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Opinion of Mr Advocate General Jacobs delivered on 13 November 1997. - 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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Opinion of the Advocate-General

1 In this case the Commission has brought an action against France under Article 169 of the Treaty for a declaration that France is in breach of its obligations under the Sixth VAT Directive, (1) in particular Article 17(2), by not allowing taxable persons under certain circumstances to deduct VAT on means of transport put to business use.

The relevant Community rules

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

`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 However, Article 17(6) of the Directive 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 The Council has not as yet taken the decision envisaged by the first sentence of that provision.

The contested French rules

5 Article 237 of Annex II of the French Code Général des Impôts (`CGI') provides:

`VAT 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 Subject to certain exceptions the rule covers bicycles, motorcycles, private motor cars, boats, aeroplanes and helicopters. It does not apply to commercial vehicles such as vans, lorries and tractors. Helicopters do not qualify for deduction even where they are used for aerial photography, publicity, pilot training or topographical or geodesic surveys. (2)$

7 The Commission claims that Article 237 of Annex II of the CGI, as interpreted and applied by the French tax authorities, is contrary to Article 17(2) of the Sixth Directive in so far as it denies taxable persons the right to deduct VAT on goods which constitute the `very tool or object' (`l'outil ou objet même') of their trade. By that term the Commission confines its application to cases where the goods in question `are a necessity to such an extent that they condition in an absolute manner the exercise of the trade itself', as distinct from cases in which the goods `contribute substantially to facilitating the exercise of the trade'.

8 By way of example of goods used as the actual tool of a taxable person's trade the Commission refers in its application to the case of a firm which uses helicopters for aerial work other than the transport of passengers. In its letter of formal notice of 6 September 1991 the Commission also referred to the case of a driving school whose business depended on the use of motor cars for the purpose of giving driving instruction. However, following an amendment to the French legislation, (3) permitting deduction of VAT on motor cars used exclusively for the purposes of driving instruction, the Commission no longer pursues its complaint in that regard.

9 By contrast the Commission's application does not extend to, for example, cars used by sales representatives or by veterinary surgeons. Although considerably facilitating the exercise of a trade, such goods cannot, according to the Commission, be regarded as tools of a trade.

10 France and the United Kingdom, which has intervened in support of France, contend that the second subparagraph of Article 17(6) of the Directive expressly permits the maintenance of all the French provisions, which - as the Commission concedes - predate the entry into force of the Sixth Directive. I share that view.

11 The Commission contends that France reads the second subparagraph of Article 17(6) out of context. In its view the term `exclusions' in the second subparagraph of Article 17(6) is a contraction of the expression `expenditure which is not strictly business expenditure' in the second sentence of the first subparagraph of that provision. Expenditure on goods which are the tools of a taxable person's trade cannot be regarded as expenditure which is not strictly business expenditure and therefore cannot be the subject of exclusions retained under the second subparagraph.

12 However, that analysis is incorrect. The first sentence of the first subparagraph of Article 17(6) provides for the adoption by the Council of rules specifying expenditure that `shall not be eligible for a deduction of value added tax'. The second sentence of the subparagraph adds that VAT shall `in no circumstances be deductible on expenditure which is not strictly business expenditure, such as that on luxuries, amusements or entertainment'. (4) It is apparent from the wording and structure of the subparagraph that what was envisaged was the adoption by the Council of comprehensive rules on all the categories of expenditure which were not eligible for deduction, including - but not limited to - expenditure that was not strictly business expenditure.

13 Under the second subparagraph of Article 17(6) Member States are permitted `until the above rules come into force' to retain `all the exclusions' provided for under their national laws when the Directive came into force. Thus the second subparagraph is linked not to the second sentence of

the first subparagraph but to the first: Member States are entitled under the second subparagraph to retain all the exclusions in the areas which are to be the subject of common rules adopted by the Council under the first sentence of Article 17(6).

