OPINION OF ADVOCATE GENERAL

KOKOTT

of 4 May 2006 1(1)

Case C-251/05

Talacre Beach Caravan Sales Ltd

v

Commissioners of Customs & Excise

(Reference for a preliminary ruling from the Court of Appeal (England and Wales) (Civil Division), United Kingdom)

(Sixth VAT Directive – Article 28 – Reduced rate taxation (zero-rate) – Supply of caravans – Contents supplied with them being excluded from the zero?rate)

I – **Introduction**

1. Article 28 of the Sixth VAT Directive (2) ('the Sixth Directive') authorises the Member States, on a transitional basis and under certain conditions, to retain reduced rates of VAT. In compliance with that rule, the United Kingdom applies to certain residential caravans a tax rate of 0% (exemption from VAT with a right to deduct input tax, also known as *zero-rating*). The zero rate does not, however, apply to the removable contents (3) of the caravan.

2. Talacre Beach Caravan Sales Ltd ('Talacre' or 'the appellant') contests this in the main proceedings. It takes the view that caravans and their contents comprise a *single* supply. According to the principles of the Sixth Directive, a single supply may be subject to only one rate of VAT. In the present case this is the zero rate applicable to the main element of the supply, the caravan.

3. By its reference, the Court of Appeal (England and Wales) (Civil Division) seeks clarification of whether the applicant's understanding is correct. This would, in the view of the referring court, have the effect that the national provisions, which lead to separate taxation of the supply of the contents at the standard rate, must not be applied.

II – **Legal context**

A – *Relevant provisions of the Sixth VAT Directive*

4. Article 12(3) of the Sixth Directive (4) governs the standard rate of VAT, which may not be lower than 15%, and the reduced tax rates which may be applied to certain supplies listed in Annex H thereto.

5. Article 28(2) of the Sixth Directive (5) permits derogations therefrom on a transitional basis:

'… Notwithstanding Article 12(3), the following provisions shall apply during the transitional period referred to in Article 28l. (6)

a) Exemptions with refund of the tax paid at the preceding stage and reduced rates lower than the minimum rate laid down in Article 12(3) in respect of the reduced rates, which were in force on 1 January 1991 and which are in accordance with Community law, and satisfy the conditions stated in the last indent of Article 17 of the second Council Directive of 11 April 1967, (7) may be maintained.

…'.

B – *National provisions*

6. Section 30 of the Value Added Tax Act 1994 governs more precisely tax exempted supplies with a right to deduct input tax (zero?rating). As regards the supplies to which zero-rate tax applies, section 30(2) refers to Schedule 8 to the VAT Act 1994. Group 9 of that schedule includes as Item No 1 'Caravans exceeding the limits of size for the time being permitted for the use on roads of a trailer drawn by a motor vehicle having an unladen weight of less than 2 030 kilogrammes'.

7. It is clear from a legally binding note (8) to Item No 1 that the exemption in respect of caravans does not apply to their removable contents.

III – **Facts and the question referred for a preliminary ruling**

8. Talacre operates holiday home parks and in that connection sells new, large, non-mobile residential caravans which are placed in their parks. The available caravans are offered to the customer completely fitted and furnished. Customers can have no further influence over the contents.

9. In the caravan manufacturer's invoices to Talacre the price of the caravan without VAT and the price of the contents (9) with VAT at the standard rate are shown separately. Talacre sells the caravans to the end consumer at an inclusive price which also includes the rental of the pitch. The invoices are not broken down into separate sums for individual items, nor is VAT in any form mentioned.

10. Talacre submitted without success to the Commissioners of Customs and Excise that there should be a refund of the VAT accounted for in respect of the contents of the caravans. Before the lower courts, the appellant's claim that zero-rate tax should be applied to the complete caravan, including the removable contents, was also not accepted.

