not supply goods to a consumer, he does not provide services to an identifiable consumer and he does not provide any benefit capable of forming a cost component of the activity of another person in the commercial chain.

27. In the order for reference in the present case, delivered before the Court's ruling in *Mohr*, the national court arrived at a similar conclusion as a matter of German law:

'... the identity of the intended recipient of the service is open to question. Whilst Paragraph 1(1)(1) of the Umsatzsteuergesetz (Turnover Tax Law — UStG) (GDR and Federal Republic of Germany) does not expressly state that the service must be rendered to a specific recipient, that requirement is nevertheless apparent, first, from the nature of the matter and the character of turnover tax as a tax on consumption, and, second, from numerous other provisions of the UStG in which this is presumed to be self-evident (e. g. Paragraphs 3(1), 6(2), 7, 9(1) and 10(2) of the UStG (GDR and Federal Republic of Germany)). It is frequently the case, where subsidies from public funds are involved, that no such specific recipient is identifiable. Whilst it is true that, in so far as it is in the public interest to promote such conduct on the part of the taxable person, the public at large may be regarded as the

recipient of the service, the referring court is of the view that the public at large cannot constitute a specific recipient of the kind which must exist in order to give rise to a transaction chargeable to turnover tax. Nor can the authority paying the subsidy be regarded as a recipient. The taxable person does not render that authority any specific service. He does not extensify his agricultural production for the benefit of the authority granting the subsidy ...'

28. The situation in the present case may be contrasted with that in which a taxable person's competitor enters into a (possibly anti-competitive) agreement to limit the taxable person's production. By paying the taxable person to do so the competitor hopes to raise the price of his goods. The service purchased from the taxable person is clearly a cost component of the competitor's sales just as much as his raw material or labour costs. The competitor is an identifiable consumer of the taxable person's service consisting in limiting production or refraining from marketing.

29. In the present case, however, by deeming there to be a service for the purposes of VAT the Finanzamt is in fact circumventing the rule that only subsidies linked to price form part of the basis of assessment. Moreover, in the case of a subsidy such as that in issue here the Finanzamt would be able to tax not only the increase in the price of the produce sold resulting from the reduction in supply (an increase which may well be greater than the amount of the subsidy granted) but also the subsidy.

30. It may also be noted that Article 12(3)(a) of the Directive, in conjunction with Annex H, makes provision only for reduced rates for supplies of foodstuffs, not for services consisting in limiting production or non-marketing of foodstuffs. In my view the German Government correctly suggests — in reply to part (c) of the national court's questions — that such a supply of services does not qualify for the reduced rate. The German Government's view therefore leads to the anomalous result that the compensation for not supplying foodstuffs to consumers would be taxed at the standard rate of tax whereas the foodstuffs themselves, had they been sold, would be eligible for a reduced rate of tax under the option granted to Member States by the above provisions.

31. Contrary to the German Government's view, I do not, on the other hand, think there is any anomaly in the fact that a farmer, by accepting the subsidy, avoids paying VAT. The response to that point is, again, that VAT is a tax not on income but on consumption.

Conclusion

32. Accordingly I am of the opinion that the questions referred by the Finanzgericht des Landes Brandenburg should be answered as follows:

A national subsidy paid to a farmer for the extensification of potato production does not constitute consideration for a supply of goods or services within the meaning of Article 11A(1)(a) of the Sixth Council Directive (77/388/EEC).