14 The above analysis is consistent with the legislative history of Article 17(6). In its explanatory memorandum accompanying its proposal for the Sixth Council Directive (5) the Commission explained that:

`certain expenditure, even though incurred in the ordinary course of business, is also incurred for private purposes, and apportionment of such expenditure between "business" and "private" purposes could not be adequately supervised'. (6)

15 Accordingly, Article 17(6) of the proposal provided:

`Value added tax on the following shall not be deductible:

(a) expenditure on accommodation, lodging, restaurants, food, drink, entertainment and passenger transport, unless incurred by an undertaking whose principal or subsidiary business is the pursuit of such activities;

(b) expenditure on luxuries;

(c) entertainment expenditure

...'

16 Thus it is clear first that, in drafting the proposal, the Commission's concern was not merely that certain items of expenditure incurred by taxable persons were not strictly business expenditure but also that certain expenditure, although incurred in connection with the normal operation of the business, was difficult to apportion between business and private use. (7) Secondly, it is apparent from a comparison of the proposed and adopted texts of Article 17(6) that, although, at the moment of the adoption of the Sixth Directive, Member States were in substantial agreement with regard to certain categories of expenditure, in particular luxuries, amusements and entertainment, no agreement could be reached on the treatment of passenger transport.

17 Further guidance as to what the Commission itself considered to be the scope of the matters upon which a decision was deferred at the moment of the adoption of the Sixth Directive is provided by the proposals submitted by the Commission under the first sentence of Article 17(6). The Commission's proposal of 25 January 1983 for a Twelfth Council Directive, (8) in addition to laying down rules disallowing deduction of tax on transport expenses, (9) accommodation, food and drink, (10) entertainment expenditure (11) and amusements and luxuries, (12) contained detailed provisions on means of transport. Article 1(1) of the proposal provided that VAT was not to be deductible on `the purchase, manufacture, importation, leasing or hire, use, modification, repair or maintenance of passenger cars, pleasure boats, private aircraft or motor cycles'. `Passenger car' was defined as `any road vehicle (including any trailer) other than one which, by its design and equipment, is intended solely for the transport of goods or is intended for industrial or agricultural use or has a seating capacity of more than nine persons including the driver'. Article 1(2) provided exceptions for vehicles or craft which were:

`(a) used for carriage for hire or reward;

(b) used for driving training or instruction;

(c) hired out;

(d) part of the stock in trade of a business'.

18 On 20 February 1984 the Commission presented an amended proposal (13) in which it altered the treatment of passenger cars and motor cycles. Under a new paragraph 1a, inserted into Article 1, Member States were to restrict the right of deduction to a proportion of the VAT on such goods. In addition it proposed the insertion of a new Article 3a providing as follows:

`A taxable person may request application of Article 17(2) of Directive 77/388/EEC in respect of the items of expenditure listed in Articles 1, 2 and 3 above if he can furnish proof that such expenditure has been made exclusively for business purposes.

Member States shall maintain in force or introduce arrangements for verifying ex post facto that such expenditure was indeed made exclusively for business purposes.'

19 Thus the Commission's proposals submitted pursuant to the first sentence of Article 17(6) (now withdrawn following continued disagreement in the Council) sought the adoption of common rules on the restrictions to be imposed on input tax deductions on means of transport in general and on the scope of the exceptions to be made for certain types of business such as driving schools or car-hire firms or, more generally, for taxable persons able to show exclusive business use. In other words, they were directed precisely at the matters which are the subject of the present case.

20 During the proceedings the Commission has stressed the severe disruption to the VAT system caused by rules disallowing deduction of tax on passenger vehicles and craft. It argues that France has not shown why motor cars and other craft are singled out for special treatment and contends that the French rules are disproportionate to the aim of preventing tax evasion. Private use of such goods could be dealt with in the normal way, that is to say, either by means of an adjustment of a taxable person's input tax deduction under Articles 17 and 19 or by means of an output tax charge under Articles 5(6) and 6(2).

21 I do not think it is necessary for France in these proceedings to explain the merits of its rules. As I have explained, it is clear from the text and legislative history of Article 17(6), and from the proposals submitted by the Commission pursuant to the first sentence of that provision, that as yet there are no common rules on deduction of VAT on passenger vehicles and craft and that, pending the adoption of such rules, Member States are entitled to retain all the exclusions in that area which they applied at the moment when the Sixth Directive came into force. Article 17(6) does not, as the Commission seems to suggest, merely confer on Member States the power to retain anti-evasion measures whose legality falls to be tested judicially against the principle of proportionality.

