OPINION OF ADVOCATE GENERAL

KOKOTT

delivered on 13 December 2007 (1)

Case C?309/06

Marks & Spencer plc

v

Her Majesty's Commissioners of Customs and Excise

(Reference for a preliminary ruling from the House of Lords (United Kingdom))

(Value added tax – Derogation under Article 28 of Directive 77/388 – Principle of neutrality – Principle of equal treatment – Right to obtain a refund of the tax in the event of incorrect interpretation of domestic provisions by the tax authorities – Unjust enrichment)

I – **Introduction**

1. Under Article 28(2) of the Sixth VAT Directive (2) ('the Sixth Directive'), the Member States may, subject to certain conditions, maintain in force derogations as a transitional measure. In compliance with that provision, the United Kingdom applies, in respect of the supply of food, a zero-rating for VAT in conjunction with the right to deduct input tax.

2. However, that derogation does not apply to specific items of confectionery. The tax authorities originally placed Marks & Spencer's teacakes in that category and charged tax on them at the standard rate. Changing their view in 1994, they started to define teacakes as food subject to favourable tax treatment. Marks & Spencer subsequently made a claim for refund of the tax.

3. The distinctive aspect of the present case is that the applicable tax provision is a *domestic* provision that derogates from the general provisions of the Sixth Directive but may none the less be maintained in force as an exception. The House of Lords therefore seeks to ascertain the extent to which the principles of the common system of value added tax apply in this context and, where appropriate, whether the domestic rules on refunds, in particular the objection of unjust enrichment provided for in those rules in specific circumstances, meet the requirements of Community law.

II – **Relevant legislation**

A – *Community law*

4. Article 12 of the Sixth Directive lays down rules on the applicable rate. Article 12(1) accordingly provides that '[t]he rate applicable to taxable transactions shall be that in force at the

time of the chargeable event'. The standard rate of value added tax is provided for under Article 12(3) thereof; (3) reduced rates may be fixed for certain supplies of goods and services. (4)

5. Under Article 28(2) of the Sixth Directive, Member States may derogate from those rules as a transitional measure; the provision originally read:

'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.'

6. Following its replacement by Directive 92/77/EEC, (5) Article 28(2) provides:

'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 – *Domestic legislation*

7. In general, the supply of food is zero-rated for value added tax ('VAT') in the United Kingdom (section 30 and Schedule 8, Part II, Group 1, Item No 1, of the Value Added Tax Act 1994). Confectionery is an exception to such favourable tax treatment and is taxed at the full rate. There is an exception to that exception for cakes and biscuits, which are subject to the zero rate of tax applying to food. Biscuits wholly or partly covered with chocolate, however, are regarded as confectionery and taxed accordingly at the full rate.

8. Section 80 of the Value Added Tax Act 1994 provides for a right, in specific circumstances, to recover overpaid VAT:

'(1) Where a person has (whether before or after the commencement of this Act) paid an amount to the Commissioners by way of VAT which was not VAT due to them, they shall be liable to repay the amount to him.

…

(3) It shall be a defence, in relation to a claim under this section, that repayment of an amount would unjustly enrich the claimant.'

9. In the period material to the dispute in the main proceedings, the above rules applied to net payers only, that is to say, to taxable persons who, in a given tax period, owe the tax authorities a greater amount of output tax than they are able to offset by way of input tax deduction. *Repayment traders*, by contrast, are entitled to a tax refund because their deductible input tax in a given tax period exceeds their output tax. A rule comparable to that laid down in section 80(3) did not exist for *repayment traders*. (8)

III – **Facts, procedure and questions referred for a preliminary ruling**

10. Since 1973, the Commissioners of Customs and Excise had charged VAT on the teacakes sold by Marks & Spencer plc at the standard rate as they treated them as chocolate-covered biscuits. In September 1994, however, the Commissioners acknowledged that the teacakes ought to have been classified as cakes and, as such, zero-rated for tax purposes. Marks & Spencer made a claim in that respect for repayment of the full amount of VAT, namely GBP 3.5 million, for which it had wrongly accounted over the years.

11. On the basis of section 80(3) of the Value Added Tax Act, the Commissioners submitted as a defence that Marks & Spencer had passed on 90% of the VAT to its customers. The VAT and Duties Tribunal upheld that defence and ruled that Marks & Spencer was entitled to recover only 10% of the sum claimed. It also applied a limitation provision that had been introduced with retroactive effect.

12. Marks & Spencer pursued the dispute further to the Court of Appeal. In addition to the tax refund for the teacakes, the proceedings before that court also concerned a further claim for a refund in connection with the tax treatment of gift vouchers. The Court of Appeal made a reference to the Court of Justice for a preliminary ruling on the question of whether the limitation provisions were compatible with Community law. As far as the Court of Appeal was concerned, only the treatment of the gift vouchers was still in question in those proceedings. As regards the teacakes, the Court of Appeal evidently assumed that no requirements could be derived from Community law in the absence of harmonisation of the tax rate in the Sixth Directive.

13. In its judgment of 11 July 2002 (‘*Marks & Spencer I* judgment’), (9) the Court, responding to the questions referred, did not concern itself with the tax refund for the teacakes. In his Opinion in that case, Advocate General Geelhoed none the less remarked incidentally on the teacakes and expressed the view that the non-reimbursement of VAT was a manifest breach of Community law. (10) That view notwithstanding, the Court of Appeal dismissed the action in relation to the VAT on the teacakes.