11. By order of 24 May 2004, which was received by the Court of Justice a good year later on 15 June 2005, the Court of Appeal, hearing Talacre's appeal, referred the following question for a preliminary ruling under Article 234 EC:

'Where a Member State has, pursuant to Article 28(2)(a) of the Sixth Directive, by its domestic legislation exercised its right of derogation so as to zero-rate a supply of specified goods but in the

same legislation has identified items that should not be included in the scope of the zero-rating (“excluded items”), does the fact that there is a single supply of goods (together with the excluded items) preclude the Member State from charging VAT at the standard rate on the supply of the excluded items?’

IV – **Legal assessment**

12. It is not in dispute that the relevant national provision is an exemption and largely corresponds to the requirements of the transitional scheme in Article 28(2)(a) of the Sixth Directive. (10) It must be presumed from this in particular that the zero rate for certain caravans was applicable on 1 January 1991 and that the rule is for clearly defined social reasons for the benefit of the final consumer within the meaning of Article 17 of the Second VAT Directive. (11)

13. In addition, it is agreed for the purposes of the reference for a preliminary ruling (12) that in the present situation application of the zero rate to the removable contents is precluded under national law, since the ‘exception to the exception’ in the note to Item No 1 of Group 9 of Schedule 8 to the VAT Act 1994 applies.

14. All that remains to be clarified is whether in the circumstances of the present case the Sixth Directive requires delivery of a caravan and removable contents to be classified as a single supply to which one VAT rate applies, namely the zero rate, which is applicable to the caravans because they are the main element of the supply. In other words, the question is whether the directive precludes national rules which require the supply of caravans and their removable contents to be subject to different rates of taxation.

A – *Interpretation of Article 28(2)(a) of the Sixth Directive*

15. Article 28(2)(a) of the Sixth Directive authorises the Member States to maintain, as a transitional measure, exemptions which were in force on 1 January 1991. The directive thereby refers to the relevant national rules. The form of those rules therefore determines which supplies are exempt from VAT. According to the relevant rules of the United Kingdom, the caravan itself is taxed at a zero rate but not its removable contents.

16. This determination under national law should, in principle, be strictly observed and, according to the clear wording of Article 28(2)(a) of the Sixth Directive, not be extended, as the United Kingdom Government and the Commission rightly observe; it would at most be permissible to restrict the scope of the exemption. (13) This is because Article 28(2)(a) of the Sixth Directive is a kind of stand-still clause. The provision was already contained in the original version of the directive and at that time permitted the maintenance, on a transitional basis, of exemptions existing on 31 December 1975. It was intended to prevent the immediate abolition of exemptions not included in the directive from leading to social hardship. (14)

17. The national exemptions which may be maintained in accordance with Article 28(2)(a) of the Sixth Directive depart in various respects from the system of the directive and must therefore be interpreted narrowly. (15)

18. The following features characterise this system. In principle all transactions of a taxable person effected for consideration within the territory of the country, and the importation of goods, are subject to VAT (Article 2 of the Sixth Directive). In general the standard rate of tax more precisely defined in Article 12(3)(a), first subparagraph, of the directive applies.

19. However, the directive itself provides for a series of exceptions to this principle, which often have a socio-political background. Thus the Member States may subject certain transactions to a

reduced rate of tax. (16) Other transactions are wholly exempted from VAT by Article 13 of the Sixth Directive.

20. The Sixth Directive sets out – apart from certain options available to the Member States – a definitive list of the transactions that are exempt or taxed at a reduced rate. This serves the purpose of harmonising the levying of VAT as widely as possible and thus of excluding distortions of competition. Moreover, harmonisation ensures a uniform tax yield in the Member States and corresponding contributions to the Community's own resources.

21. In derogation from this, under Article 28(2)(a) of the Sixth Directive, transactions that do not belong to the category of exempt or reduced-rate transactions, which the directive itself defines, may be given favourable treatment. These are non-harmonised additional concessions for social reasons that depend on political decisions by the Member States. (17) The present case concerns such a situation.

22. The form of the relief at issue here also departs from the system of the directive. The latter provides only for reduced rates of taxation, which are not to be less than 5%. If they are applied, the right to deduct input tax is retained. On the other hand, in the event of a complete exemption from VAT under Article 13 of the Sixth Directive, the right to deduct input tax is excluded. (18) Only the extra value added at the last stage of the transaction with the final consumer is thereby exempt from VAT.

