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OPINION OF ADVOCATE GENERAL

POIARES MADURO

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Case C?288/07

The Commissioners of Her Majesty's Revenue & Customs

v

Isle of Wight Council,

Mid-Suffolk District Council,

South Tyneside Metropolitan Borough Council,

West Berkshire District Council

(Reference for a preliminary ruling from the High Court of Justice of England and Wales (Chancery Division))

(Value added tax – Activities engaged in by bodies governed by public law – Off-street parking for which a charge is made – Distortions of competition)

1. The questions in this reference for a preliminary ruling concern the interpretation of the second subparagraph of Article 4(5) 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 (2) ('the Sixth Directive'), which provides that bodies governed by public law are to be taxable persons for the purposes of value added tax ('VAT') in respect of the activities in which they engage as public authorities where treatment as non-taxable persons would lead to significant distortions of competition. The Court is thus called upon to explain the conditions of this derogation from the rule, laid down in the first subparagraph of Article 4(5), that bodies governed by public law are not taxable persons in respect of the activities in which they engage as public authorities. In other words, the Community judicature must explain the criteria governing the reintroduction of the general principle that economic activities are subject to VAT.

I – **Legal context, facts of the main proceedings and questions referred for a preliminary ruling**

2. The main proceedings concern the operation of off-street car-parking facilities by four local authorities in the United Kingdom of Great Britain and Northern Ireland: Isle of Wight Council, Mid-Suffolk District Council, South Tyneside Metropolitan Borough Council and West Berkshire District Council. (3) The private sector provides similar services in each of the local authority areas.

3. Historically, local authorities considered themselves to be taxable persons for VAT purposes in respect of payments made by persons using those facilities. Users were charged VAT and the proceeds of the tax were paid over to the United Kingdom tax authorities.

4. However, on the basis of the first subparagraph of Article 4(5) of the Sixth Directive the respondents in the main proceedings consider that they are entitled to reimbursement of VAT previously paid since, according to that provision, 'States, regional and local government authorities and other bodies governed by public law shall not be considered taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with these activities or transactions'.

5. The following subparagraphs of Article 4(5) of the Sixth Directive none the less provide that, in certain circumstances, those bodies remain liable for VAT. It is thus stated:

'However, when they engage in such activities or transactions, they shall be considered taxable persons in respect of these activities or transactions where treatment as non-taxable persons would lead to significant distortions of competition.

In any case, these bodies shall be considered taxable persons in relation to the activities listed in Annex D, provided they are not carried out on such a small scale as to be negligible.

Member States may consider activities of these bodies which are exempt under Article 13 or 28 as activities which they engage in as public authorities.'

6. Taking the view that they did not fulfil the conditions of these exceptions to the rule under which they are not taxable, and fortified in this regard by the judgment in *Fazenda Pública*, (4) the local authorities made claims to the competent tax authority (the Commissioners of Her Majesty's Revenue & Customs, the appellant in the main proceedings) for repayment of the VAT paid since 2000. In their submission, treating them as non-taxable persons leads to no distortion of competition and, a fortiori, to no significant distortion of competition, in their local authority areas.

7. The Commissioners refused reimbursement. After the local authorities had succeeded in their appeals against the Commissioners' decision which they brought before the VAT and Duties Tribunal, the Commissioners appealed to the High Court of Justice of England and Wales (Chancery Division), which decided to stay proceedings and refer the following questions to the Court of Justice for a preliminary ruling:

'(1) Is the expression "distortions of competition" to be ascertained on a public body by public body basis such that, in the context of the present case, it should be determined by reference to the area or areas where the particular body in question provides off-street parking or by reference to the totality of the national territory of the Member State?

(2) What is meant by the expression "would lead to"? In particular, what degree of probability or level of certainty is required for that condition to be satisfied?

(3) What is meant by the word “significant”? In particular, does “significant” mean an effect on competition that is more than trivial or *de minimis*, a “material” effect or an “exceptional” effect?’