14. The House of Lords, as the court of law currently seised of the dispute, felt compelled, in the light of the Commission’s observations and the Opinion of Advocate General Geelhoed in *Marks & Spencer I* , to refer the following questions to the Court of Justice for a preliminary ruling:

‘(1) Where, under Article 28(2)(a) of the Sixth VAT Directive (both before and after its amendment in 1992 by Directive 92/77), a Member State has maintained in its domestic VAT legislation an exemption with refund of input tax in respect of certain specified supplies, does a trader making such supplies have a directly enforceable Community law right to be taxed at a zero rate?

(2) If the answer to Question 1 is in the negative, where, under Article 28(2)(a) of the Sixth VAT Directive (both before and after its amendment in 1992 by Directive 92/77), a Member State has maintained in its domestic VAT legislation an exemption with refund of input tax in respect of certain specified supplies but has mistakenly interpreted its domestic legislation with the

consequence that certain supplies benefiting from exemption with refund of input tax under its domestic legislation have been subject to tax at the standard rate, do the general principles of Community law, including fiscal neutrality, apply so as to give a trader who made such supplies a right to recover the sums mistakenly charged in respect of them?

(3) If the answer to Question 1 or Question 2 is in the affirmative, do the Community law principles of equal treatment and fiscal neutrality in principle apply with the result that they would be infringed if the trader in question is not repaid the entire amount mistakenly charged on the supplies made by him in circumstances where:

(i) the trader would be unjustly enriched by repayment to him of the entire amount;

(ii) domestic legislation provides that overpaid tax cannot be repaid to the extent that repayment would lead to unjust enrichment of the trader; but

(iii) domestic legislation makes no provision similar to that referred to in (ii) in the case of claims by "repayment traders"? (A "repayment trader" is a taxable person who, in a given prescribed accounting period, makes no payment of VAT to the competent national authorities but receives a payment from them because, in that period, the amount of VAT that he is entitled to deduct exceeds the amount of VAT due in respect of supplies made by him.)

(4) Is the answer to Question 3 affected by whether or not there is evidence that the difference of treatment between traders making claims for the repayment of overpaid output tax and traders making claims for additional amounts by way of input tax deduction (resulting from the over-declaration of output tax) has, or has not, caused any financial loss or disadvantage to the former and, if so, how?

(5) If, in the situation described in Question 3, the Community law principles of equal treatment and fiscal neutrality apply and would otherwise be infringed, does Community law require or permit a court to remedy the difference of treatment by upholding a trader's claim to a repayment of overpaid tax in such a way as to enrich him unjustly or require or permit a court to grant some other remedy (and, if so, which)?'

15. Marks & Spencer, Ireland, the Governments of the United Kingdom and of Cyprus and the Commission of the European Communities have each submitted observations in the proceedings before the Court of Justice.

IV – **Legal assessment**

A – *Preliminary remark*

16. The Sixth Directive approximated to a large extent the arrangements for charging VAT in the Member States. However, the provisions of the Directive are not definitive. In addition to the various options presented to the Member States by the Directive as regards transposition and powers of definition, Article 28 of the Directive in particular allows certain domestic derogations to be maintained in force as transitional measures.

17. Three findings in that connection are undisputed in the main proceedings:

– The domestic provision concerning the application of the zero rate together with the right to deduct input tax in respect of food with the exception of certain items of confectionery is in accordance with Article 28(2) of the Sixth Directive.

– From 1973 to 1994 the tax authority applied that provision incorrectly in that it did not

subject the Marks & Spencer teacakes to tax at the zero rate.

– Marks & Spencer was able to pass on the VAT to its customers.

18. It is necessary to determine in essence whether the fact that the Value Added Tax Act 1994 precludes the right to a refund in the circumstances at issue in this case on the ground of unjust enrichment but does not do so in other circumstances where the charging of tax is subsequently corrected (as in the case of *repayment traders*) is consistent with Community law. Questions 3 to 5 deal with these issues.

19. As a prelude – as it were – to addressing those issues, the House of Lords considers it essential to clarify whether this is at all a situation to which Community law applies and which confers certain rights on taxable persons. Those issues are addressed in Questions 1 and 2, which will be discussed together below.

B – *The first and second questions referred*

20. As the Court of Justice pointed out in the *Marks & Spencer I* judgment, not only are Member States bound correctly to transpose a directive into national law, but individuals are also entitled to rely on that directive before the courts in order to ensure that the national implementing provisions are applied in such a way as to achieve the result sought by the directive. (11)

21. Having regard to well-established case-law, the Court of Justice further held that the right to obtain a refund of charges levied in a Member State in breach of rules of Community law is the consequence and the complement of the rights conferred on individuals by Community provisions. (12)

22. The Member States involved in the present proceedings now take the view that Article 28(2)(a) of the Sixth Directive more or less excludes national derogations from the scope of the Directive. Like the Court of Appeal, they make the following inferences from the case-law cited above: since a *Community law* right to the application of zero-rate tax does not exist, but such a right exists under the unharmonised *domestic legislation*, a Community law right to a refund in respect of charges unduly levied likewise does not exist. Domestic legislation alone, which is not to be measured in this case against the Community law standard, has to be applied to the refund.

23. I, on the other hand, consider wrong the premiss that, in the circumstances referred to in Article 28(2)(a), the Directive does not apply or that it does not in this case confer on the taxable person any rights to have the zero rate of tax applied or to claim tax refunds in the event of its erroneous non-application.

– Application of Community law in the event of non-harmonised derogations

24. The first paragraph of Article 1 of the First VAT Directive (13) made it clear at the outset that a comprehensive system of VAT was to be introduced, even though the VAT rates and exemptions in force at that time were not harmonised: (14)

‘Member States shall replace their present system of turnover taxes by the common system of value added tax defined in Article 2.’

