

# 61985J0415

Judgment of the Court of 21 June 1988. - Commission of the European Communities v Ireland. - Value added tax - Zero rating. - Case 415/85.

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## Keywords

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*1 . Action against a Member State for failure to fulfil its obligations - Objective nature - Objectives pursued by the Commission - Not to be considered*

*( EEC Treaty, Art . 169 )*

*2 . Tax provisions - Harmonization of legislation - Turnover tax - Common system of value-added tax - Reduced rates and exemptions retained on a transitional basis for "clearly defined social reasons and for the benefit of the final consumer" - Concept*

*( Council Directive 67/228, Art . 17, last indent, and Council Directive 77/388, Art . 28 ( 2 ) )*

## Summary

*1 . An action by the Commission pursuant to Article 169 of the Treaty against a Member State for failure to fulfil its obligations, the bringing of which is a matter for the Commission in its entire discretion, is objective in nature . In the context of the balance of powers between the institutions laid down in the Treaty, it is not for the Court to consider what objectives are pursued in such an action . Its role is to decide whether or not the Member State in question has failed to fulfil its obligations as alleged .*

*2 . The identification of "clearly defined social reasons" for which certain reduced rates and exemptions from value-added tax may be retained on a transitional basis pursuant to the last indent of Article 17 of the Second Directive and Article 28 ( 2 ) of the Sixth Directive is in principle a matter of political choice for the Member States and can be the subject-matter of supervision at the Community level only in so far as, by distorting that concept, it leads to measures which*

*because of their effects and their true objectives lie outside its scope .*

*Since, under the general scheme of value-added tax, the final consumer is the person who acquires goods or services for personal use, as opposed to an economic activity, and thus bears the tax, the second condition laid down in those provisions for the retention of certain reduced rates and exemptions, that is to say that they must be "for the benefit of the final consumer" must in the light of the social purpose of Article 17 be understood as meaning that the beneficiary must not use exempted goods or services in the course of an economic activity . The provision of goods or services at a stage higher in the production or distribution chain which is nevertheless sufficiently close to the consumer to be of advantage to him must also be considered to be for the benefit of the final consumer as so defined .*

## **Parties**

*In Case 415/85*

*Commission of the European Communities, represented by its Legal Adviser D . R . Gilmour, acting as Agent, with an address for service in Luxembourg at the office of G . Kremlis, a member of its Legal Department, Jean Monnet Building, Kirchberg,*

*applicant,*

*v*

*Ireland, represented by L . J . Dockery, Chief State Solicitor, acting as Agent, with an address for service in Luxembourg at the Irish Embassy, 28 route d' Arlon,*

*defendant,*

*APPLICATION for a declaration that by applying a system of zero-rating to certain groups of goods and services Ireland has failed to fulfil its obligations under 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 - Common system of value-added tax : uniform basis of assessment ( 77/388/EEC, Official Journal 1977, L 145, p . 1 ),*

**THE COURT**

*composed of : Lord Mackenzie Stuart, President, G . Bosco, O . Due, J . C . Moitinho de Almeida and G . C . Rodríguez Iglesias ( Presidents of Chambers ), T . Koopmans, U . Everling, K . Bahlmann, Y . Galmot, C . Kakouris, R . Joliet, T . F . O' Higgins and F . Schockweiler, Judges,*

*Advocate General : M . Darmon*

*Registrar : H . A . Ruehl, Principal Administrator*

*having regard to the Report for the Hearing and further to the hearing on 15 September 1987, after hearing the Opinion of the Advocate General delivered at the sitting on 2 December 1987, gives the following*

*Judgment*

# Grounds

1 By an application lodged at the Court Registry on 13 December 1985 the Commission of the European Communities brought an action pursuant to Article 169 of the EEC Treaty for a declaration that by continuing to apply a zero rate of value-added tax to certain groups of goods and services Ireland has contravened the provisions of 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 ( Official Journal 1977, L 145, p . 1 ) ( hereinafter referred to as "the Sixth Directive ") and has therefore failed to fulfil its obligations under the EEC Treaty .

2 Article 28 of the Sixth Directive lays down transitional provisions for the progressive adaptation of national legislation in certain respects . Article 28 ( 2 ) provides as follows :

"Reduced rates and exemptions with refund of the tax paid at the preceding stage which are in force on 31 December 1975, and which satisfy the conditions stated in the last indent of Article 17 of the Second Council Directive of 11 April 1967, may be maintained until a date which shall be fixed by the Council, acting unanimously on a proposal from the Commission, but which shall not be later than that on which the charging of tax on imports and the remission of tax on exports in trade between the Member States are abolished . Member States shall adopt the measures necessary to ensure that taxable persons declare the data required to determine own resources relating to these operations .

