An unresolved long-standing controversy: the Supreme Court once again classifies charges for municipal drinking water supplies as rates, even when the service is managed by a private company

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The Supreme Court has once again addressed the issue of whether the price paid by users of a privately-managed municipal water supply service should be considered a private charge or a rate, expressly ruling that it is a rate.

The wording of article 2(2)(a) of the General Tax Act 58/2003 (abbrev. LGT) led to a wide-ranging debate on the legal nature of payments for the municipal supply of drinking water, as it classifies as rates those taxes whose taxable event is the provision of mandatory services under public law, but then adds in the second paragraph, introduced during the parliamentary procedure following two amendments by the Catalan Parliamentary Group, that "services shall be considered to be provided and activities shall be considered to be carried out under public law when done by *any of the means provided in administrative legislation for the management of public services* and such service is owned by a public body"

The Sustainable Economy Act 2/2011 was meant to put an end to this controversy by eliminating such second paragraph, once again as a result of a compromise amendment introduced by the Catalan Parliamentary Group with the stated purpose of clarifying that charges for activities carried out or services provided by public bodies or entities operating under private law shall not be considered to be rates.

This interpretation appeared in a Report issued by the Directorate-General for Taxation on 26 July 2011 (N/REF 2011-28394), in which it stated that, following the aforementioned amendment, if a local authority directly manages the public service without any kind of delegation, it must charge rates, but if the entity managing the public service is a municipal enterprise or a private company that has signed a management agreement with the local authority, the charges must be classified as non-tax revenue rather than tax revenue.

However, the Supreme Court judgment of 23 November 2015 (Appeal no. 491/2013) has rekindled the debate by once again holding these charges to be rates. After analysing the legislation and Constitutional Court case law, the judgment concludes that, as already stated in its judgment of 20 July 2009 (Appeal no. 4089/2003), "drinking water supply and distribution services must be subject to a tax (art. 20(4)(t) of the Local Public Finance Act). (…) The price paid by users of a drinking water supply service provided through a concession must be classified as rates, regardless of the management model employed, even in cases where the service is managed by a public body governed by private law".

Although the 2009 judgment was given to resolve a case filed before the entry into force of the LGT, the 23 November 2015 judgment contends that its legal doctrine remains valid in view of the legislation regulating local public finance authorities (which was not modified by either the LGT or, consequently, its amendment) and, above all, by the Constitutional Court's doctrine. According to this doctrine, the form or regime under which a public service is provided by its owner does not affect the nature of the charges,

but rather whether we are faced with imposed charges for obligatory, indispensable or monopolistic services: if so, said charges must be regarded as revenue of a tax nature (STC 185/1985).

The 23 November 2015 judgment highlights that these concepts of public service and tax revenue were once again pointed out by the Constitutional Court in its judgment no. 102/2005, which on a question of unconstitutionality held that art. 70(1) and (2) of the State Harbours and Merchant Navy Act 27/1992 were unconstitutional and void, inasmuch as classifying as "private charges" the rates for harbour services which must be classified as taxes regardless of whether such harbour services are provided directly or indirectly by the harbour authority.

The importance of the view held by the Supreme Court, if confirmed, is obvious, since the classification of the charges paid by the users of the drinking water supply service as rates could have significant consequences, such as: attachment to the principles and guarantees governing taxes; requisite prior approval by a tax ordinance; maximum amount equal to or lower than the cost of providing the service; amount free from the devolved regions' control of authorised prices; and responsibility of local councils, not concessionaires, for enforcing payment by way of distraint proceedings.

It is worth noting that this doctrine regarding the tax nature of the charge to be paid by the user would, in principle, also apply to other municipal services where the public authorities have a de facto or de jure monopoly, such as municipal sewerage or solid waste collection.

However, in spite of this judgment, the long-standing controversy to which we alluded in the title remains "unresolved" since the same Division of the Supreme Court took a different approach just a few months earlier. The 28 September 2015 judgment (Appeal no. 2042/2013), handed down by the same Division, upheld the legality of a municipal decision approving the modification of the legal nature of prices charged for the provision of mortuary services in 2012 by the public-private partnership in which the public partner is a municipal association, which were reclassified from rates to private fees.

It is true that the legal grounds of the 23 November judgment expressly mention the prior ruling, not only affirming that it is meant to "refine" such doctrine but also mentioning, as an element that differentiates the two cases, the fact that mortuary services were liberalized by Royal Decree-Act 7/1996, meaning that local councils are no longer required to provide such services. Therefore, the prices charged for such services by entities governed by private law cannot be classified as rates.

The Directorate-General for Taxation, however, did not see it the same way, and on 20 May issued a report "in respect of the rates for the provision of water supply and sewage services"[1], where, relying on certain paragraphs of the 25 September 2015 judgment, it maintained its stance and stated that "if public water and sewage services are directly managed by a local authority without any type of delegation, the price paid by users must be legally classified as rates. On the other hand, if such services are managed by a public-private partnership or by a private company that has signed a management agreement with a local authority, the charges must be classified as non-tax revenue rather than tax revenue. And, as a result, it concludes that "in the case of the provision of a public service by a public or private company or a public-private partnership, the government authority owning such service still has the possibility of opting to compensate the operator by way of a fee or price to be paid directly by the users, remuneration to be paid directly by such government authority or a combination of the two".

The scene is set, once again, for controversy, controversy that unfortunately can only be resolved if lawmakers, instead of systematically limiting themselves to passing stop-gap measures in the form of compromise amendments, decide to undertake a serious, rigorous and far-reaching regulation of the legal and financial framework applicable to a public service of such great importance for the people as is that of water supply.

[1] Available at the website of the Ministry of Public Finance and Administration: http://www.minhap.gob.es/Documentacion/Publico/DGCFEL/Tasa%20agua.pdf