25. Be that as it may, the common system of VAT still leaves the Member States a considerable degree of discretion and allows derogations and special provisions. Accordingly, the standard rate of VAT and the reduced rate or rates, in particular, have not been completely harmonised thus far. What is more, the Member States may set those rates themselves within certain margins. Even if the Member States avail themselves fully of that discretion and those

derogations, they still remain within the scope of the Directive.

26. That assessment can also be applied to Article 28(2)(a) of the Sixth Directive, under which 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 may be maintained.

27. One of the objectives of that provision is *zero-rating*. (15) If it was simply a case of allowing certain particularly low rates, it probably would not have been necessary to mention the right to deduct input tax since claims to input tax deduction under the Directive are not usually affected, so long as the inputs correlate with outputs to which a reduced rate applies. However, in addition to the derogation from Article 12(3) of the Sixth Directive, a derogation should be permitted at the same time from Article 17(2) thereof, under which input tax may be deducted only in respect of goods and services used for the purposes of the *taxable transactions* of the taxable person. As any reference to 'taxable transactions' can only really ever be in a notional sense when the zero rate of tax is being applied, Article 28(2)(a) needed to include an express reference to the fact that the right to deduct input tax exists even when a tax rate that has been reduced (to 0%) is being applied.

28. Even though, therefore, domestic rules that derogate in two respects from the Directive may be maintained, that does not mean that transactions to which those derogations apply fall, as a whole, outside the scope of the Directive. Rather, unless Article 28(2)(a) allows a derogation therefrom, all provisions of the Directive apply to those transactions, as do the general principles of law that Member States have to observe in their transposition and implementation. (16)

29. Outright exclusion from the scope of the Sixth Directive of the transactions taxed pursuant to a derogation under Article 28(2)(a) cannot be reconciled with the wording of the provision. As indicated by the reference to the derogation from Article 12(3) in the introduction to Article 28(2) and under (a), any derogation should be only from individual provisions of the Directive. Moreover, it would be contrary to the requirement to interpret exemptions narrowly (17) if Article 28(2)(a) was construed more or less as a derogation for specific transactions.

30. As I have already explained in my Opinion in *Talacre Beach Caravan Sales*, that conclusion is borne out by the condition contained in Article 28(2)(a), added to the Directive in 1992, that the exemptions permitted under that provision must be in accordance *with Community law*. (18) Ultimately, however, that addition serves merely to provide clarification. The obligation to comply with Community law (including the additional provisions of the Sixth Directive itself) still exists irrespective of that condition. As to the periods to which the claims for refund relate, there is therefore no need to make a distinction between the periods before and after the passage cited was introduced.

31. That conclusion is also borne out in the judgment in *Commission* v *France*. In that judgment, the Court held that it was permissible to maintain, pursuant to Article 28(2)(a), a specific reduced rate of 2.1% for reimbursable medicinal products, whereas the supply of non-reimbursable medicinal products was subject to a rate of 5.5%, only in so far as it was consistent with the principle of fiscal neutrality inherent in the common system of VAT. (19) The Court did not therefore find itself prevented from having regard to that principle inherent in the common system of VAT as a result of France's maintenance of an exemption provision under Article 28(2)(a).

32. The *Idéal tourisme* (20) judgment, to which the Member States involved in these proceedings refer, does not conflict with the view expressed here.

33. In that case, a coach operator claimed that the principle of equal treatment had been infringed inasmuch as its international passenger transport operations carried out within the

Community were subject to VAT, whereas passenger transport by air was exempt from such tax. The tax exemption applying to air transport under Belgian law was based in that case on Article 28(3)(b) of the Sixth Directive, under which Member States may, during the transitional period, continue to exempt certain activities which would otherwise be taxable under the Directive.

34. The Court first pointed to the fact that the Sixth Directive had only partially harmonised the Member States' VAT legislation. (21) It further held: 'Consequently, in so far as a Member State retains such provisions, it does not transpose the Sixth Directive and thus does not infringe either that directive or the general Community principles which Member States must, according to *Klensch,* [(22)] comply with when implementing Community legislation.' (23)

35. Bearing in mind the context of that ruling, I understand that finding to mean that the Court was not seeking to rule out every application of Community provisions where domestic exemptions are to be applied to certain transactions. On the contrary, the obligation to comply with Community law does not apply only *inasmuch as* the domestic provisions are allowed to derogate from the requirements of the Directive and cannot therefore be regarded as transposing the Directive. Applied to the case at issue, that means that the United Kingdom cannot be criticised for taxing food at a rate below the minimum rates fixed in accordance with Article 12(3) of the Sixth Directive. After all, Article 28(2)(a) even allows zero-rating. Similarly, there are no grounds for complaining that the input tax can be deducted in spite of the de facto tax exemption.

36. In accordance with the judgment in *Idéal tourisme,* a taxable person may not continue to invoke the principle of equal treatment if the difference in treatment is the result of the coexistence of harmonised and non-harmonised provisions, that is to say, if it is more or less created by the system in place. That is not the case here, however. It is not disputed that food is taxed more favourably in the United Kingdom than transactions involving other goods benefiting from the minimum rates fixed pursuant to Article 12(3) of the Sixth Directive. In fact, the only point at issue here involves the consistent application of the domestic exemption.

– Community law requirements for the application of domestic derogations

37. Even if a Member State applies a derogation under national law for the purposes of Article 28(2)(a), it none the less continues to be bound by the Directive and the general principles of law to be observed in its transposition and application. It remains to be clarified whether the Community law requirements confer on individuals a right to insist on application of the correct rate (or a right to the exemption from tax).

38. Marks & Spencer is seeking to infer that right from Article 12(1) of the Sixth Directive, which states that the rate applicable to taxable transactions is to be that in force at the time of the chargeable event. That inference cannot be upheld. The significance of that provision is in fact limited by its clear wording to determining the temporal point of reference for applying a given rate.