II – **Legal analysis**

A – *The first question referred for a preliminary ruling*

8. By this question, the national court essentially asks whether, in the situation referred to in the second subparagraph of Article 4(5) of the Sixth Directive, any distortion of competition caused by considering public bodies not to be taxable persons where they engage in certain activities as public authorities is to be assessed at a local level, which requires the conditions of competition on the relevant market to be established, or whether it must be assessed solely in the light of the activity concerned.

1. Introductory remarks on the system under Article 4(5) of the Sixth Directive

9. For the purpose of answering the first question, the system under Article 4(5) of the Sixth Directive should be outlined. The rule laid down in this provision is that bodies governed by public law are not taxable persons for VAT purposes when they act as public authorities. In derogation from this rule set out in the first subparagraph of Article 4(5) of the Sixth Directive, the second subparagraph of Article 4(5) provides that such bodies must none the less pay VAT where failure to tax the activities in question would lead to significant distortions of competition. This general exception is, moreover, supplemented by the third subparagraph which establishes certain activities in respect of which bodies governed by public law will remain taxable persons for VAT purposes despite engaging in them as public authorities; however, if those activities are carried out on such a small scale as to be negligible, the Member States may remove them from the scope of VAT if they so wish.

10. The various subparagraphs of Article 4(5) of the Sixth Directive are consequently closely linked. In order for the second subparagraph to apply, it is necessary to fall within the field of application of the first subparagraph. The Court has interpreted the first subparagraph as laying down two cumulative conditions for treatment as a non-taxable person. First, the activities must be carried out by a body governed by public law and, second, they must be carried out by that body acting as a public authority. The Court has then specified that the activities covered are the activities engaged in by those bodies under the special legal regime applicable to them and do not include activities pursued by them under the same legal conditions as those that apply to private economic operators. (5)

11. In this regard, it is possible to express doubts in the present case, as the Commission of the European Communities has done in its observations, as to whether the provision of parking spaces by local authorities satisfies those conditions. More specifically, it is not certain that the provision of off-street parking is subject to a legal regime specific to the public body. However, since the High Court has not referred this question to the Court of Justice and it is for national courts to review whether those conditions are met, (6) it is not appropriate to examine this issue any further.

2. Interpretation of the second subparagraph of Article 4(5) of the Sixth Directive

12. As previously noted, the Court is called upon by the central question raised in the present case to rule on the approach that should be adopted in determining whether there is significant distortion of competition as referred to in the second subparagraph of Article 4(5) of the Sixth Directive, which derogates from the rule laid down in the first subparagraph of Article 4(5) that

bodies governed by public law are not taxable persons when acting as public authorities.

13. The parties are divided on this point. While the respondents in the main proceedings and the Italian Government argue in favour of a competition-based approach, involving specific prior analysis of the relevant market in order to determine whether the transaction in question must be subject to VAT, the appellant in the main proceedings expresses its preference for a fiscal approach based on the activity concerned. The United Kingdom dwells in addition on the difficulties involved in applying competition tests in tax matters. Ireland seeks to reconcile these positions, submitting that it is for the Member States in the exercise of their discretion to choose between these options.

14. As will be shown below, the fiscal approach must prevail. The tax system laid down by the Sixth Directive has the aim of making all economic activities subject to VAT. Thus, Article 2 of the Sixth Directive states that the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such and the importation of goods are to be subject to VAT. It is only by way of derogation from this general rule that certain activities are removed from the scope of VAT. In this regard, the first subparagraph of Article 4(5) of the Sixth Directive provides that activities engaged in by a public body acting as a public authority are not subject to tax. On the other hand, even if the conditions for this derogation from liability for tax are met, the Community legislature has considered it necessary, in the third subparagraph of Article 4(5), to retain liability for tax in respect of certain of those activities. Since Article 4(5) of the Sixth Directive, whichever the subparagraph at issue, concerns the same bodies acting as public authorities, the justification for the various paragraphs' different tax treatment of the activities concerned can only be founded on the difference in nature of those various activities. This view is confirmed by the Court which has stated that the reintroduction of liability for tax that is provided for in the third subparagraph of Article 4(5) of the Sixth Directive is intended to ensure that 'certain categories of economic activity *the importance of which derives from their subject-matter* are not [exempted from] VAT'. (7)