23. The zero-rating applicable in the dispute giving rise to the main proceedings is, on the other hand, more favourable. When the zero rate is applied, the transaction is deemed formally to be taxed, so that there is a right to deduct input tax. With this particular form of exemption it is not therefore merely the extra value added upon the supply to the final consumer which is tax exempt but also the value added at the previous stages. This particularly wide exemption is in itself foreign to the Sixth Directive. (19) Only intra?Community supplies are tax exempt under the directive but nevertheless give a right to deduct input tax. (20) However, in that context the zero-rating does not have any beneficial effect but merely take into account the fact that the tax obligation passes to the acquirer in the State of destination

B – *The compatibility of the national exemptions with Community law*

24. Article 28(2)(a) of the Sixth Directive permits only the maintenance of national exemptions which are *in accordance with Community law*. This condition, expressly included in the Directive only in 1992, can only be understood as meaning that the national rules must be consistent with the requirements of Community law *in other respects,* thus inasmuch as Article 28 does not itself permit derogations, as for example in the case of the rate of tax or the right to deduct.

25. The Court has power to examine whether the requirements of Article 28 of the Sixth Directive are satisfied for the maintenance of corresponding national rules. In so doing, the intensity of its examination is restricted, in so far as Community law gives the Member States some latitude, e.g. in regard to the determination of the social objectives pursued by an exemption. (21) However, this restriction does not apply to the observance of Community law in other respects. Thus the Court of Justice has examined national exceptions also in regard to observance of the principle of tax neutrality. (22)

26. Talacre submits that it is contrary to the principles of Community law on the treatment of composite supplies to apply the zero rate only to the supply of the outer shell of the caravan and not to the contents supplied with it.

1. The Court’s case-law on composite supplies

27. The Sixth Directive does not contain any specific provision concerning the conditions under which several connected supplies are to be treated as one comprehensive supply. (23) However, in *CPP* (24) the Court made the following fundamental observations on this point:

‘In this respect, taking into account, first, that it follows from Article 2(1) of the Sixth Directive that every supply of a service must normally be regarded as distinct and independent and, second, that a supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system, the essential features of the transaction must be ascertained in order to determine whether the taxable person is supplying the customer, being a typical consumer, with several distinct principal services or with a single service.’

28. In the case of a transaction comprising a bundle of supplies it is therefore necessary to consider the matter as a whole in order to determine whether there are several separate supplies or one single supply. (25) When making that decision there are two opposing aims. First of all it is necessary to differentiate between the various individual supplies according to their character. On the other hand, splitting a comprehensive supply into too many separately classified individual supplies would overcomplicate the application of the VAT rules. (26)

29. There is a single supply in particular where one or more elements constitute the principal supply, whilst one or more other elements are to be regarded as ancillary supplies which share the tax treatment of the principal supply. (27) A supply must be regarded as ancillary to a principal supply if it does not constitute for customers an aim in itself, but a means of better enjoying the principal supply. (28)

30. The same is true where two or more elements supplied by the taxable person to the customer, being a typical consumer, are so closely linked that they form, objectively, a single, indivisible economic supply which it would be artificial to split. (29)

31. The question of the scope of a transaction may be of particular importance, for VAT purposes, not only for identifying the place where the taxable transactions take place but also for applying the rate of tax or the exemptions provided for in the Sixth Directive. (30) If an exemption is applicable to the principal element of a comprehensive supply, this exemption may, according to the principles set out above, also be extended to the subordinate elements that would be taxable as separate transactions. (31)

32. Only *one* rate of taxation can be applied to *one* (composite) supply. If it were to be assumed that there was one supply, but the taxable amount were nevertheless to be split for the application of several rates of taxation, this would be contrary to the aim of the case-law on composite supplies, namely to maintain the functioning of the VAT system.