39. However, the general principles of law that a Member State must observe when implementing Community law or national provisions transposing that law (24) require a tax rate laid down by national law in respect of certain transactions actually to be applied to the relevant transactions.

40. This follows primarily from the principle of the lawfulness of administrative action, which, according to the Court's case-law, is one of the legal principles recognised in Community law. (25) Under that principle, the tax authorities are bound by law and statute and may not charge tax in a manner inconsistent with the relevant legislation. Furthermore, it would be contrary to the principle of legal certainty if a taxable person were unable to rely on a transaction being taxed in the manner laid down by statute.

41. Whether or not an erroneous application of the domestic VAT provisions also constitutes an infringement of the principles of equal treatment and neutrality depends on the individual case. Under the principle of equal treatment, which in the field of VAT has taken on the specific form of the principle of fiscal neutrality, (26) similar transactions must be subject to the same rate. (27) If the tax authority charges tax at the standard rate on the supply of Marks & Spencer's teacakes but applies the zero rate of tax laid down by statute to comparable products of other suppliers, those principles would be undermined.

42. The fact that a derogation under domestic law, rather than the Sixth Directive itself, determines the rate actually to be applied does not preclude recourse to Community law in substantiation of the claim at issue. While the provisions of a directive must appear, as far as their subject-matter is concerned, to be unconditional and sufficiently precise so that individuals can rely upon them, (28) recourse to the Sixth Directive and to the principles of law that must be observed in its implementation cannot be ineffective on the ground that the Directive confers discretion on the Member States to determine the rate of the tax. (29) The effect of the Directive would otherwise be significantly restricted: the Directive not only entrusts the Member States with determining the rate in the event of exemptions under Article 28(2) but also harmonises the rates, albeit not completely. However, relying on the Directive in conjunction with the general principles of law mentioned in points 40 and 41 above, individuals may insist that the Member State apply to a transaction the actual rate that it, in the exercise of its discretionary power, has established in its legislation in respect of transactions of that kind.

43. If a Member State has mistakenly failed to apply a domestic derogation to certain transactions, the resulting charge to tax will accordingly infringe not only national tax law but also Community law.

– Consequences of the misapplication of a domestic derogation

44. In the present case, the Member State concerned is in principle obliged, by virtue of Community law, to refund the charges levied. As already stated above, the right to obtain a refund of charges levied in a Member State in breach of rules of Community law is the consequence and the complement of the rights conferred on individuals by Community provisions. (30) The tax refund eliminates the consequences of the infringement at a later stage and results in tax being charged in conformity with Community law. Even when establishing the rules governing the right to obtain a refund, the Member State is therefore bound by the general legal principles which must be observed in the transposition and implementation of Community law.

45. The first two questions in the reference should therefore be answered as follows:

Where, under Article 28(2)(a) of the Sixth Directive (both before and after its amendment by Directive 92/77), a Member State has maintained in its domestic legislation a tax exemption with refund of input tax in respect of certain supplies, a trader is entitled under the Directive, in conjunction with the general principles of law to be applied in connection with its implementation, in particular the principles of equal treatment, neutrality, the lawfulness of administrative action and legal certainty, to insist on the correct application of that provision.

Where the tax authorities have mistakenly interpreted the domestic legislation in such circumstances, with the result that certain supplies benefiting from exemption with refund of input tax under its domestic legislation have been subject to tax at the standard rate, Community law in principle confers on the trader a right to obtain a refund of the VAT wrongly charged. When establishing the rules governing that right, the general principles of Community law, including the principles of equal treatment and fiscal neutrality, must be observed.

C – *The third, fourth and fifth questions referred*

46. By its third, fourth and fifth questions, which should be examined together, the House of Lords essentially seeks to determine the circumstances under which the Member State may invoke the defence of unjust enrichment against the claim for refund of VAT.

47. In the absence of a Community provision on the refund of charges levied, it is for the domestic legal order of the individual Member States to lay down the conditions under which such a refund may be claimed; those conditions must meet the principles of equivalence and effectiveness, that is to say, they may not be less favourable than those relating to similar claims based on provisions of domestic legislation, and they may not be so framed as to render virtually impossible the exercise of rights conferred by Community law. (31)

48. In that respect, the Court has recognised in principle that national law can preclude a refund in so far as it would entail unjust enrichment of the taxpayer on the ground that he has demonstrably passed on the burden of the charges to other persons. (32)

49. Since such provisions involve exceptions to the principle that taxes levied in breach of Community law must be refunded, the Court has imposed stringent requirements as regards proof of enrichment. (33) Thus, in the case of indirect charges, it cannot automatically be assumed that they have actually been passed on to the consumer. (34) Whether the economic effects suffered by the taxpayer as a result of the charging of the tax are actually cancelled out by passing on such charges and the refund of the charges consequently leads to enrichment depends also on numerous factors which have to be clarified by means of economic analysis. (35)

50. According to the account given by the United Kingdom Government at the hearing, the courts hearing the case in the main proceedings have collected wide-ranging evidence on this matter. Thus, for the purposes of the preliminary ruling procedure, it may be considered to be established that a full refund of the VAT would lead to unjust enrichment of Marks & Spencer.

51. Consequently, the principle of effectiveness does not preclude a refusal to refund the tax. Nor is there anything to suggest that the principle of equivalence has been infringed, at least so long as that principle is construed as it is currently defined, to the effect that it prohibits the less favourable treatment of claims for refund founded on Community law as against corresponding, purely domestic claims. (36)

52. However, the domestic legislation provided for the defence of enrichment in the relevant period only in the event that the taxable person claiming the refund has accounted for output VAT

in an accounting period, that is to say, has not had sufficiently large claims to input tax deduction to offset in full the output tax to be paid. In the case of *repayment traders*, the right to a (larger) tax refund, generated as a result of a correction to the tax classification of the relevant outputs, could not be restricted by the defence of enrichment.