On the basis of a report from the Commission, the Council shall review the abovementioned reduced rates and exemptions every five years and, acting unanimously on a proposal from the Commission, shall where appropriate, adopt the measures required to ensure the progressive abolition thereof ."

3 The last indent of Article 17 of Council Directive 67/228/EEC of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes - Structure and procedures for application of the common system of value-added tax ( Official Journal, English Special Edition 1967, p . 16 ) ( hereinafter referred to as "the Second Directive "), to which Article 28 of the Sixth Directive refers, provides that Member States may :

"provide for reduced rates or even exemptions with refund, if appropriate, of the tax paid at the preceding stage, where the total incidence of such measures does not exceed that of the reliefs applied under the present system . Such measures may only be taken for clearly defined social reasons and for the benefit of the final consumer, and may not remain in force after the abolition of the imposition of tax on importation and the remission of tax on exportation in trade between Member States ".

4 On the basis of Article 28 ( 2 ) of the Sixth Directive, Ireland has continued to apply a system called "zero-rating " . The Irish legislation on the matter is contained in the Value-Added Tax Act 1972, as amended in particular by the Finance Act 1985 .

5 The Commission considered that certain of the zero rates provided for by the Irish legislation did not comply with the criteria contained in the last indent of Article 17 of the Second Directive; by a letter of 19 October 1981 it therefore called on the Irish Government to submit its observations in accordance with the first paragraph of Article 169 of the EEC Treaty .

6 The Irish Government did not agree that it had failed to fulfil its obligations under the Treaty, and on 4 September 1984 the Commission therefore delivered a reasoned opinion . Since the Irish

*Government did not comply with that opinion, the Commission brought these proceedings .*

*7 Reference is made to the Report for the Hearing for a fuller account of the facts of the case, the course of the procedure and the submissions and arguments of the parties, which are mentioned or discussed hereinafter only in so far as is necessary for the reasoning of the Court .*

#### *The jurisdiction of the Court*

*8 Ireland contends that there is a political motive behind the Commission' s application to the Court and that such a motive is not a proper basis for an action pursuant to Article 169 of the EEC Treaty . The Commission' s action is intended in fact to attain by means of judicial proceedings an objective which can be achieved only by a decision of the Community legislature . It is clear from the Commission' s reply that its intention in bringing these proceedings is to bypass the procedural requirements of Article 28 of the Sixth Directive, under which it is for the Council, acting unanimously, to decide to abolish the exemptions permitted by that article . Ireland therefore submits that it is not the task of the Court "to substitute itself for the political procedures envisaged by Article 28 of the Sixth Directive and to substitute an immediate obligation upon a Member State for the progressive compliance envisaged by Article 28 ".*

*9 That argument cannot be upheld . In the context of the balance of powers between the institutions laid down in the Treaty, it is not for the Court to consider what objectives are pursued in an action brought under Article 169 of the Treaty . Its role is to decide whether or not the Member State in question has failed to fulfil its obligations as alleged . As the Court held in its judgment of 10 December 1968 in Case 7/68 Commission v Italian Republic (( 1968 )) ECR 423, an action against a Member State for failure to fulfil its obligations, the bringing of which is a matter for the Commission in its entire discretion, is objective in nature .*

#### *Substance*

*10 It should be pointed out first of all that the Commission does not dispute the legality of the zero-rating system in general; it considers that system to be essentially equivalent to the exemptions provided for by Article 28 of the Sixth Directive, as it expressly stated in its proposal for a Sixth Directive submitted to the Council on 29 June 1973 . It submits, however, that the requirements laid down in the last indent of Article 17 of the Second Directive, which provides that exemptions may be made only "for clearly defined social reasons and for the benefit of the final consumer", are not met with regard to the following groups of goods and services included in the Finance Act 1985 :*

*"( vii)animal feedingstuff, excluding feedingstuff which is packaged, sold or otherwise designated for the use of dogs, cats, caged birds or domestic pets;*

