Conclusions
OPINION OF ADVOCATE GENERAL
STIX-HACKL
delivered on 14 December 2004(1)

Case C-33/03

Commission of the European Communities
v
United Kingdom of Great Britain and Northern Ireland

(Failure of a Member State to fulfil obligations – Articles 17(2)(a) and 18(1)(a) of the Sixth VAT Directive 77/388/EEC – National provision under which an employer is allowed to deduct input tax in relation to his reimbursements of his employees' road fuel costs)

I – Introduction

1. By the present application the Commission asks the Court to declare that the United Kingdom of Great Britain and Northern Ireland has failed to fulfil its obligations under the EC Treaty, in that, contrary to Articles 17 and 18 of the Sixth Directive 77/388/EEC ('the Sixth Directive'), (2) it has granted taxable persons the right to deduct value added tax in respect of certain supplies of road fuel to non-taxable persons.

2. The question arises in particular in these proceedings whether the United Kingdom system of value added tax under which an employer is entitled to deduct input tax in relation to the costs reimbursed by him for fuel supplied to his employees is comparable to the Netherlands system of deduction which the Court held in its judgment of 8 November 2001 in Case C-338/98 (3) to be incompatible with Articles 17(2)(a) and 18(1)(a) of the Sixth Directive.

II – Legal context

A – *Community legislation*

3. Article 4 of the Sixth Directive provides, in extract:

'1. "Taxable person" shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.

…

4. The use of the word "independently" in paragraph 1 shall exclude employed and other persons from the tax in so far as they are bound to an employer by a contract of employment or by any other legal ties creating the relationship of employer and employee as regards working conditions, remuneration and the employer's liability.

…'

4. Paragraph 2(a) of Article 17 of the Sixth Directive, headed 'Origin and scope of the right to deduct', reads as follows, in extract:

'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 within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person'.

5. Article 18 of the Sixth Directive, headed 'Rules governing the exercise of the right to deduct', reads as follows, in extract:

'1. To exercise his right to deduct, the taxable person must:

(a)in respect of deductions under Article 17(2)(a), hold an invoice, drawn up in accordance with Article 22(3);

…

3. Member States shall determine the conditions and procedures whereby a taxable person may be authorised to make a deduction which he has not made in accordance with the provisions of paragraphs 1 and 2.

…'

6. Article 22(3)(a) of the Sixth Directive provides, in extract:

'Every taxable person shall issue an invoice, or other document serving as invoice, in respect of goods and services which he has supplied or rendered to another taxable person or to a non-taxable legal person. …

Every taxable person shall likewise issue an invoice in respect of any payment to account made to him before any supplies of goods referred to in the first subparagraph and in respect of any payment to account made to him by another taxable person or by a non-taxable legal person before the provision of services is completed.'

7. Article 22(3)(c) of the Sixth Directive reads:

'Member States shall lay down the criteria that shall determine whether a document may be considered an invoice.'

B – *National legislation*

8. Articles 2 and 3 of the Value Added Tax (Input Tax) (Person Supplied) Order 1991 ('the 1991 Order'), which entered into force on 1 December 1991, provide as follows with reference to the reimbursement of fuel costs by a taxable person:

'2. Article 3 below shall apply where road fuel is supplied to a person who is not a taxable person and a taxable person pays to him –

(a) the actual cost to him of the fuel; or

(b) an amount, the whole or part of which approximates to and is paid in order to reimburse him for the cost of the fuel, determined by reference to –

(i)the total distances travelled by the vehicle in which the fuel is used (whether or not including distances travelled otherwise than for the purposes of the business of the taxable person), and

(ii)the cylinder capacity of the vehicle, whether or not the taxable person makes any payment in order to reimburse him for any other cost.

3. Where this article applies, the fuel shall be treated for the purpose of section 14(3) of the Value Added Tax Act 1983 as having been supplied to the taxable person for the purpose of a business carried on by him and for a consideration equal to the amount paid by him under article 2(a) or (b) above, as the case may be (excluding any reimbursement of any cost other than the cost of the fuel).'