53. In Marks & Spencer's view, that differing definition of the constituent elements of the refund is at variance with the principles of equal treatment and fiscal neutrality.

54. In the *Marks & Spencer I* judgment, the Court already recognised that, when framing the provisions on refunds within the scope of Community law, Member States must observe not only the principles of equivalence and effectiveness but also the general principles of law which form part of the Community legal order. (37) This in particular includes the obligation to comply with the principle of equal treatment and – in the field of VAT – the principle of fiscal neutrality, which I should like to address first.

55. Before that, however, I should like to make the following points with regard to the facts:

– It cannot be inferred either from the order for reference or from the observations of the parties to the proceedings before the Court that any trader other than Marks & Spencer has claimed or obtained refunds of VAT on the ground that it sold teacakes that were originally classified wrongly as confectionery.

– The retail operator Tesco, as claimed by Marks & Spencer (although this could not be confirmed by the United Kingdom Government at the hearing), obtained tax refunds as a *repayment trader*. Those refunds were made in the light of a revision of the tax treatment of products other than teacakes (mineral water and fruit juice). No objection that the payment led to unjust enrichment on the ground that the tax had been passed on to the customers was levelled against Tesco.

– Principle of fiscal neutrality

56. The Court initially concluded from the principle of fiscal neutrality that within each country similar goods must bear the same tax burden whatever the length of the production and distribution chain. (38) Neutrality in this sense is guaranteed by the right to input tax deduction. Deduction of input tax means that all intermediate stages are relieved entirely of the VAT burden and the consumer is ultimately charged with a tax that is exactly proportionate to the value of the supply.

57. The Court later deduced, very generally, from the principle of fiscal neutrality that similar – and thus competing – goods must be treated in the same way for VAT purposes. (39) That aspect of the principle of neutrality has been significant in the established case-law, in particular in determining the taxable transactions and interpreting the constituent elements of exemptions under Article 13 of the Sixth Directive.

58. In further decisions, the Court also held that, in accordance with the principle of fiscal neutrality, economic operators carrying out the same transactions may not be treated differently in relation to the levying of VAT. (40) Although the issue of the equal treatment of different economic operators appears to have acquired greater prominence here, I still understand that finding as meaning that different economic operators may not be treated differently specifically in relation to their similar transactions.

59. In the end, the Court held that the principle of fiscal neutrality includes the principle of elimination of distortion in competition as a result of differing treatment for VAT purposes.

Therefore, distortion is established once it has been found that supplies of services are in competition and are treated unequally for the purposes of VAT. (41)

60. It follows from that definition of the principle of neutrality, as regards the case here at issue, that it is not permissible to treat supplies of (comparable) teacakes differently for tax purposes. The provisions on the refund of the tax may also not, at a later stage, lead to different treatment of supplies of comparable products.

61. However, the principle of neutrality does not cover general discrimination as between different economic operators which, completely unrelated to the charging of tax on similar transactions, involves other features. Therefore, the fact that Tesco might have obtained tax refunds in respect of other goods, although the taxes concerned were passed on, is of no consequence to the application of the principle of neutrality.

62. Infringement of the principle of neutrality is established if the zero-rating was applied from the outset to the supply of teacakes by other traders whereas corresponding supplies by Marks & Spencer were taxed at the standard rate. The infringement is also established if, in contrast to Marks & Spencer, other traders subsequently obtained a refund of the VAT as a consequence of the reappraisal of the relevant supplies, but no recourse was had to the defence of enrichment. The burden of proof does not call for any further-reaching economic disadvantage. After all, the different tax treatment of similar transactions is sufficient indication that competition has been distorted.

63. Since the tax authority alone has the information necessary for establishing conclusively whether the principle of neutrality has been infringed as a result of a specific administrative practice, only a limited burden to provide information can be imposed on the taxable person concerned. It should normally be sufficient for the party concerned to name other traders which supply comparable products and which may have benefited from more favourable tax treatment. It will then fall to the tax authority to provide information on the tax which those other traders have actually been charged.

– Principle of equal treatment

64. In addition to the principle of fiscal neutrality, Member States, when implementing the Sixth Directive, must also observe the general principle of equal treatment, under which comparable situations must not be treated differently and different situations must not be treated in the same way unless such treatment is objectively justified. (42)

65. The United Kingdom Government does not dispute that different rules applied to *repayment traders* and *payment traders* in terms of the defence of enrichment until the Value Added Tax Act was amended in 2005. However, it takes the view that the claims for refund made in the respective situations are not comparable.

66. I, however, like the Commission and Marks & Spencer, can see no difference that would be material to deciding whether or not to invoke the defence of enrichment.

67. In each case, the price initially paid for the product supplied includes VAT. The purchaser pays the entire amount to the taxable person. Both a *repayment trader* and a *payment trader* offset the tax to be paid to the tax authority with their claim for refund of input tax. In the case of a *repayment trader,* there is a resulting credit in favour of the taxable person; he has a claim for refund against the tax authority. In the other case, there is a resulting credit in favour of the tax authority that the taxable person must settle.

68. If it is established at a later stage that certain transactions should have been taxed at the zero rate rather than at the standard rate, one of the offsetting items is thereby reduced. In the case of a *repayment trader,* this leads to an increase in the credit to his account whilst leading, in the case of a *payment trader,* to a reduction in the credit to the tax authority. To rectify the tax error, the tax authority is required in each case to repay the amount concerned to the taxable person, which can in each case lead to unjust enrichment if the tax in respect of the output concerned has been passed on in full to customers and no other economic disadvantages preclude enrichment.