*( viii)fertilizer ( within the meaning of the Fertilizers, Feedingstuffs and Mineral Mixtures Act, 1955 ) which is supplied in units of not less than 10 kg and the sale or manufacture for sale of which is not prohibited under section 4 or 6 of the said Act;*

*( xiv)medicine of a kind used for animal oral consumption, excluding medicine which is packaged, sold or otherwise designated for the use of dogs, cats, caged birds or domestic pets;*

*( xv)seeds, plants, trees, spores, bulbs, tubers, tuberous roots, corms, crowns and rhizomes, of a kind used for sowing in order to produce food;*

*( xx ) ( a ) electricity .*

*However, in the case of item xx the objection does not extend to supplies made to final consumers ."*

*11 Ireland disputes the Commission' s position . It argues first of all that the Commission gives too restrictive an interpretation to Article 28 ( 2 ) of the Sixth Directive and the last indent of Article 17 of the Second Directive; secondly, it argues that the tax relief in question must be considered to be legitimate in the light of Articles 27 and 25 of the Sixth Directive .*

*12 Consequently, it must be determined whether the zero-rating of the goods and services at issue complies with the conditions laid down in the provisions referred to, and whether the argument put forward by the Irish Government on the basis of Articles 27 and 25 of the Sixth Directive justifies the retention of zero rates for those goods and services .*

*The concept of "clearly defined social reasons"*

*13 With regard to the first condition, that is to say that exemption may be granted only for clearly defined social reasons, the parties are agreed that the determination of their own social policy is a matter for the discretion of the Member States . They accept, however, that that discretion may be subject to supervision at the Community level .*

*14 In particular, the Commission states that by "social reasons" it understands measures which are introduced primarily for general social purposes and not principally for industrial, sectoral or fiscal reasons; it accepts, however, that it may not challenge measures taken in pursuance of a Member State' s social policy unless it can be shown that the social policy is not sufficiently clearly defined or that the measures in question either are not justified by or are disproportionate to the social reasons advanced .*

*15 The identification of social reasons is in principle a matter of political choice for the Member States and can be the subject-matter of supervision at the Community level only in so far as, by distorting that concept, it leads to measures which because of their effects and their true objectives lie outside its scope .*

*The phrase "for the benefit of the final consumer"*

*16 The Commission regards as "final consumers" those persons who stand at the final stage in the manufacturing and commercial chain and have no right to deduct value-added tax, that is to say non-taxable persons .*

*17 Ireland disputes in particular the Commission' s argument to the effect that only measures of direct benefit to the final consumer can be justified under Article 17 of the Second Directive .*

*18 Under the general scheme of value-added tax the final consumer is the person who acquires goods or services for personal use, as opposed to an economic activity, and thus bears the tax . It follows that having regard to the social purpose of Article 17 the term "final consumer" can be applied only to a person who does not use exempted goods or services in the course of an economic activity . The provision of goods or services at a stage higher in the production or distribution chain which is nevertheless sufficiently close to the consumer to be of advantage to him must also be considered to be for the benefit of the final consumer as so defined .*

*The applicability to the products in issue of Articles 27 and 25 of the Sixth Directive*

*19 Ireland considers that the zero-rating of the products at issue can be justified on the basis of Articles 27 and 25 of the Sixth Directive .*

20 Paragraphs ( 1 ) and ( 5 ) of Article 27 provide as follows :

*"( 1 ) The Council, acting unanimously on a proposal from the Commission, may authorize any Member State to introduce special measures for derogation from the provisions of this directive, in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance . Measures intended to simplify the procedure for charging the tax, except to a negligible extent, may not affect the amount of tax due at the final consumption stage .*

...

*( 5 ) Those Member States which apply on 1 January 1977 special measures of the type referred to in paragraph 1 above may retain them providing they notify the Commission of them before 1 January 1978 and providing that where such derogations are designed to simplify the procedure for charging tax they conform with the requirement laid down in paragraph 1 above ."*

*21 In disputing Ireland' s argument the Commission points out first of all that the respective spheres of application of Articles 27 and 28 are entirely separate and there is no relationship of complementarity between them . In particular, Article 27 cannot be used to extend zero-rating, by way of simplification measures or measures designed to prevent tax evasion, to a new category of goods or services and thus to circumvent the rules of Article 28 ( 2 ). The Commission adds that Article 27 provides for permanent simplification measures, whereas the exemptions provided for by Article 28 are permitted only on a transitional basis .*

