JUDGMENT OF THE COURT
21 June 1988 *

In Case 416/85

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

applicant,

v

United Kingdom of Great Britain and Northern Ireland, represented by S. J. Hay, of the Treasury Solicitor's Department, acting as Agent, assisted by D. Vaughan, QC, with an address for service in Luxembourg at the British Embassy, 28 boulevard Royal,

defendant,

APPLICATION for a declaration that by applying a system of zero-rating to certain groups of goods and services the United Kingdom has failed to fulfil its obligations under Article 28 (2) of the Sixth Council Directive of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value-added tax: uniform basis of assessment (77/388/EEC, Official Journal 1977, L 145, p. 1),

THE COURT,

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

Advocate General: M. Darmon
Registrar: H. A. Rühl, Principal Administrator

* Language of the Case: English.

having regard to the Report for the Hearing and further to the hearing on 15 September 1987,

after hearing the Opinion of the Advocate General delivered at the sitting on 2 December 1987,

gives the following

Judgment

1 By an application lodged at the Court Registry on 13 December 1985 the Commission of the European Communities brought an action pursuant to Article 169 of the EEC Treaty for a declaration that by continuing to apply a zero rate of value-added tax to certain groups of goods and services the United Kingdom of Great Britain and Northern Ireland has contravened the provisions of Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value-added tax: uniform basis of assessment (Official Journal 1977, L 145, p. 1) (hereinafter referred to as 'the Sixth Directive') and has therefore failed to fulfil its obligations under the EEC Treaty.

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

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

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

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

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

4 On the basis of Article 28 (2) of the Sixth Directive, the United Kingdom has continued to apply a system called 'zero-rating'. Originally Schedule 4 to the Finance Act 1972 contained a list of 17 groups of goods or services which were zero-rated. That list was incorporated almost in its entirety in Schedule 5 to the Value-added Tax Act 1983.

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

6 The United Kingdom did not agree that it had failed to fulfil its obligations under the Treaty, and on 4 September 1984 the Commission therefore delivered a reasoned opinion. Since the United Kingdom did not comply with that opinion, the Commission brought these proceedings.

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

The jurisdiction of the Court

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

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

Substance

10 It should be pointed out first of all that the Commission does not dispute the legality of the zero-rating system in general; it considers that system to be essentially equivalent to the exemptions provided for by Article 28 of the Sixth Directive, as it expressly stated in its proposal for a Sixth Directive submitted to the Council on 29 June 1973. It submits, however, that the requirements laid down

in the last indent of Article 17 of the Second Directive, which provides that exemptions may be made only 'for clearly defined social reasons and for the benefit of the final consumer', are not met with regard to certain groups of goods and services included in Schedule 5 to the Value-added Tax Act 1983.

11 It must therefore be determined whether the zero-rating of the goods and services at issue complies with the conditions laid down in those provisions.

The concept of 'clearly defined social reasons'

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

13 In particular, the United Kingdom accepts that the Commission may challenge a measure where the social reason cannot be said to be sufficiently 'clearly defined', where the social reason advanced cannot justify the measure or if the measure lacks all proportionality. The Commission states that by 'social reasons' it understands measures which are introduced primarily for general social purposes and not principally for industrial, sectoral or fiscal reasons; it accepts, however, that it may not challenge measures taken in pursuance of a Member State's social policy unless it can be shown that the social policy is not sufficiently clearly defined or that the measures in question either are not justified by or are disproportionate to the social reasons advanced.

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

The phrase 'for the benefit of the final consumer'

15 The Commission regards as 'final consumers' those persons who stand at the final stage in the manufacturing and commercial chain and have no right to deduct VAT, that is to say non-taxable persons.

16 The United Kingdom considers that there is nothing in the general scheme of VAT to indicate that the term 'final consumer' should be treated as synonymous with the term 'non-taxable person'. On the contrary, the final consumer must be taken to be the natural or legal person at the end of a particular production or distribution chain for a particular product or service, even where that product or service is used in the production of other products or the provision of other services, regardless of whether or not the person is a taxable person.

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

The zero rates at issue

A — *Group 1 — Food* (2. Animal feedingstuffs; 3. Seeds or other means of propagation of plants comprised in Items 1 or 2; 4. Live animals of a kind generally used as, or yielding or producing, food for human consumption)

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

19 The United Kingdom argues that the application of a positive rate of VAT to these products would entail an increase in food prices and thus jeopardize the achievement of the social objectives which it is pursuing. It also disputes the Commission's argument concerning remoteness from the final product.

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

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

B — *Group 2 — Sewerage services and water supplies*

22 The Commission's submission in this respect concerns services provided to industry regarding the emptying of cesspools and septic tanks made necessary by the absence of a mains drainage system, on the one hand, and the supply of water to industry, on the other.

23 In neither of these cases can the provision of services to industry be regarded as fulfilling the second criterion laid down in Article 17, since industrial users cannot be regarded as final consumers.

24 With regard in particular to the supply of water to industry, the United Kingdom pointed out that such supplies are exempted in another Member State. In the course of the proceedings the Commission explained that that exemption is based on Article 28 (3) (b) of the Sixth Directive, according to which the Member States may, during the transitional period, continue to exempt the activities set out in

Annex F, in this instance 'the supply of water by public authorities'. The United Kingdom has not sought to rely on that provision.

25 The failure of the United Kingdom to fulfil its obligations in respect of these products and services is therefore established.

C — *Group 6 — News services provided to certain undertakings*

26 The Commission's submissions concern the supply of news services to undertakings which themselves provide services which are not zero-rated, such as banks or insurance companies.