69. Since the respective situations of *repayment* and *payment traders* are, accordingly, the same in terms of enrichment, the principle of equal treatment requires that the defence of enrichment may also be invoked in the same way in the respective claims for refund. However, that was not the case under United Kingdom law until the legal position changed in 2005.

70. The action of the legislature in itself suggests that, previously, comparable situations were clearly treated differently. If the situations had not actually been comparable, the legislature would not have been allowed to extend the defence of enrichment under section 80(3) of the Value Added Tax Act 2005 to the situation of *repayment traders*.

71. In that regard, the inequality of treatment presented thus far is all the more unfathomable as the issue whether a taxable person finds himself in either of those situations in a given assessment period depends on all manner of unforeseeable circumstances and factors that could change at any time, such as the composition of the range of products or the investment position.

– Remedy in the event of infringement of the principles of fiscal neutrality and equal treatment

72. It must be borne in mind first that the national courts, which have to apply Community law in cases within their jurisdiction, must guarantee the full effect of that law and protect the rights conferred upon individuals by Community law. (43) In that regard, the primacy of Community law requires any provision of national law which contravenes a Community rule to be disapplied, regardless of whether it was adopted before or after that rule. (44)

73. Member States have, admittedly, the choice as to how they intend to eliminate infringements of the principle of equal treatment in future. They can, in principle, remove the tax burden for one category or extend its imposition in the same way to the other category. As to the tax position in the past, retroactive extension of the tax burden would, by contrast, probably offend in general against the principle of the protection of legitimate expectations. (45)

74. In addition, as the Court has repeatedly held in situations of discrimination contrary to Community law, for as long as measures reinstating equal treatment have not been adopted, observance of the principle of equality can be ensured only by granting to persons within the disadvantaged category the same advantages as those enjoyed by persons within the favoured category. In such a situation, a national court must set aside any discriminatory provision of national law, without having to request or await its prior removal by the legislature, and apply to members of the disadvantaged group the same arrangements as those enjoyed by the persons in the other category. (46)

75. It follows that the objection that Marks & Spencer has been enriched cannot be invoked as long as it offends against the principle of equal treatment.

76. It is true that no person may call for equality in illegality. (47) Thus the Court has held, in the context of State aid provisions for example, that those liable to pay a tax cannot, in order to avoid

payment of that tax, rely on the argument that the exemption enjoyed by other businesses constitutes State aid; the addition of other undertakings to the circle of potential beneficiaries would not eliminate the effects of aid granted unlawfully but would, on the contrary, lead to an increase in the effects of that aid. (48)

77. The Court has consistently held, however, that Member States are not obliged to preclude the refund of charges levied in breach of Community law where it would lead to unjust enrichment. In fact, according to the case-law, refund is supposed to be the norm from which a derogation *can* be made in order to avoid unjust enrichment. (49) Consequently, it is not unlawful for a national provision to allow a refund of charges levied in breach of Community law without constraint from an objection of enrichment, as was clearly the case until 2005 in the United Kingdom with regard to *repayment traders*. Eliminating unequal treatment by disapplying the defence of enrichment in respect of *payment traders* does not therefore create 'equality in illegality'.

78. At the hearing, in particular, Marks & Spencer stressed that the refusal to grant it a refund would, in its view, lead to the unjust enrichment of the tax authority itself. After all, the customers of Marks & Spencer who ultimately paid the VAT that was not due would actually be the persons entitled to the refund. Challenging that argument, the United Kingdom maintained that the State none the less used the tax revenue that had been unduly raised in the public interest, with the result that the customers of Marks & Spencer also derived benefit from it.

79. In that connection, it should be borne in mind that a Member State may not in principle take advantage of its own failure to comply with Community law. (50) Besides, it would be a step too far if the Court were to assess whether the State or Marks & Spencer would manage the revenue unduly collected more efficiently and to the greater benefit of Marks & Spencer's customers.

V – **Conclusion**

80. I accordingly propose that the questions referred for a preliminary ruling be answered as follows:

(1) Where, under Article 28(2)(a) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment (both before and after its amendment by Council Directive 92/77/EEC of 19 October 1992), a Member State has maintained in its domestic legislation a tax exemption with refund of input tax in respect of certain supplies, a trader is entitled under the Directive, in conjunction with the general principles of law to be applied in connection with its implementation, in particular the principles of equal treatment, neutrality, the lawfulness of administrative action and legal certainty, to insist on the correct application of that provision.

Where the tax authorities have mistakenly interpreted the domestic legislation in such circumstances, with the result that certain supplies benefiting from exemption with refund of input tax under its domestic legislation have been subject to tax at the standard rate, Community law in principle confers on the trader a right to obtain a refund of the VAT wrongly charged. When establishing the rules governing that right, the general principles of Community law, including the principles of equal treatment and fiscal neutrality, must be observed.

(2) The Directive does not in principle preclude a provision of domestic legislation which does not allow VAT charged in breach of Community law to be refunded in so far as that would result in unjust enrichment of the taxable person.

However, it is contrary to the principle of equal treatment, which must be applied when the Directive is being implemented, for the defence of enrichment to apply only in respect of taxable

persons who have paid output VAT in a given assessment period and not in respect of taxable persons whose claim to input tax deduction exceeded the VAT payable in respect of their outputs (*repayment traders*).

The national courts, which have to apply Community law in cases within their jurisdiction, must guarantee the full effect of that law and protect the rights conferred upon individuals by Community law by disapplying a domestic provision that is contrary to the principle of equal treatment.

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 – A minimum standard rate of 15% was introduced for a fixed term 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). Thereafter the period of applicability of the minimum standard rate was continuously extended, most recently up to the end of 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).

