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Opinion of Mr Advocate General Jacobs delivered on 1 April 1993. - Wilfried Lange v Finanzamt Fürstenfeldbruck. - Reference for a preliminary ruling: Finanzgericht München - Germany. - Value added tax - Sixth directive - Exemption of prohibited exports. - Case C-111/92.

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Opinion of the Advocate-General

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My Lords,

1. In the present case the Finanzgericht Muenchen seeks a ruling on the interpretation of the Sixth Directive on value added tax (Council Directive 77/388/EEC; Official Journal 1977 L 145, p. 1). The Finanzgericht has referred two questions on the liability to value added tax (VAT) of illegal exports which are made in contravention of an embargo imposed in every Member State. The questions referred are the following:

"1. Is Article 15(1) of the [Sixth Directive] to be interpreted as meaning that the tax exemption for export turnover provided for therein is to be refused if, in breach of national provisions making exports subject to authorization, goods are supplied to countries for which no authorization would be available in any Member State of the European Communities as a result of the existence of national embargoes?

2. If question 1 is answered in the affirmative:

May tax exemptions be denied solely on the basis of the existence of an objective breach of national provisions concerning authorization or must it be shown that the exporter was himself aware of the breach in respect of each supply?"

2. It appears that during the years 1985 and 1986 the plaintiff was engaged in the export of computer systems from Germany. The plaintiff applied for export permits under Paragraph 17(1) of the Aussenwirtschaftsverordnung (Foreign Trade Regulation, hereafter "AWV"), identifying the final destination of the exports as either Pakistan or Israel. On the basis of those applications the German Federal Trade Office issued the required permits. The goods were dispatched to either Belgrade or Vienna, but were then diverted to Bulgaria, Hungary, the USSR and Czechoslovakia rather than being sent on to their declared destinations. The order for reference does not specify whether those diversions were made with the knowledge of the plaintiff.

3. At the material time, exports of computer systems of the kind in question to countries of the former Eastern bloc were prohibited in all the Member States, pursuant to arrangements made

within the framework of COCOM (the Coordinating Committee for Multilateral Export Controls). (1) All the Member States are members of COCOM with the exception of Ireland, which none the less has a policy of complying with the rules agreed in COCOM. In Germany the relevant restrictions were implemented by Paragraph 5 and Annex AL of the AWV, according to which exports of goods listed in that annex are subject to authorization. In the absence of such authorization, therefore, export of the goods to the destinations specified is prohibited and, by Paragraph 33(1) and (4) and Paragraph 70(1)(1) of the AWV, is made a criminal offence.

4. The plaintiff claimed that the transactions in question were exempt from VAT, pursuant to Paragraph 4(1) of the Umsatzsteuergesetz 1980 (Turnover Tax Law, hereafter "UStG"), which implements Article 15(1) and (2) of the Sixth Directive, and claimed the right to make deductions of "input" tax pursuant to Paragraph 15, subparagraphs 1 and 3(1a), of the UStG, which implement Article 17(2) and Article 17(3)(b) of the Sixth Directive. The defendant Finanzamt took the view that, since the exports in question were unlawful, the plaintiff could not benefit from that exemption, and concluded that the transactions were liable to VAT. The plaintiff appealed against that decision to the Finanzgericht.

5. In what follows, I shall first set out the relevant provisions of the Sixth Directive, and then turn to consider the questions referred. It should be noted from the outset, however, that the case raises three distinct issues. In the first place there is the question, not referred by the national court, whether unlawful exports of the kind in question are transactions coming within the scope of the Directive. Secondly, if the exports are to be regarded as coming within its scope, the question then arises whether they none the less enjoy an exemption from tax under the provisions of the Directive. Finally, depending upon the answers given to those questions, the question may arise whether the exporter' s knowledge of the breach of the prohibitions on export is relevant to the availability of the exemption.

The Community provisions

6. By Article 2 of the Sixth Directive:

"The following shall be subject to value added tax:

(1) the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such;

(2) the importation of goods."

Article 3 defines the expression "territory of the country". Article 15 provides that:

"Without prejudice to other Community provisions Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of such exemptions and of preventing any evasion, avoidance or abuse:

(1) the supply of goods dispatched or transported to a destination outside the territory of the country as defined in Article 3 by or on behalf of the vendor;

(2) the supply of goods dispatched or transported to a destination outside the territory of the country as defined in Article 3 by or on behalf of a purchaser not established within the territory of the country, with the exception of goods transported by the purchaser himself for the equipping, fuelling and provisioning of pleasure boats and private aircraft or any other means of transport for private use;

...".

According to Article 17(2) of the Directive:

"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;

(b) value added tax due or paid in respect of imported goods;

...".