15. The rationale for the derogation, provided for in Article 4(5) of the Sixth Directive, from the rule that economic activities are subject to tax is founded on the weak presumption that activities engaged in by public bodies as public authorities are activities of an essentially regulatory nature that are linked to the exercise of rights and powers of public authority. In those circumstances, the fact that the activities are not subject to VAT does not potentially have an anticompetitive effect vis-à-vis activities engaged in by the private sector, inasmuch as they are generally undertaken exclusively, or almost exclusively, by the public sector. Fiscal neutrality is thus observed.

16. However, that presumption remains a weak one. Inasmuch as the definition of public bodies acting as public authorities, while founded on Community criteria, nevertheless depends on the internal organisation of each Member State, the probability that certain of these activities engaged in by these public bodies are also entrusted to the private sector remains strong. Activities of an essentially economic nature can indeed fall within the conditions of the derogation provided for in the first subparagraph of Article 4(5) of the Sixth Directive where national law makes the public body act under a 'special legal regime applicable to it', the specific nature of such a regime entailing, in accordance with the Court's case-law, that the activity is classified as one engaged in by the body as a public authority. Not making such, essentially economic, activities subject to tax may become a source of distortion of competition inasmuch as they are or may be generally engaged in, in parallel or even principally, by the private sector. The effect of not taxing them would thus be to divert the VAT system which rests above all on the principle of fiscal neutrality.

17. It is principally this situation that the Community legislature sought to avoid by providing in the third subparagraph of Article 4(5) of the Sixth Directive that certain activities specifically listed

in Annex D to that directive are subject to tax. Those activities correspond to: telecommunications; the supply of water, gas, electricity and steam; the transport of goods; port and airport services; passenger transport; the supply of new goods manufactured for sale; the transactions of agricultural intervention agencies in respect of agricultural products carried out pursuant to regulations on the common organisation of the market in these products; the running of trade fairs and exhibitions; warehousing; the activities of commercial publicity bodies; the activities of travel agencies; the running of staff shops, cooperatives and industrial canteens and similar institutions; and transactions other than those specified in Article 13A(1)(q) of the Sixth Directive of radio and television bodies. It is clear upon reading that subparagraph that these activities are subject to tax regardless of whether there is actual or potential competition at the level of certain local markets upon which the activities may equally be engaged in by public bodies under a special regime applicable to them. Solely the nature of the activity concerned matters.

18. Consequently, the second subparagraph of Article 4(5) of the Sixth Directive which, like the third subparagraph, lays down a derogation from the rule of freedom from VAT, must be interpreted as sharing the same logic as the third subparagraph, namely re-establishment of the principle that activities of an economic nature are subject to VAT.

19. From this viewpoint, the criterion of distortion of competition has the sole purpose of helping the competent national authorities to determine which activities are to be subject to VAT. The concept of distortion of competition operates not as a principle regulating particular economic situations, such as cartels or abuse of a dominant position, but as an incidental criterion available to the Member States for implementation of the VAT system so that they can determine the activities the carrying out of which must be subject to VAT. (8) This criterion thus falls within Community fiscal policy which, in accordance with the principle of fiscal neutrality, seeks to make all economic activities subject to VAT.

20. Furthermore, only this approach makes it possible to safeguard the principle of simplicity that is linked to the need for legal certainty in the levying of tax. These principles would be seriously undermined by a case-by-case analysis of the state of competition on the relevant markets. In this connection, the approach adopted incidentally has the advantage of avoiding particularly onerous administrative costs for the competent national authorities.

