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Judgment of the Court (Sixth Chamber) of 18 June 1998. - Commission of the European Communities v French Republic. - Failure to fulfil obligations - Sixth Council Directive 77/388/EEC - Article 17(2) and (6) - Right to deduct VAT - Exclusions provided for by national rules predating the Sixth Directive. - Case C-43/96.

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Keywords

Tax provisions - Harmonisation of laws - Turnover taxes - Common system of value added tax - Deduction of input tax - Expenditure which is strictly business expenditure - Exclusions provided for by national rules predating the Sixth Directive - Exclusion of the right to deduct value added tax on means of transport constituting the very tool of the taxable person's trade - Whether permissible

(Council Directive 77/388, Art. 17(2)(a) and (6))

Summary

A national system of value added tax in existence at the time of the entry into force of the Sixth Directive 77/388 on the harmonisation of the laws of the Member States relating to turnover taxes, which excludes the right to deduct tax on means of transport which constitute the very tool of the taxable person's trade, is not in breach of Article 17(2) of the directive since the second subparagraph of Article 17(6) thereof authorises the Member State to maintain, until the entry into force of rules to be adopted by the Council, all the exclusions of the right to deduct provided for under their national laws at the time of the directive's entry into force.

It is apparent from the wording of Article 17(6) of the Sixth Directive that, while it is for the Council to decide what expenditure is not eligible for a deduction of value added tax, the rules which the Council is called upon to adopt are not automatically limited to expenditure that is not strictly business expenditure. In those circumstances, the expression `all the exclusions', used in the second subparagraph of Article 17(6) of the directive, comprises expenditure which is strictly business expenditure.

Parties

In Case C-43/96,

Commission of the European Communities, represented by H. Michard and E. Traversa, of its Legal Service, acting as Agents, with an address for service in Luxembourg at the office of C. Gómez de la Cruz, also of its Legal Service, Wagner Centre, Kirchberg,

applicant,

v

French Republic, represented by C. de Salins, Deputy Director in the Legal Directorate, Ministry of Foreign Affairs, assisted by G. Mignot, Foreign Affairs Secretary in the same Ministry, acting as Agents, with an address for service in Luxembourg at the French Embassy, 8B Boulevard Joseph II,

defendant,

supported by

United Kingdom of Great Britain and Northern Ireland, represented by S. Ridley, of the Treasury Solicitor's Department, acting as Agent, with an address for service in Luxembourg at the British Embassy, 14 Boulevard Roosevelt,

intervener,

APPLICATION for a declaration that, by maintaining in force legislation which denies taxable persons the right to deduct value added tax on means of transport which constitute the very tool of their trade, the French Republic has failed to fulfil its obligations under the 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), and in particular Article 17(2) thereof,

THE COURT

(Sixth Chamber),

composed of: R. Schintgen, President of the Second Chamber, acting for the President of the Sixth Chamber, G.F. Mancini, P.J.G. Kapteyn, J.L. Murray and G. Hirsch (Rapporteur), Judges,

Advocate General: F.G. Jacobs,

Registrar: D. Louterman-Hubeau, Principal Administrator,

having regard to the Report for the Hearing,

after hearing oral argument from the parties at the hearing on 25 September 1997,

after hearing the Opinion of the Advocate General at the sitting on 13 November 1997,

gives the following

Judgment

Grounds

1 By application lodged at the Court Registry on 14 February 1996, the Commission of the European Communities brought an action under Article 169 of the EC Treaty for a declaration that, by maintaining in force legislation which denies taxable persons the right to deduct value added tax (VAT) on means of transport which constitute the very tool of their trade, the French Republic has failed to fulfil its obligations under the 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, hereinafter `the Sixth Directive'), and in particular Article 17(2) thereof.

The Sixth Directive

2 Article 17(2) of the Sixth Directive provides as follows:

`In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:

(a) value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person;

...'

3 Article 17(6) provides:

`Before a period of four years at the latest has elapsed from the date of entry into force of this directive, the Council, acting unanimously on a proposal from the Commission, shall decide what expenditure shall not be eligible for a deduction of value added tax. Value added tax shall in no circumstances be deductible on expenditure which is not strictly business expenditure, such as that on luxuries, amusements or entertainment.

Until the above rules come into force, Member States may retain all the exclusions provided for under their national laws when this directive comes into force.'

4 On 25 January 1983 the Commission submitted to the Council a Proposal for a Twelfth Directive on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: expenditure not eligible for deduction of value added tax (OJ 1983 C 37, p. 8), which was amended by another proposal submitted by the Commission to the Council on 20 February 1984 (OJ 1984 C 56, p. 7). That proposal was not adopted by the Council.

The national legislation

5 The French rule at issue is Article 237 of Annex II to the French Code Général des Impôts (hereinafter `the CGI'), which entered into force on 27 July 1967 and which provides as follows:

`Value added tax shall not be deductible on vehicles or machines, whatever their nature, designed for the transport of persons or for mixed use which constitute fixed assets or, if not, are not intended for resale in a new state.'