9. The explanatory note accompanying the Order states:

'This Order, which comes into force on 1st December 1991, gives statutory effect to a long-standing administrative practice. The Order provides for road fuel bought by employees to be treated as being supplied to the employer where the employee is reimbursed by means of a mileage allowance or the actual amount paid. …'

10. According to the explanation given by the United Kingdom Government, reimbursement by the employer in accordance with article 2(b) of the 1991 Order in practice takes place as follows. The employee provides the employer with detailed mileage records showing the journeys on the employer's business, the corresponding mileage and the cylinder capacity of the vehicle used. The employee also gives the employer a 'simplified' fuel invoice, which does not identify the recipient of the fuel by name.

11. The employer then calculates the fuel costs on the basis of a published list of average fuel costs per mile, compiled by the Royal Automobile Club or the Automobile Association or by Customs and Excise using rates approved by the Inland Revenue and detailed information from manufacturers. With the help of those factors – mileage of business journeys and fuel costs per mile for the relevant type of vehicle – the employer, according to the United Kingdom Government, can calculate the exact costs of the employee's business journeys and reimburse them accordingly.

III – Pre-litigation procedure and proceedings before the Court

12. Since it considered that, in the absence of an invoicing requirement, the possibility of deduction provided for in articles 2 and 3 of the 1991 Order infringed Article 18(1)(a) of the Sixth Directive, the Commission by letter of formal notice of 10 May 1995 initiated a procedure under Article 226 EC against the United Kingdom.

13. After a detailed examination, the Commission extended its complaint in two supplementary letters of formal notice dated 17 October 1996 and 3 December 1997, adding a complaint of breach of Article 17 of the Sixth Directive. It said that the 1991 Order infringed that provision too, since it permitted deduction of tax in respect of supplies of goods and services to employees, in other words non-taxable persons, and for purposes other than those of the employer's transactions.

14. The United Kingdom Government rejected the Commission's complaints in letters of 13 July 1995, 16 December 1996 and 28 January 1998 respectively, arguing that a right of deduction in respect of the reimbursement of the fuel costs of his employees incurred for purposes of the employer's business, as regulated in the 1991 Order, had to exist under the Sixth Directive.

15. Since the Commission maintained its position, it sent a reasoned opinion on 14 October 1998 to the United Kingdom Government, which however likewise maintained its position in its reply of 15 December 1998. After delivery of the judgment in *Commission* v *Netherlands* on 8 November 2001, which it had waited for, the Commission brought the present action by an application of 27 January 2003, registered at the Court on 28 January 2003.

16. The Commission claims that the Court should:

–declare that, by granting taxable persons the right to deduct value added tax in respect of certain supplies of road fuel to non-taxable persons, contrary to Articles 17 and 18 of the Sixth Council Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, the United Kingdom of Great Britain and Northern Ireland has failed to fulfil its obligations under the EC Treaty;

–order the United Kingdom of Great Britain and Northern Ireland to pay the costs.

The United Kingdom of Great Britain and Northern Ireland contends that the Court should dismiss the Commission's application.

IV – Examination of the Commission's pleas in law

17. The pleas in law put forward by the Commission concern, first, the conditions for the existence of the right to deduct input tax laid down in Article 17(2) of the Sixth Directive and, second, the conditions for the exercise of the right to deduct input tax governed by Article 18 of that directive. (4)

A – *Infringement of Article 17 of the Sixth Directive*

1. Principal submissions of the parties

18. According to the *Commission*, the contested 1991 Order infringes Article 17(2)(a) of the Sixth Directive firstly in that it permits the deduction of input tax in relation to supplies to non-taxable persons, namely employees, and secondly in that it does not ensure that the right to deduct input tax relates only to supplies of fuel used for the taxable transactions of the employer. The Commission relies principally on *Commission* v *Netherlands* and submits that the United Kingdom rules at issue are comparable with those which the Court held in that judgment to be incompatible with the Sixth Directive.