27 The United Kingdom argues that the services in question can be included as an 'incidental benefit' and that the intrinsic characteristics of news services remain the same whether they are supplied to a bank or to a newspaper, the latter being zero-rated.

28 Leaving aside the fact that an incidental benefit such as that relied on by the United Kingdom has no place in the concept of a benefit to the final consumer for the purposes of Article 28 of the Sixth Directive, it is clear that since the undertakings to which the news services in question are provided, such as banks and insurance companies, cannot be regarded as final consumers, the second criterion laid down in Article 17 of the Second Directive is not fulfilled.

29 The failure of the United Kingdom to fulfil its obligations in respect of these services is therefore established.

D — *Group 7 — Fuel and power* (coal, coke, coal gas, water gas, petroleum gases, fuel oil, gas oil, electricity, etc.)

30 The Commission challenges the zero-rating of supplies of fuel and power other than to final consumers.

31 In its defence the United Kingdom relies essentially on the negative effects from the social point of view of any taxation of supplies of fuel and power, in particular to schools and hospitals.

32 Whilst the Court does not call in question the social reasons underlying that policy, it must point out that the services in question cannot be considered to have been provided for the benefit of final consumers, since final consumers as defined above derive only very indirect advantages from zero-rating. They therefore do not fulfil the second criterion of Article 17 of the Second Directive.

33 With regard to the United Kingdom's alternative argument to the effect that the difficulties in administering the tax if only supplies to final consumers were zero-rated would probably be insurmountable, it must be observed that where a Member State wishes to make use of the derogations in question it must take all the practical measures necessary for the correct application of those provisions. If it considers that such measures cannot be implemented, it must refrain from applying zero rates.

34 The alleged failure of the United Kingdom to fulfil its obligations is therefore established.

E — *Group 8 — Construction of buildings* (including in particular the initial sale of new buildings, the services provided by a contractor constructing a new building for a client who owns the site, the construction of commercial and industrial buildings, civil engineering works, the construction of roads, railways and airports)

35 The Commission challenges the zero-rating of all the items in Group 8 with the exception of housing constructed by local authorities. With regard to the housing sector, the Commission argues that the indiscriminate application of a zero rate to the whole sector, regardless of the nature of the dwellings concerned, is contrary to the first criterion laid down in the last indent of Article 17 inasmuch as it is

disproportionate in relation to the objectives of the United Kingdom's social policy in housing matters. With regard to commercial and industrial buildings and to community and civil engineering works the Commission considers that any benefit to the final consumer is too remote to meet the second criterion laid down in the last indent of Article 17.

36 With regard to buildings intended for housing, the Commission's arguments cannot be upheld. The measures adopted by the United Kingdom in order to implement its social policy in housing matters, that is to say, facilitating home ownership for the whole population, fall within the purview of 'social reasons' for the purposes of the last indent of Article 17 of the Second Directive.

37 By applying a zero rate to the activities comprised in Group 8 with regard to housing constructed both by local authorities and by the private sector, the United Kingdom has not, therefore, contravened the last indent of Article 17 of the Second Directive.

38 However, activities included in Group 8 in relation to the construction of industrial and commercial buildings and to community and civil engineering works cannot be considered to be for the benefit of the final consumer.

39 It follows that the United Kingdom has failed to fulfil its obligations, as alleged by the Commission, in so far as it applies a zero rate to services in relation to the construction of industrial and commercial buildings and to community and civil engineering works.

F — *Group 17 — Clothing and footwear*

40 The Commission submits that the supply of these products to employers for the use of their employees cannot benefit from zero-rating because they cannot be regarded as inputs in the chain of production of products which are zero-rated.

41 The United Kingdom argues that protective boots and helmets must be considered in their own right, not as part of a production process. The employer must, it says, be regarded as the final consumer of these goods.

42 In the light of the considerations set out above, it must be held that the persons to whom these goods are supplied cannot be regarded as final consumers.

43 The alleged failure of the United Kingdom to fulfil its obligations in this respect is therefore established.

44 It follows from all the foregoing that by continuing to apply a zero rate of value-added tax to the groups of goods and services specified above, the United Kingdom has contravened the provisions of Directive 77/388 and has therefore failed to fulfil its obligations under the EEC Treaty.

Costs

45 Under Article 69 (2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs. Since the United Kingdom has failed in most of its submissions, it must be ordered to pay the costs.

On those grounds,

THE COURT

hereby:

(1) Declares that by continuing to apply a zero rate of value-added tax:

to supplies to industry of water and sewerage services (emptying of cesspools and septic tanks) included in Group 2 of Schedule 5 to the Value-added Tax Act 1983, in so far as they are not supplied to final consumers,

to news services included in Group 6, in so far as they are not provided to final consumers,

to supplies of fuel and power included in Group 7 and to protective boots and helmets included in Group 17, in so far as they are not supplied to final consumers,

to the provision of goods and services included in Group 8 in relation to the construction of industrial and commercial buildings and to community and civil engineering works, in so far as they are not provided to final consumers,

the United Kingdom of Great Britain and Northern Ireland has contravened the provisions of Council Directive 77/388 of 17 May 1977 and has therefore failed to fulfil its obligations under the EEC Treaty;

(2) For the rest, dismisses the application;

(3) Orders the United Kingdom to pay the costs.

Mackenzie Stuart Bosco Due Moitinho de Almeida Rodríguez Iglesias

Koopmans Everling Bahlmann

Galmot Kakouris Joliet O'Higgins Schockweiler

Delivered in open court in Luxembourg on 21 June 1988.

J.-G. Giraud
Registrar

A. J. Mackenzie Stuart
President