4 – The provisions of the Sixth Directive concerning the level of the reduced rates and the supplies to which those rates may be applied (see, in this connection, Annex H to the Sixth Directive) were progressively harmonised.

5 – 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 – Under the second sentence of the third paragraph of Article 28l of the Sixth Directive, the period of application of the transitional arrangements is to be extended automatically until the date of entry into force of a definitive system, which has not, however, been established thus far.

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, p. 16) read: ‘With a view to the transition from the present system 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, 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.’

8 – The United Kingdom introduced a further enrichment provision for *repayment traders*, effective as from 26 May 2005, only after infringement proceedings had been brought concerning the difference in treatment as between those two categories of taxable persons.

9 – Case C?62/00 [2002] ECR I?6325.

10 – Opinion in *Marks & SpencerI* (cited in footnote 9), point 44.

11 – Cited in footnote 9, paragraph 27.

12 – *Marks&SpencerI* (cited in footnote 9), paragraph 30, which refers to Case 309/85 *Barra* [1988] ECR 355, paragraph 17; Case C?62/93 *BP Supergas* [1995] ECR I?1883, paragraph 40; Case C?343/96 *Dilexport* [1999] ECR I?579, paragraph 23; and Joined Cases C?397/98 and C?410/98 *Metallgesellschaft and Others* [2001] ECR I?1727, paragraph 84.

13 – First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes (OJ, English Special Edition 1967, p. 14). With effect from 1 January 2007, Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1) replaced the First VAT Directive. Having regard to its predecessor provision, Article 1(1) of Directive 2006/112 reads: 'This Directive establishes the common system of value added tax (VAT).'

14 – See also, to that effect, the eighth recital in the preamble thereto, which reads: '… the replacement of the cumulative multistage tax systems in force in the majority of Member States by the common system of value added tax is bound, even if the rates and exemptions are not harmonised at the same time, to result in neutrality in competition, in that within each country similar goods bear the same tax burden, whatever the length of the production and distribution chain, and that in international trade the amount of the tax burden borne by goods is known so that an exact equalisation of that amount may be ensured; … therefore, provision should be made, in the first stage, for adoption by all Member States of the common system of value added tax, without an accompanying harmonisation of rates and exemptions'.

15 – See Commission proposal of 29 June 1973 for a Sixth Council Directive on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, *Bulletin of the European Communities*, Supplement 11/73, p. 31. See, on the effect of applying the zero rate, my Opinion in Case C-251/05 *Talacre Beach Caravan Sales* [2006] ECR I?6269, points 22 and 23.

16 – See, concerning regard for the general principles of law, in particular fundamental rights, in the implementation and application of Community law, Joined Cases 201/85 and 202/85 *Klensch and Others* [1986] ECR 3477, paragraphs 8 to 10; Case 5/88 *Wachauf* [1989] ECR 2609, paragraph 19; Case C?260/89 *ERT* [1991] ECR I?2925, paragraph 42 et seq.; Case C?381/97 *Belgocodex* [1998] ECR I?8153, paragraph 26; Case C?441/02 *Commission* v *Germany* [2006] ECR I?3449, paragraphs 107 and 108; and Case C-384/04 *Federation of Technological Industries and Others* [2006] ECR I-4191, paragraph 29.

17 – See, to that effect, the Opinion in *Talacre Beach Caravan Sales* (cited in footnote 15), point 17 with further references. See also, on exceptions under Article 28(3)(a) of the Sixth Directive, Case C?240/05 *Eurodental* [2006] ECR I?11479, paragraph 54.

18 – Cited in footnote 15, point 24.

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

20 – Case C?36/99 [2000] ECR I?6049.

21 – *Idéal tourisme* (cited in footnote 20), paragraph 37. See also *Eurodental* (cited in footnote 17), paragraphs 50 and 51.

22 – *Klensch and Others* (cited in footnote 16), paragraph 9.

23 – *Idéal tourisme* (cited in footnote 20), paragraph 38. See also *Eurodental* (cited in footnote 17), paragraph 52.

24 – See, to that effect, the case-law cited in footnote 16.

25 – See Joined Cases C?182/03 and C?217/03 *Belgium and Forum 187* [2006] ECR I?5479, paragraph 69.

26 – See, in connection with the principles of equal treatment and neutrality, Joined Cases C?443/04 and C?444/04 *Solleveld and van den Hout-van Eijnsbergen* [2006] ECR I?3617, paragraph 35.

27 – *Commission* v *France* (cited in footnote 19), paragraph 22; generally on the principle of fiscal neutrality, see Case C?216/97 *Gregg* [1999] ECR I?4947, paragraphs 19 and 20; Joined Cases C?453/02 and C?462/02 *Linneweber and Akritidis* [2005] ECR I?1131, paragraph 24; Case C?498/03 *Kingscrest Associates and Montecello* [2005] ECR I?4427, paragraph 54; and Case C?363/05 *JP Morgan Fleming Claverhouse Investment Trust and The Association of Investment Trust Companies* [2007] ECR I?0000, paragraph 46.

28 – Case 8/81 *Becker* [1982] ECR 53, paragraph 25; Case C?141/00 *Kügler* [2002] ECR I?6833, paragraph 51; *Linneweber and Akritidis* (cited in footnote 27), paragraph 33; and *JP Morgan Fleming Claverhouse Investment Trust and TheAssociation of Investment Trust Companies* (cited in footnote 27), paragraph 58.

29 – See, in respect of the discretion conferred on the Member States to determine exempt establishments, Case C?45/01 *Dornier* [2003] ECR I?12911, paragraph 81. See also *JP Morgan Fleming Claverhouse Investment Trust and The Association of Investment Trust Companies* (cited in footnote 27), paragraphs 60 and 61.