*22 With regard to Article 25, which authorizes under certain circumstances the application of a flat-rate scheme for farmers, the Commission points out that that provision is itself a derogation from the general rules of the Sixth Directive and cannot serve as a basis for extending the range of exemptions beyond those permitted by Article 28 .*

*23 The concept of simplification measures cannot be regarded as equivalent to that of exemption measures, especially since the second sentence of Article 27 ( 1 ) provides expressly that simplification measures may not "except to a negligible extent ... affect the amount of tax due at the final consumption stage ".*

*24 With regard to the application of Article 25, it is sufficient to point out that that provision is intended to alleviate the difficulties which farmers might encounter in the application of the normal system of value-added tax by establishing a flat-rate scheme . That scheme consists in essence in the payment of compensation on a flat-rate percentage basis so as to "offset the value-added tax charged on purchases of goods and services" ( Article 25 ( 1 ) ).*

*25 It follows from the foregoing that that provision, which presupposes the payment of value-added tax on inputs ( Article 25 ( 3 ) ), cannot justify the zero-rating of goods or services used in the production of agricultural products .*

*26 The submissions put forward by Ireland must therefore be rejected .*

*The zero rates at issue*

*A - Agricultural inputs ( Finance Act 1985, Items ( vii ), ( viii ), ( xiv ) and ( xv ) )*

*27 The Commission submits that the zero-rating of these products does not comply with the second condition laid down in the last indent of Article 17 of the Second Directive . It states that transactions in these products are too remote from the final zero-rated food product to fulfil the criterion of benefit to the final consumer .*

28 Ireland disputes that argument; on the contrary, it says, the goods in question are directly linked to the final zero-rated food product . Moreover, the Irish legislation exempts from value-added tax only those goods which are actually used as agricultural inputs . Finally, Ireland argues that the application of zero rates is of direct benefit to the final consumer inasmuch as it avoids an increase in costs .

29 All the supplies at issue contribute to the production of substances intended for human consumption and are sufficiently close to the final consumer to be of advantage to him . Moreover, the negative effects of any taxation of those products on food prices, increases in which are particularly sensitive for the final consumer, who himself enjoys zero-rating, cannot be neglected .

30 It follows that with regard to the products of this group at issue the alleged failure of Ireland to fulfil its obligations has not been established .

*B - Electricity ( Finance Act 1985, Item ( xx ) ( a ) )*

31 The Commission challenges the zero-rating of supplies of electricity to industry, inasmuch as the supplies are not made to final consumers .

32 The first argument put forward by the Irish Government, to the effect that the difficulties in administering the tax if only supplies to final consumers were zero-rated would probably be insurmountable, cannot be upheld . Where a Member State wishes to make use of the derogations in question it must take all the practical measures necessary for the correct application of those provisions . If it considers that such measures cannot be implemented, it must refrain from applying zero rates .

33 Supplies of electricity to industry cannot be considered to have been provided for the benefit of final consumers, since final consumers as defined above derive only very indirect advantages from zero-rating . They therefore do not fulfil the second criterion of Article 17 of the Second Directive .

34 In its second argument, Ireland relies on Article 27 of the Sixth Directive, arguing that the zero-rating of supplies of electricity to industry is justified as a simplification measure .

35 That argument cannot be upheld . It is clear from the remarks set out above that Article 27 provides no basis for exemptions .

36 The alleged failure of Ireland to fulfil its obligations is therefore established .

37 It follows from the foregoing that by continuing to apply a zero rate of value-added tax to supplies of electricity, in so far as it is not supplied to final consumers, Ireland has contravened the provisions of Directive 77/388 and has therefore failed to fulfil its obligations under the EEC Treaty .

## **Decision on costs**

### **Costs**

38 Under Article 69 ( 3 ) of the Rules of Procedure, where each party succeeds on some and fails on other heads the Court may order that the parties bear their own costs . Since each party has failed on one head of claim, the parties must bear their own costs .

## Operative part

*On those grounds,*

*THE COURT*

*hereby :*

*( 1 ) Declares that by continuing to apply a zero rate of value-added tax to supplies of electricity included in Item ( xx ) ( a ) of the Finance Act 1985, in so far as it is not supplied to final consumers, Ireland has contravened the provisions of Council Directive 77/388 of 17 May 1977 and has therefore failed to fulfil its obligations under the EEC Treaty;*

*( 2 ) For the rest, dismisses the application;*

*( 3 ) Orders the parties to bear their own costs .*