21. Therefore, the second subparagraph of Article 4(5) of the Sixth Directive must be interpreted as meaning that it is incumbent upon the Member States, within the framework of the discretion that is accorded to them for implementation of that provision, (9) to determine on the basis of the activities concerned whether there would be a risk of distortion of competition if bodies governed by public law engaging in those activities as public authorities were not taxable persons for VAT purposes.

B – *The second question referred for a preliminary ruling*

22. By its second question, the national court raises the issue of what is meant by the words ‘ *would lead to* significant distortions of competition’ in the second subparagraph of Article 4(5) of the Sixth Directive. It seeks to ascertain whether this provision covers only actual competition or whether it also extends to potential competition.

23. It follows logically from the interpretation adopted in answering the first question that potential competition is to be taken into account. Inasmuch as the activity-based approach prevails, the state of competition on a given local market is unimportant.

24. Above all, the Court has already explained that, ‘with a view to ensuring the neutrality of the tax, which is the major objective of the Sixth Directive, [the second subparagraph of Article 4(5) of

the Sixth Directive] envisages the situation in which bodies governed by public law engage, under the special legal regime applicable to them, in activities which may also be engaged in, in competition with them, by private individuals under a regime governed by private law or on the basis of administrative concessions'. (10) If actual competition only were to be taken into consideration, fiscal neutrality would no longer be preserved inasmuch as actual competition alone precludes account being taken of future or immediate entry of certain private operators, who, in all events, will be taxable persons for VAT purposes. In those circumstances, it is, however, clear that freedom from tax of public operators engaging in the same activity as private operators, who are taxable persons for VAT purposes, may lead to a significant distortion of competition.

25. Moreover, as Advocate General Kokott has pointed out, '(t)he risk of distortions of competition can be real even if no competitor is at present offering competing supplies subject to value added tax. A disadvantageous starting point is in itself liable to dissuade potential competitors from becoming active in the market …' (11)

26. Consequently, and in accordance with the view put forward by the Commission, the words 'would lead to' must be understood as including both actual competition and potential competition in so far as the possibility of the latter is real.

C – *The third question referred for a preliminary ruling*

27. The national court's third question concerns the meaning of the phrase '*significant* distortions of competition'. (12) Does it mean an effect on competition that is not trivial or only an 'exceptional' effect going beyond the distortions which would normally flow from the coexistence of taxed and untaxed suppliers on the same market?

28. I must admit that my initial instinct would be to reply: neither one nor the other. The Community legislature no doubt specifically intended to opt for a word such as 'significant' presupposing a distortion of competition that is probably more than trivial, but is not exceptional. In this connection, the answer which could be given to the question brings to mind the observation of George Bernard Shaw that 'no question is so difficult to answer as that to which the answer is obvious'.

29. The risk run by replacing one word with another is that of choosing wording that is just as equivocal. It seems to me to be more pertinent to begin by recognising the limits to the interpretation of certain terms, which in actual fact resist all predetermination by means of general and abstract interpretation. They acquire their full and complete meaning only when they are applied, on a case-by-case basis and in the light of the objectives of the enactment in which they appear. From this viewpoint, in the present context the interpretation of the concept 'significant' must take account of the discretion that the Sixth Directive leaves the Member States to determine what this word covers in the context in which it is applied. (13)

30. In addition, quite often the interpretation of such a concept can be established only by means of a negative definition highlighting more what it is not than what it is. In this regard, as already noted, the various subparagraphs of Article 4(5) are closely linked so that the interpretation of one of them cannot be isolated from the interpretation to be placed on each of the others. Thus, the view that the mere exercise of rights and powers of public authority, which characterise the activity as being that of an authority acting as a public authority, is sufficient to preclude the existence of any distortion of competition with, in particular, private operators would effectively render the second subparagraph of Article 4(5) of the Sixth Directive redundant. Similarly, the exclusion from the scope of VAT that is enjoyed by a body acting as a public authority cannot be considered in itself to entail a distortion of competition justifying treatment as a taxable person under the second subparagraph of Article 4(5) of the Sixth Directive. Only a *significant*

distortion of competition is to trigger payment of VAT by bodies acting as public authorities if the first subparagraph of Article 4(5) is not to be rendered redundant. Any other interpretation would risk including practically all transactions or activities engaged in by a public authority, acting as such, within the scope of the derogation from the rule that such bodies are not taxable persons for VAT purposes.