33. In Case C-384/01 *Commission* v *France* (32) the Court nevertheless seems to accept that ‘one part’ of a supply may be subject to a reduced rate of taxation. The subject?matter of the decision was the reduced rate of taxation for the connection charge for electricity and gas supplies, whereas the standard rate applied to quantity-related charges.

34. However, in that action for failure to fulfil obligations the Court was principally concerned with the question whether the Commission had produced evidence that the application of the reduced rate of taxation led to a distortion of competition. Consequently, from this decision it is not possible to draw wide?ranging conclusions for the question at issue here. Indeed the Court has only

recently confirmed that classification as a composite supply is of significance for the application of the rate of taxation. (33) If, also in the case of a composite supply, the application of different rates of taxation to the parts of a supply were required, the classification as a comprehensive supply would have precisely no effect whatsoever on the applicable rate of taxation.

2. Is the case?law on composite supplies transferable to the situation at issue here?

35. If one were to apply the principles developed in the case-law on composite supplies irrespective of the particular circumstances of the present case, one might conclude that caravans and their removable contents in fact constitute one single supply. Only one rate of VAT would then have to be applied to that supply, namely the rate applicable for the principal element of the supply. Assuming that the principal element is the caravan, the zero rate would have to be extended to the ancillary supply of the removable contents. (34)

36. However, in the present situation the extension of the exemption would be contrary to the objectives of Article 28 of the Sixth Directive, as set out above. This conflict between the principle that national exemptions under Article 28(2)(a) of the Sixth Directive should not be extended and the rules developed in the case-law for the treatment of composite supplies can be resolved by comparing the purpose of each principle.

37. The rules established in *CPP* and other relevant decisions are based on the consideration that splitting transactions too much could endanger the functioning of the VAT system. In contrast to this objective, is the concern to limit national derogations from the rules of the Sixth Directive to those which are absolutely necessary.

38. When balancing these objectives, the interest in not undermining the harmonisation of law achieved by the Sixth Directive by extending national exceptions should be given priority over the objectives pursued by the Court with its rules determining the scope of a supply. In essence those rules have been developed only for reasons of practicality and do not claim absolute application.

39. Thus in *CPP* the Court emphasises that the question of the correct method of proceeding when determining the scope of a supply cannot, in view of the diversity of commercial operations, be answered exhaustively for all cases. (35) The rules laid down in *CPP* cannot therefore be applied systematically. Instead, when determining the scope of a supply all the circumstances must be taken into account, including the specific legal framework. In the present case, it is necessary to have regard to the particularity that the United Kingdom has established the exemption in a specific way in accordance with its socio-political evaluation and that national reliefs under the transitional regime of Article 28 may continue to exist but may not be extended.

40. The application of a national exemption under Article 28(2)(a) of the Sixth Directive is permissible only if it is – in the view of the Member State – necessary for precisely defined social reasons for the benefit of the final consumer. In that regard the United Kingdom has determined that the zero rate should be applied only to the supply of caravans. It did not consider that the inclusion of the removable contents was justified on social grounds. This assessment of the national legislature cannot simply be overridden.

41. Moreover, the functioning of the VAT system is not seriously called into question if the supply of caravans and their removable contents – possibly departing from the principles laid down in *CPP* – had to be regarded as separately taxable transactions. In particular it is not apparent that the separate indication of the relevant components of the price and the application of different rates of taxation to those components presents significant difficulties, as the manufacturer of the caravan already sets out both parts of the supply separately in its invoice to Talacre.

42. Finally, although it must be conceded that the Court has accepted that tax exemptions for the principal element of a composite supply may be extended to ancillary supplies connected with it, (36) nevertheless, as the United Kingdom Government rightly submits, those cases concerned exemptions under Article 13 of the Sixth Directive, and therefore exemptions enshrined in the scheme of the directive and in the application of which the right of deduction is excluded. In contrast, the national exceptions under Article 28 lie outside the harmonised framework. They are not directed at the same objectives as the exemptions provided for in the directive itself and differ in form from those exemptions. Consequently, in those cases it is necessary to take particular care that the exceptions are not extended.