30 – See the established case-law cited in footnote 12.

31 – Case 199/82 *San Giorgio* [1983] ECR 3595, paragraph 12; *Marks & SpencerI* (cited in footnote 9), paragraph 39; Case C?147/01 *Weber's Wine World and Others* [2003] ECR I?11365, paragraph 103; and Case C?35/05 *Reemtsma* [2007] ECR I?2425, paragraph 37.

32 – See, to that effect, Case 68/79 *Just* [1980] ECR 501, paragraph 26; *San Giorgio* (cited in footnote 31), paragraph 13; Joined Cases C?192/95 to C?218/95 *Comateb and Others* [1997] ECR I?165, paragraph 23; Joined Cases C?441/98 and C?442/98 *Michaïlidis* [2000] ECR I?7145, paragraph 31; and *Weber's Wine World and Others* (cited in footnote 31), paragraph 94.

33 – For a summary, see *Weber's Wine World and Others* (cited in footnote 31), paragraph 94 et seq.

34 – Joined Cases 331/85, 376/85 and 378/85 *Bianco and Girard* [1988] ECR 1099, paragraph 17; *Weber's Wine World and Others* (cited in footnote 31), paragraph 96; and *Comateb and Others* (cited in footnote 32), paragraph 25.

35 – See *Bianco and Girard* (cited in footnote 34), paragraph 20; *Comateb and Others* (cited in footnote 32), paragraph 29 et seq.; *Michaïlidis* (cited in footnote 32), paragraphs 34 and 35; and *Weber's Wine World and Others* (cited in footnote 31), paragraph 97 et seq.

36 – One might, however, ask whether that principle does not already require that all claims for refund based on Community law be treated equally. That question can go unanswered here since

the principles of equal treatment and fiscal neutrality have to be observed in any case (see, to that effect, point 56 et seq. below).

37 – *Marks & SpencerI* (cited in footnote 9), paragraph 44. In those proceedings, the principle of the protection of legitimate expectations had to be observed.

38 – See Case 268/83 *Rompelman* [1985] ECR 655, paragraph 19; Case C?317/94 *Elida Gibbs* [1996] ECR I?5339, paragraph 20; and Case C?465/03 *Kretztechnik* [2005] ECR I?4357, paragraph 34.

39 – *Commission* v *France* (cited in footnote 19), paragraph 22; *Gregg* (cited in footnote 27), paragraphs 19 and 20; *Linneweber and Akritidis* (cited in footnote 27), paragraph 24; *Kingscrest Associates and Montecello* (cited in footnote 27), paragraph 54; and *JP Morgan Fleming Claverhouse Investment Trust and The Association of Investment Trust Companies* (cited in footnote 27), paragraph 46.

40 – Case C-382/02 *Cimber Air* [2004] ECR I-8379, paragraphs 23 and 24; Case C-280/04 *Jyske Finans* [2005] ECR I-10683, paragraph 39; and Case C-169/04 *Abbey National and Inscape Investment Fund* [2006] ECR I-4027, paragraph 56.

41 – *JP Morgan Fleming Claverhouse Investment Trust and The Association of Investment Trust Companies* (cited in footnote 27), paragraph 47 with further references.

42 – See, inter alia, Case C?309/89 *Codorniu* v *Council* [1994] ECR I?1853, paragraph 26; Case C?354/95 *National Farmers' Union and Others* [1997] ECR I?4559, paragraph 61; and Case C?291/03 *MyTravel* [2005] ECR I?8477, paragraph 44.

43 – See, in particular, Case 106/77 *Simmenthal* [1978] ECR 629, paragraph 16; Case C?213/89 *Factortame and Others* [1990] ECR I?2433, paragraph 19; Case C?453/99 *Courage and Crehan* [2001] ECR I?6297, paragraph 25; and Joined Cases C?295/04 to C?298/04 *Manfredi and Others* [2006] ECR I?6619, paragraph 89.

44 – See, inter alia, Case C?198/01 *CIF* [2003] ECR I?8055, paragraph 48, and *Manfredi and Others* (cited in footnote 43), paragraph 39.

45 – See Case C?396/98 *Schloßstraße* [2000] ECR I?4279, paragraphs 44 and 47, and *Marks & SpencerI* (cited in footnote 9), paragraphs 45 and 46.

46 – Joined Cases C?231/06 to C?233/06 *Jonkman and Others* [2007] ECR I?0000, paragraph 39, with reference to Case C?408/92 *Avdel Systems* [1994] ECR I?4435, paragraphs 16 and 17; Case C?442/00 *Rodríguez Caballero* [2002] ECR I?11915, paragraphs 42 and 43, and Case C?81/05 *Cordero Alonso* [2006] ECR I?7569, paragraphs 45 and 46.

47 – See Case 188/83 *Witte* v *Parliament* [1984] ECR 3465, paragraph 15, and Case 134/84 *Williams* v *Court of Auditors* [1985] ECR 2225, paragraph 14.

48 – Joined Cases C?393/04 and C?41/05 *Air Liquide Industries Belgium* [2006] ECR I?5293, paragraphs 43 and 45, and Case C?368/04 *Transalpine Ölleitung* [2006] ECR I?9957, paragraphs 49 and 50.

49 – See points 48 and 49 above and the case-law cited there.

50 – See, in that respect, Case 148/78 *Ratti* [1979] ECR 1629, paragraph 22; *Becker* (cited in footnote 28), paragraph 24; Case 152/84 *Marshall* [1986] ECR 723, paragraph 49; and Case

C?91/92 *Faccini Dori* [1994] ECR I?3325, paragraphs 22 and 23.