6 The basic documentation of the French tax authority (Série 3 C A, Division D, feuillets 1532 and 1533, updated on 1 May 1990) states that the vehicles covered by that provision are bicycles, motorcycles, private motor cars, boats, aeroplanes and helicopters. However, the aforesaid rule does not apply to commercial vehicles such as vans, lorries, tractors and other `highly specialised vehicles'. Furthermore, helicopters are not eligible for deduction even where they are used for aerial photography, publicity, pilot training, or topographical or geodesic surveys.

The pre-litigation procedure

7 By letter of 6 September 1991 the Commission informed the French Republic that it regarded Article 237 of Annex II to the CGI as incompatible with the Sixth Directive and, in particular, Article 17(2) thereof, in so far as it does not confer the right to deduct VAT on vehicles used for the purposes of driving instruction.

8 By letter of 6 September 1991 the French Government informed the Commission that the contested provision had been amended, with effect from 1 January 1993, in such a way as to render vehicles or equipment used exclusively for the purposes of driving instruction eligible for deduction.

9 By letter of 12 July 1993 the Commission informed the French Government that both the condition that a vehicle must be used exclusively for the purposes of driving instruction and the exclusion of the right to deduct which continued to affect taxable persons whose work by its very nature involved the use of certain means and forms of transport (such as helicopters used for lifting by an undertaking engaged in aerial work) were in breach of Article 17(2) of the Sixth Directive.

10 By letter of 4 October 1993 the French Government replied that the condition that a driving-school vehicle must be used exclusively for the purposes of driving instruction had been relaxed by administrative order of 4 February 1993. It also pointed out that the exclusion of the right to deduct VAT on means of transport which constitute the very object of a taxable person's trade was authorised by Article 17(6) of the Sixth Directive.

11 In the case of vehicles used for the purposes of driving instruction, the Commission decided to discontinue the procedure. However, taking the view that the principle of the right to deduct VAT on a means of transport which constitutes the very object of a taxable person's trade was fundamental, the Commission issued a reasoned opinion to the French Republic on 8 November 1994, requesting it to take the requisite measures within a period of two months.

12 In its reply of 9 January 1995, the French Government expressed its total disagreement with the Commission's analysis and set out in more detail the observations it had formulated in its reply to the letter of formal notice.

The application

13 In support of its application, the Commission claims that the exclusion, provided for by Article 237 of Annex II to the CGI, of the right to deduct VAT on goods which constitute the very tool or object of a taxable person's trade is contrary to Article 17(2) of the Sixth Directive.

14 Admittedly, the second subparagraph of Article 17(6) of the directive expressly authorises Member States to retain provisions excluding the right to deduct which, like Article 237 of Annex II to the CGI, predate the entry into force of the Sixth Directive.

15 According to the Commission, however, the exclusion of the right to deduct provided for by Article 17(6) of the Sixth Directive relates only to expenditure which is not strictly business expenditure. Thus, the only expenditure liable to be excluded from the right to deduct is that incurred by a taxable person on goods and services which are not absolutely essential for the operation of his business. That possibility is designed to prevent a taxable person from being able to obtain for his own final use goods and services which have not been taxed.

16 That interpretation cannot be accepted, as it is not consistent with the wording of Article 17(6) of the Sixth Directive.

17 The first subparagraph of Article 17(6) of the Sixth Directive provides that the Council is to decide what expenditure is not eligible for a deduction of VAT. The next sentence states that `value added tax shall in no circumstances be deductible on expenditure which is not strictly business expenditure'. It follows, in particular, from that second sentence that the rules which the Council is called upon to adopt are not automatically limited to expenditure which is not strictly business expenditure.

18 In those circumstances, the expression `all the exclusions', used in the second subparagraph of Article 17(6), clearly comprises expenditure which is strictly business expenditure. That provision accordingly authorises the Member States to retain national rules which deny taxable persons the right to deduct VAT on means of transport which constitute the very tool of their trade.

19 As the Advocate General has pointed out in paragraphs 14 to 16 of his Opinion, that interpretation is confirmed by the origin of Article 17(6) of the Sixth Directive. In the first place, in the explanatory memorandum accompanying its proposal for the Sixth Directive (Bulletin of the European Communities, Supplement 11/73, p. 1), the Commission stated that certain expenditure, even though incurred in the ordinary course of the undertaking's business, would be difficult to apportion between business use and private use. Secondly, it is clear from a comparison of the wording of Article 17(6) proposed by the Commission and that adopted by the Council that, when the Sixth Directive was adopted, the Member States were unable to agree on the arrangements applicable specifically to expenditure on passenger transport.

20 In the light of those considerations, it is apparent that, by maintaining in force legislation which denies taxable persons the right to deduct VAT on means of transport which constitute the very tool of their trade, the French Republic has not failed to fulfil its obligations under the Sixth Directive, and in particular Article 17(2) thereof. The application for a declaration that it has failed to fulfil its obligations must therefore be dismissed as unfounded.

Decision on costs

Costs

21 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs. Since the Commission has been unsuccessful, it must be ordered to pay the costs. Under Article 69(4) of the Rules of Procedure, Member States and institutions which intervene in

the proceedings are to bear their own costs.

Operative part

On those grounds,

THE COURT

(Sixth Chamber)

hereby:

1. Dismisses the application;

2. Order the Commission of the European Communities to pay the costs;

3. Orders the United Kingdom of Great Britain and Northern Ireland to bear its own costs.