43. In summary, I reach the following conclusion: The rules on determining the scope of a transaction cannot be understood in such a way that they require a national exemption under Article 28(2)(a) of the Sixth Directive to be extended to items which national law expressly excludes from the scope of the exception.

44. In the alternative, the United Kingdom, supported by the Commission, also submits that caravans and their removable contents in fact do not constitute a composite supply for the purposes of the case-law, because the items are physically and economically separable. (37) The Commission emphasises in particular that the provision at issue relates to *removable* equipment.

45. As the case-law on composite supplies is in any event not transferable systematically to the situation at issue here, this question can be left open. Only if the Court were not to adopt the solution put forward here would it be necessary for the national court to decide whether there may in fact be no composite supply. The contrary would however seem to be indicated by the fact that a normal consumer would regard a caravan without equipment or even equipment without a caravan as largely useless, even if those items could in principle be delivered separately.

V – **Conclusion**

46. In conclusion I propose the following answer to the question referred by the Court of Appeal:

The rules on determining the scope of a transaction do not preclude an exemption of a Member State, under Article 28(2)(a) of Sixth Directive 77/388/EC 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, which zero-rates the supply of specified goods and excludes other items from the scope of the zero-rating, even if the excluded items and the included items are delivered together.

1 – Original language: German.

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).

3 – Where reference is made in this Opinion simply to contents, the notion of ‘*removable contents*’ in national law is meant.

4 – The minimum standard rate was limited to this amount by Council Directive 92/111/EEC of 14 December 1992 amending Directive 77/388/EEC and introducing simplification measures with regard to value added tax (OJ 1992 L 384, p. 47). The duration of validity of the minimum standard rate was subsequently consistently extended, most recently until 2010 by Council Directive

2005/92/EC of 12 December 2005 amending Directive 77/388/EEC with regard to the length of time during which the minimum standard rate of VAT is to be applied (OJ 2005 L 345, p. 19).

5 – As amended by Council Directive 92/77/EEC 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).

6 – According to Article 28l(4), second sentence, of the Sixth Directive the validity of transitional rules is automatically extended until the entry into force of a final rule, which has, however, not yet occurred.

7 – The relevant passage of Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes – Structure and procedures for application of the common system of value added tax (OJ, English Special Edition 1967 (I), p. 16), no longer in force, provided: 'With a view to the transition from the present systems of turnover taxes to the common system of value added tax, 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 …'.

8 – Section 96 of the VAT Act 1994 lays down that schedules are to be interpreted in accordance with the notes contained therein.

9 – Standard contents include: bathroom suites, floor coverings, curtain rails, curtains, cupboards, fitted kitchens (including cooking appliances), seating units with fitted banquettes, dining tables, chairs, stools, coffee tables, display units, mirrors, wardrobes, beds and mattresses.

10 – In that regard the United Kingdom Government refers to Case 416/85 *Commission* v *United Kingdom* [1988] ECR 3127, paragraph 34 et seq. in particular, in which the Commission did not object in that respect to the exemption in question.

11 – Cited in footnote 7.

12 – It appears still to be in dispute in the main proceedings what items are to be regarded as *removable contents*.

13 – See Case C-136/97 *Norbury Developments* [1999] ECR I-2491, paragraph 19, and Case C?36/99 *Idéal toursime* [2000] ECR I-6049, paragraph 32.

14 – Commission proposal of 29 June 1973 for a sixth Council Directive on the harmonisation of the legislation of the Member States concerning turnover taxes – Common system of value added tax: uniform basis of assessment, *Bulletin of the European Communities*, Volume 11/73, p. 31.

15 – The Court of Justice has emphasised the requirement for a narrow interpretation of the special schemes set out in the Sixth Directive (for the special scheme for farmers: Case C-43/04 *Stadt Sundern* [2005] ECR I-4491, paragraph 27, and Case C-321/02 *Harbs* [2004] ECR I-7101, paragraph 27, and for the special scheme for travel agents, Case C-308/96 and C-94/97 *Madgett and Baldwin* [1998] ECR I-6229, paragraph 34).