19. The Commission does not exclude the possibility that in many cases purchases by employees are in reality supplies made to their employers and hence to a taxable person entitled

to deduct input tax. In the present case, however, in contrast to the *Intiem* case, (5) there is no direct link between two taxable persons, in this case the supplier of the fuel and the employer.

20. The *United Kingdom Government* refers first to the importance of the principle that a taxable person, if and in so far as goods and services are used for the purposes of his taxable transactions, is entitled to deduct the value added tax on the goods or services used. That is intended to ensure the fiscal neutrality of all economic transactions in the Community.

21. The issue in the present case is whether Article 17 of the Sixth Directive gives a right to deduct input tax in situations in which an employee makes a purchase for or on behalf of the employer's business and the employee is then reimbursed the cost by the business. Where goods or services are used in the context of a taxable transaction, it cannot make any difference whether the actual (or contractual) recipient of the goods or services is the employer himself or his employee or agent.

22. The Commission ignores the economic reality. If its – formal – argument were followed, an employer would, contrary to the Sixth Directive, be unable to deduct input tax in relation to all expenditure of the business. The fuel is in reality supplied via the employee to the taxable employer for the latter's taxable transactions. The situation is comparable, for instance, with one in which an employee incurs accommodation, subsistence and travel costs on the occasion of a business trip, or an employee of a construction firm working on an outside building site purchases tools. The purchase of fuel admittedly involves particular problems of delimitation, but that cannot, in principle, preclude the right to deduct.

23. The United Kingdom Government admits that there is a resemblance between the system concerned in *Commission* v *Netherlands* and the United Kingdom system. Unlike the former, however, the United Kingdom system – in so far as this is reasonably possible with a system which is necessarily based on estimations – ensures that value added tax is deductible only in relation to the employees' actual travel costs. The United Kingdom Government agrees with the view that the right to deduct input tax under the 1991 Order should be limited to the fuel used for the employer's transactions. In the application in practice of the 1991 Order, the right to deduct input tax is in fact limited in that way. Nor does the employer have any interest in reimbursing fuel costs over and above the costs of business travel.

24. In its written answer to the question put by the Court, the United Kingdom Government conceded that the 1991 Order does not lay down a legally binding link between the employer's right to deduct under articles 2 and 3 of the Order and the use for the taxable transactions of the employer of the fuel purchased by the employee. However, the necessary link is provided by reference to the general legislation, the Value Added Tax Act 1994. The provisions of that Act described by the United Kingdom Government contain the legal basis for the 1991 Order, a general definition of value added tax (value added tax on supplies of goods and services for the purpose of the taxable person's business), and the rule that in the case of mixed use the input tax is deductible only for the proportion of the goods and services used for business purposes.

2. Assessment

25. Before examining whether the contested deduction mechanism under the 1991 Order is compatible with Article 17 of the Sixth Directive, certain principles of the law on input tax deduction governed by that provision should first be recalled.

26. The right to deduct input tax is, according to settled case-law, an integral part of the machinery of value added tax and can in principle not be restricted. (6) The provision on deduction is intended to relieve the operator entirely of the burden of the value added tax payable or paid in the course of his economic activities. The common system of value added tax consequently ensures the neutrality of taxation of all economic activities, regardless of their aim or result, provided that they are themselves subject to value added tax. (7)

27. According to Article 17(2) of the Sixth Directive, 'the taxable person' is entitled to deduct from the tax which he is liable to pay the value added tax due or paid in respect of goods or services supplied to him 'by another taxable person', '[i]n so far as the goods and services are used for the purposes of his taxable transactions'.