22 I do not in any event find it altogether surprising that some Member Sates consider that passenger vehicles and craft merit special treatment. As the Commission itself suggested in the explanatory memorandum to its proposal for a Sixth Directive, the private use of such goods is particularly difficult to monitor; moreover, in the case of luxury vehicles the final consumption and business elements may be indistinguishable. In addition the extremely high value of such goods provides considerable incentive for undeclared private use. For similar reasons some Member States also restrict the deductibility of expenditure on motor vehicles for the purposes of income and corporation taxes. (14)

23 That is not to say that the Council's failure to reach agreement is not regrettable. As the Commission explained with commendable clarity at the hearing, rules preventing taxable persons from deducting VAT on such important categories of expenditure severely disrupt the functioning and neutrality of the VAT system. I doubt moreover whether the risk of tax evasion can justify total exclusion of such goods from the deduction mechanism.

24 It is however equally clear that the problem calls for a legislative solution. That point is amply demonstrated by the weaknesses of the criterion suggested by the Commission in these proceedings. The mere fact that a passenger vehicle or craft constitutes a `tool of the trade' does not remove the possibility of tax evasion or non-taxation of final consumption. Conversely, a vehicle or craft which is not a `tool of the trade' may nevertheless be essential for the running of a business, as is shown by the examples which the Commission itself gives as cases outside the scope of its challenge, namely motor vehicles used by travelling sales representatives or veterinary surgeons in rural areas. The - perhaps necessarily - simplistic criterion proposed to the Court by the Commission in these proceedings may be contrasted with the rather more sophisticated set of rules which it put forward in its proposal for a Twelfth Directive. It is in any event clear that, as France and the United Kingdom point out, the criterion proposed here has no basis in the Sixth Directive.

25 Contrary to the Commission's assertion, I do not think the comments which I made at paragraphs 78 and 79 of my Opinion in Lennartz (15) are of assistance to it. As the United Kingdom points out, in that Opinion I merely suggested that Article 17(6) did not authorize a general exclusion such as a rule treating goods as being used wholly for private purposes where the element of business use was very small. Drawing support from the proposal for a Sixth Directive and the proposal for a Twelfth Directive I concluded that the measures falling within the contemplation of the last sentence of Article 17(6) were those concerning specific categories of goods, such as motor vehicles, whose use for business purposes was difficult to verify. The French rules in issue here clearly fall within that category.

Conclusion

26 Accordingly, I am of the opinion that the Court should:

(1) dismiss the Commission's application;

(2) order the Commission to pay the costs.

(1) - Sixth 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, OJ 1977 L 145, p. 1.

(2) - Documentation administrative de base (D.B.) of the French tax authority, série 3 CA, division D, feuillets 1532 to 1533 (version of 1 May 1990), annexed to France's defence.

(3) - Article 237 septies A of the CGI, introduced by Article 13 of the Law of 26 July 1991.

(4) - In the light of other language versions it would appear that the term `in no circumstances' should be understood as meaning `not in any event': see, for example, the Dutch (`in elk geval'), French (`en tout état de cause'), German (`auf jeden Fall') and Italian (`comunque') language versions.

(5) - Bulletin of the European Communities, Supplement 11/73.

(6) - Cited in note 5, p. 18.

(7) - See also to the same effect the second recital in the preamble to the proposal for a Twelfth Council Directive on the harmonization 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, COM (82) 87 final, OJ 1983 C 37, p. 8.

(8) - Cited in note 7.

(9) - Article 2.

(10) - Article 3.

(11) - Article 4.

(12) - Article 5.

(13) - COM (84) 84 final, OJ 1984 C 56, p. 7.

(14) - See, for example, as regards France, Fiscal 1996, Francis Lefebvre, pp. 162 to 163 and 309, and, as regards the United Kingdom, UK Tax Guide, Butterworths, 1995-96, pp. 479 to 480.

(15) - Case C-97/90 Lennartz [1991] ECR I-3795.