16 – See Article 12(3)(a), third subparagraph, in conjunction with Annex H, and (b) and (c) of the Sixth Directive.

17 – This has a bearing on the intensity of the examination by the Court of Justice (see point 25

below).

18 – This follows simply from the wording of Article 17(2) of the Sixth Directive, which grants the right to deduct 'insofar as the goods and services are used for the purposes of [the taxable person's] taxable transactions'. See, in regard to the connection between the right to deduct and the taxability of transactions, also Case C-184/04 *Uudenkaupungin kaupunki* [2006] ECR I-0000, paragraph 24.

19 – See Terra/Kajus, *Introduction to European VAT and other indirect taxes* 2005, Vol. 1. 16.2., p 712 et seq.

20 – See Article 28c(A)(a) in conjunction with Article 17(2)(d) in the version of Article 28f of the Sixth Directive.

21 – The Court merely checks whether the identification of the social reasons would, by distorting that concept, lead to measures which, because of their effects or their true objectives, lie outside the scope of Community law (see *Commission* v *United Kingdom* (cited in footnote 10, paragraph 14).

22 – Case C-481/98 *Commission* v *France* [2001] ECR I-3369, paragraph 21.

23 – See my Opinion in Case C-41/04 *Levob* [2005] ECR I?0000, point 65.

24 – Case C-349/96 [1999] ECR I-973, paragraph 29; see also *Levob*, cited in footnote 23, paragraph 20.

25 – *Levob* (cited in footnote 23, paragraph 19), referring to Case C-231/94 *Faaborg-Gelting Linien* [1996] ECR I-2395, paragraphs 12 to 14, and *CPP* (cited in footnote 24, paragraphs 28 and 29).

26 – See my Opinion in *Levob* (cited in footnote 23, paragraph 66). Some Opinions even indicate a tendency to give priority in such a situation to considerations of practicality rather than precision; see Opinion of Advocate General Cosmas in *Faaborg Gelting Linien* (cited in footnote 25, paragraph 14); Opinions of Advocate General Fennelly in Case C-327/94 *Dudda* [1996] ECR I-4595, paragraph 35, and in *CPP* (cited in footnote 24, paragraph 47 et seq.).

27 – *CPP* (cited in footnote 24, paragraph 30), Case C-34/99 *Primback* [2001] ECR I-3833 (paragraph 45) and *Levob* (cited in footnote 24, paragraph 21).

28 – *CPP* (cited in footnote 24, paragraph 30) and *Madgett and Baldwin* (cited in footnote 15, paragraph 24).

29 – *Levob* (cited in footnote 23, paragraph 22).

30 – *CPP* (cited in footnote 24, paragraph 27) and *Levob* (cited in footnote 23, paragraph 18).

31 – See Case 173/88 *Henriksen* [1989] ECR 2763. In this case the Court extended the exemption under Article 13B(b) of the Sixth Directive for the letting of immovable property to a car parking space let in connection with residential property, even though the letting of car parking spaces is as such taxable. In *CPP* (cited in footnote 24) the issue was whether the tax exemption for insurance services under Article 13B(a) of the Sixth Directive was to be extended to certain ancillary services connected with the insurance service.

32 – [2003] ECR I-4395, paragraph 26.

33 – *Levob* (cited in footnote 23, paragraph 18).

34 – Alternatively a situation in conformity with the principles of taxation of composite supplies could be achieved by subjecting the composite supply of caravan and removable contents as a whole to the standard rate of taxation. As directives cannot have direct effect to the disadvantage of individuals, the national legislature would have to act in order to adopt this solution and abolish the exception.

35 – *CPP* (cited in footnote 24, paragraph 27).

36 – See point 31 above.

37 – The United Kingdom Government refers in this respect to Case 353/85 *Commission* v *United Kingdom* [1988] ECR 817, paragraph 33, although it is not particularly pertinent to the situation at issue here.