28. So, according to the wording of that provision, the right to deduct presupposes to begin with that the person concerned is a taxable person within the meaning of the Sixth Directive and that the goods and services in question are used for the purposes of his taxable transactions. (8)

29. The wording of Article 17(2)(a) of the Sixth Directive further shows that the right to deduct input tax exists only in relation to the value added tax paid for goods or services which have been supplied to the taxable person by another taxable person.

30. As regards the Commission's complaint that the employee is not a taxable person or that the chain of supplies is broken, it must first be noted that in the present case – in accordance with the provision in Article 4(4) of the Sixth Directive – it is common ground that the employees in question whose fuel costs are reimbursed are not themselves taxable persons. (9) The issue is rather whether, despite this triangular structure, for which the 1991 Order allows deduction of input tax, there may nevertheless be considered to be a supply between taxable persons, namely the seller of the fuel and the employer.

31. It is apparent from the judgment in *Intiem* that the physical delivery of goods to the employee does not in itself preclude the employer's right to deduct. In the factual situation concerned in that case, the fuel was supplied to the employee, as in the present case. The Court held in that connection that the purpose of the restriction of the deduction of input tax to tax 'in respect of goods ... supplied to him', in Article 17(2) of the Sixth Directive, 'cannot be to exclude from the right of deduction the value added tax paid on goods which, although sold to the taxable person in order to be used exclusively in his business, were physically delivered to his employees'. (10)

32. Moreover, the Commission itself concedes that employees frequently act on behalf of their employers, and in such a case the goods and services received by the employees are in reality to be regarded as supplied to the employer. It considers, however, that this has not been demonstrated with respect to the provision at issue.

33. The question thus arises as to the circumstances in which, where goods or services are received by the employee, there is a supply to the employer. This is essentially 'a question of fact which must be determined in the light of all the circumstances of the case'. (11) The United Kingdom Government has illustrated, with the examples of the agent whose travelling expenses are reimbursed by the employer or the building worker who buys tools for the construction business, that problems of delimitation may arise in this respect.

34. It appears helpful for the further discussion to bear in mind that there is a close connection between the question of whether there is a supply between taxable persons and the question of the use of the goods or services concerned for the economic activity of the taxable person who receives the supply.

35. Thus, according to settled case-law, a person receives goods as a taxable person, rather than as a private individual or final consumer, precisely if and in so far as he acquires them for the purposes of his taxable transactions. (12) Further, where an employee uses goods or services for purposes of his employer, those goods or services are cost elements of the goods or services which the taxable employer eventually supplies. In that case the employee does not act as a final consumer, and the chain of supplies is not broken in relation to those goods or services.

36. In *Intiem* the Court evidently assumed that the supply of fuel took place in the course of the employer's business activity or that the fuel was used for business purposes of the employer. (13)

37. Moreover, as the Court said in *Commission* v *Netherlands*, in the *Intiem* case the conditions for deduction – in particular the condition of a supply between taxable persons – were fulfilled in particular because in that case the employer had arranged for goods to be supplied at his own expense to his employees and he had consequently received from the supplier invoices charging him value added tax in respect of the goods supplied. (14)

38. In the system which was the subject of *Commission* v *Netherlands*, however, those circumstances were not present; the system concerned a flat-rate reimbursement for depreciation of the employee's vehicle and his fuel consumption. That reimbursement alone was moreover not accepted by the Court as a sufficient indication of the existence of a 'supply' within the meaning of

Article 17(2)(a) of the Sixth Directive. It therefore did not appear to the Court to be possible to reconcile the Netherlands deduction mechanism with that provision. (15)

39. The Court recognised in that judgment that that solution, based on a literal interpretation of the Sixth Directive, might not appear fully consistent with the purpose of the provision in Article 17(2)(a) and with certain objectives pursued by the Sixth Directive, but saw no basis – without action on the part of the Community – for a right to deduct as laid down in Netherlands law. (16)

40. If one takes the *Commission* v *Netherlands* judgment as the basis of the present case, it must be stated that the deduction system as laid down in the 1991 Order and described by the United Kingdom Government likewise does not presuppose any direct invoicing or other direct relationship between the supplier of the fuel and the employer, so that, from that point of view, there is no supply of goods between taxable persons. The Commission's complaint in this respect is thus justified to that extent.