31. The word ‘significant’ does not imply that the distortion of competition is trivial or exceptional, but that it is out of the ordinary. The concept can be given further concrete expression only on a case-by-case basis and in the light of the objectives of the Sixth Directive which have been specified in the first part of this Opinion. It must therefore be concluded in this regard that the interpretation of such a concept falls within the discretion of the Member States inasmuch as it can acquire its meaning only in the context in which it is applied, provided that that interpretation complies with the objectives, as have been specified, of the Sixth Directive.

III – **Conclusion**

32. In the light of the foregoing considerations, I propose that the Court answer the questions referred for a preliminary ruling as follows:

(1) The second subparagraph of Article 4(5) 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, must be interpreted as meaning that it is incumbent upon the Member States, within the framework of the discretion that is accorded to them for implementation of that provision, to determine on the basis of the activities concerned whether there would be a risk of distortion of competition if bodies governed by public law engaging in those activities as public authorities were not taxable persons for VAT purposes.

(2) The words ‘would lead to’ must be understood as including both actual competition and potential competition in so far as the possibility of the latter is real.

(3) The word ‘significant’ does not imply that the distortion of competition is trivial or exceptional, but that it is out of the ordinary. The interpretation of such a concept falls within the discretion of the Member States inasmuch as it can acquire its meaning only in the context in which it is applied, provided that that interpretation complies with the objectives, as have been specified, of Directive 77/388.

1 – Original language: French.

2 – OJ 1977 L 145, p. 1. This directive, which was amended on a number of occasions, has been repealed by Council Directive 2006/112/EC of 28 November 2006 (OJ 2006 L 347, p. 1). The second subparagraph of Article 13(1) of Directive 2006/112 is in essentially the same terms as the second subparagraph of Article 4(5) of the Sixth Directive. Similarly, Annex D, referred to in the third subparagraph of Article 4(5) of the Sixth Directive, is now Annex I to Directive 2006/112.

3 – ‘The local authorities’ or ‘the respondents in the main proceedings’.

4 – Case C-446/98 [2000] ECR I?11435.

5 – *Fazenda Pública*, paragraphs 16 and 17.

6 – Joined Cases 231/87 and 129/88 *Comune di Carpaneto Piacentino and Others* (‘*Carpaneto I*’) [1989] ECR 3233, paragraph 16, and *Fazenda Pública*, paragraph 23.

7 – *Carpaneto I*, paragraph 26 (emphasis added).

8 – See, to this effect, also the view put forward by Advocate General Mischo in points 14 and 15 of his Opinion in Case C-4/89 *Comune di Carpaneto Piacentino and Others* (‘*Carpaneto II*’) [1990] ECR I?1869.

9 – For confirmation of such discretion granted to the Member States, see in particular *Carpaneto I* , paragraph 23, *Carpaneto II*, paragraph 13, and *Fazenda Pública*, paragraphs 31 and 32. It is also to be pointed out that the discretion accorded to the Member States is thus wider under the second subparagraph of Article 4(5) of the Sixth Directive than it is for transposition of the third subparagraph where the activities, which are required in principle to be subject to tax, are established in advance by the Community legislature.

10 – *Carpaneto I*, paragraph 22. The objective of fiscal neutrality pursued by this subparagraph has been consistently pointed out; see, most recently, Case C-430/04 *Feuerbestattungsverein Halle* [2006] ECR I?4999, paragraph 24.

11 – Point 131 of the Opinion in Case C-369/04 *Hutchison 3G and Others* [2007] ECR I?5247.

12 – Emphasis added.

13 – For similar reasoning, see in particular Joined Cases C-240/98 to C-244/98 *Océano Grupo Editorial and Salvat Editores* [2000] ECR I?4941, paragraph 25 et seq.