41. The Commission's complaint, however, is also directed – and this is more serious, it seems to me – to the fact that the contested mechanism for deduction of input tax does not ensure that it only affects goods which are used for taxable purposes of the employer. The United Kingdom Government has countered that the United Kingdom mechanism of deducting input tax, unlike that concerned in *Commission* v *Netherlands*, ensures that value added tax is deductible only in relation to the actual fuel costs incurred by the employee.

42. It must be admitted that the method of calculation used in the United Kingdom, based on the distance travelled, the cylinder capacity of the vehicle and the actual average fuel costs, in principle enables the employer to make a reimbursement which corresponds more precisely to the actual fuel costs for the employee's business journeys than the flat-rate approximation system at issue in *Commission* v *Netherlands*.

43. However, what is problematic about the 1991 Order is not so much the calculation formula for fuel costs as such but rather the fact that, according to the wording of the 1991 Order, there is no guarantee that the employer cannot deduct input tax in relation to fuel costs for his employees' non-business travel.

44. Article 2(b) of the 1991 Order permits deduction of input tax in relation to an amount *the whole or part of which* approximates to the fuel costs of the non-taxable person (the employee) and is paid to him to reimburse those costs.

45. The United Kingdom Government has also confirmed that there is no legally binding link between the employer's right to deduct under articles 2 and 3 of the 1991 Order and the use for taxable transactions of the employer of the fuel purchased by the employee.

46. As regards the provisions of the Value Added Tax Act 1994, which were referred to for the first time in the written answer to the question put by the Court, (17) first, it is not comprehensible how these general provisions are supposed to ensure that the right to deduct under article 2 of the 1991 Order relates exclusively to fuel used for business purposes, especially as the fuel mentioned in article 2 is, under article 3 of the Order in conjunction with section 14(3) of the Value Added Tax Act, *treated* as supplied to the taxable person for the purpose of a business carried on by him; and second, it is settled case-law that directives are to be transposed with unquestionable binding force and with the specificity, precision and clarity required to satisfy the requirement of legal certainty. (18)

47. However, the 1991 Order – in conjunction with the Value Added Tax Act 1994 – does not constitute such a transposition of the right to deduct input tax; nor, moreover, can a practice of applying the contested 1991 Order in compliance with the directive, as alleged by the United Kingdom Government, satisfy the requirements of clarity and legal certainty. (19)

48. Finally, the United Kingdom Government has stated that it is prepared to amend the 1991 Order and that it has already proposed this to the Commission. In this connection it suffices to note that, according to settled case-law, whether a Member State has failed to fulfil its obligations is to be determined by reference to the situation in the Member State on expiry of the period laid down in the reasoned opinion. The Court cannot take account of any subsequent changes. (20)

49. The Commission's complaint that the contested system of deduction in any case does not

ensure that input tax is deducted only in relation to goods and services which are used for purposes of the employer's taxable transactions is therefore justified.

50. The complaint of an infringement of Article 17 of the Sixth Directive is accordingly made out.

B – *Infringement of Article 18 of the Sixth Directive*

1. Principal submissions of the parties

51. By this plea in law the *Commission* submits that the 1991 Order infringes Article 18(1)(a) of the Sixth Directive in that it grants a right to deduct input tax without making that right depend on the taxable person being in possession of an invoice issued in accordance with Article 22(3).

52. Relying on *Commission* v *Netherlands*, it argues that, where there is no supply of goods or services between taxable persons, so that no invoice or other equivalent document could be issued, the granting of a right to deduct input tax is consequently also an infringement of Article 18(1)(a) of the Sixth Directive.

53. The *United Kingdom Government* agrees with that view, if the Court upholds the Commission's first complaint. Should the Court decide, however, that a right to deduct input tax exists in a case such as the present one, then Article 18 of the Sixth Directive cannot be interpreted as meaning that the lack of an invoice excludes that right. The United Kingdom Government refers in this connection to its right under Article 18(3) of the Sixth Directive to determine the 'conditions and procedures' of a particular right of deduction.

2. Assessment

54. The United Kingdom Government has not disputed that, if the conditions for granting a right to deduct input tax are not satisfied, Article 18(1)(a) of the Sixth Directive is also infringed. Since the contested mechanism for deduction of input tax is not consistent with Article 17 of the Sixth Directive, the Commission's second complaint is also justified.

V – Conclusion

55. I therefore propose that the Court should:

(1)declare that, by granting taxable persons the right to deduct value added tax in respect of certain supplies of road fuel to non-taxable persons, contrary to Articles 17 and 18 of 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, the United Kingdom of Great Britain and Northern Ireland has failed to fulfil its obligations under the EC Treaty;

(2)order the United Kingdom to pay the costs.

1 – Original language: German.

2 – Sixth Council Directive 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).

3 – Case C-338/98 *Commission* v *Netherlands* [2001] ECR I-8265.

4 – On this distinction, see Case C-152/02 *Terra Baubedarf-Handel* [2004] ECR I-0000, paragraph 30, and *Commission* v *Netherlands*, cited in footnote 3, paragraph 71.

5 – Case 165/86 *Intiem* [1988] ECR 1471.

6 – See inter alia Case C-90/02 *Bockemühl* [2004] ECR I-0000, paragraph 38.

7 – See inter alia Case 268/83 *Rompelman* [1985] ECR 655, paragraph 19, and Case C-37/95 *Ghent Coal Terminal* [1998] ECR I-1, paragraph 15.

8 – See Case C-137/02 *Faxworld* [2004] ECR I-0000, paragraph 24.

9 – See correspondingly *Commission* v *Netherlands*, cited in footnote 3, paragraphs 45 and 46.

10 – .*Intiem*, cited in footnote 5, paragraph 14.

11 – Case C-97/90 *Lennartz* [1991] ECR I-3795, paragraph 21.

12 – Compare inter alia *Faxworld*, cited in footnote 8, paragraph 28; *Lennartz*, cited in footnote 11, paragraphs 8 and 14; Joined Cases C-110/98 to C-147/98 *Gabalfrisa and Others* [2000] ECR I-1577, paragraph 47; and Case C-400/98 *Breitsohl* [2000] ECR I-4321, paragraph 34.

13 – Paragraphs 12, 14 and 16.

14 – See *Commission* v *Netherlands*, cited in footnote 3, paragraphs 52 and 53.
15 – Paragraphs 48 and 54.
16 – Paragraphs 55 and 56; this may be rather a restrictive interpretation compared with other judgments of the Court on the Sixth Directive. See only, for example, *Faxworld*, cited in footnote 8, paragraph 42; compare also in this connection Case C-260/95 *DFDS* [1997] ECR I?1005, paragraph 23, according to which ‘consideration of the actual economic situation is a fundamental criterion for the application of the common VAT system’.
17 – See point 24 above.
18 – Inter alia Case C-162/99 *Commission* v *Italy* [2001] I-541, paragraph 22; Case C-354/98 *Commission* v *France* [1999] ECR I-4927, paragraph 11; Case C-207/96 *Commission* v *Italy* [1997] ECR I-6869, paragraph 26; and Case C-197/96 *Commission* v *France* [1997] ECR I-1489, paragraphs 14 and 15.
19 – See inter alia Case C-59/89 *Commission* v *Germany* [1991] ECR I-2607, paragraph 28.
20 – Inter alia Case C-233/00 *Commission* v *France* [2003] ECR I-6625, paragraph 30, and Case C-152/00 *Commission* v *France* [2002] ECR I-6973, paragraph 15.