By Article 17(3):

"Member States shall also grant to every taxable person the right to a deduction or refund of the value added tax referred to in paragraph (2) in so far as the goods and services are used for the purposes of:

...

(b) transactions which are exempt under ... [Article] 15 ...;

...".

The scope of the Sixth Directive

7. The question whether illegal transactions come within the scope of the Sixth Directive has been considered by the Court on several previous occasions. In Case 294/82 Einberger v Hauptzollamt Freiburg [1984] ECR 1177 the Court held that Article 2 of the Directive must be interpreted as meaning that VAT is not chargeable on the illegal importation of drugs into the Community which are not confined "within economic channels strictly controlled by the competent authorities for use for medical and scientific purposes" (see paragraph 22 of the judgment). Similarly, in Case 269/86 Mol v Inspecteur der Invoerrechten en Accijnzen [1988] ECR 3627 and Case 289/86 Happy Family v Inspecteur der Omzetbelasting [1988] ECR 3655, the Court held that the illegal supply of drugs on the domestic market of a Member State, other than for medical and scientific purposes, did not give rise to any liability to VAT. Most recently, in Case C-343/89 Witzemann [1990] ECR I-4477 the Court held that its reasoning in the Einberger case applied a fortiori to imports of counterfeit currency, since the making, possession, importation and marketing of such currency are absolutely prohibited in all the Member States: see paragraphs 14 and 20 of the judgment.

8. The Court' s reasoning in the Einberger, Mol, Happy Family and Witzemann cases was based essentially upon the consideration that the Directive could not be taken to apply to transactions which, by the very nature of the products concerned, were illegal in all the Member States. As the Court stated at paragraph 20 of its judgment in the Einberger case:

"... as the Court has already held in relation to customs duties on importation, illegal imports of drugs into the Community, which can give rise only to penalties under the criminal law, are wholly alien to the provisions of the Sixth Directive ...".

In Case 50/80 Horvath v Hauptzollamt Hamburg-Jonas [1981] ECR 385 the Court held that customs duties could not be charged under the Common Customs Tariff in respect of the smuggling of a harmful substance such as heroin intended for an unlawful use. The Court observed, at paragraphs 9 to 11 of the judgment:

"It is important to stress at the outset that the ... question referred ... is not concerned simply with the case of the illegal importation of any product but concerns the smuggling of a harmful substance intended for an unlawful use, which was destroyed as soon as it was discovered.

It should next be remembered that a product such as heroin is not seized and destroyed only because the importer has not complied with customs formalities but primarily because it is a narcotic whose harmfulness is recognized and whose importation and marketing is prohibited in all the Member States except in trade which is strictly controlled and limited to authorized use for pharmaceutical and medical purposes.

[The Common Customs Tariff] ... can only apply to imports of the product which are intended for an authorized use. Indeed, ad valorem customs duty cannot be determined for goods which are of such a kind that they may not be put into circulation in any Member State but must on the contrary be seized and taken out of circulation by the competent authorities as soon as they are discovered."

It is clear that the Court' s reasoning in relation to the scope of the Common Customs Tariff applies equally to the scope of the Sixth Directive: see Einberger, cited above, at paragraphs 17 to 20 of the judgment, and Witzemann, also cited above, at paragraph 18. Thus, in the case of both customs duties and VAT, illegality may not in itself be sufficient to remove a transaction from the scope of the applicable Community legislation. As far as imports and domestic trade are concerned, it appears that a transaction will not fall outside the scope of the Sixth Directive unless it belongs to a category which is systematically prohibited in all the Member States for reasons related to the special characteristics of the products: see Mol, cited above in paragraph 7, at paragraph 18 of the judgment.

9. The previous cases have concerned prohibitions on imports or on domestic trade, whereas the present case concerns exports. The question therefore arises whether any distinction should be drawn between the two kinds of case. It is true that the practical consequences of excluding an export transaction from the scope of the Directive will be different. In contrast to imports and domestic supplies, exports are generally exempt from VAT: see Article 15(1) and (2) of the Sixth Directive, cited above in paragraph 6. It will be observed that there is an important difference between an export transaction which is exempt under Article 15, on the one hand, and a transaction which is not taxable because it falls outside the scope of the Directive, on the other. As we have seen, Article 17(3)(b) provides that certain categories of transaction which are exempt from VAT give rise none the less to a right to deduct "input" tax, that is to say a right to deduct the VAT payable in respect of the goods and services used for the purposes of the transactions. In particular, the exemptions provided for in Article 15(1) and (2) of the Directive give rise to the right to deduct. Thus, an illegal import or an illegal domestic supply which falls outside the scope of the Directive enjoys a freedom from VAT which is not normally accorded to lawful imports or supplies. In contrast, an illegal export which fell outside the scope of the Directive would not enjoy any advantage as compared with a lawful export: it would on the contrary suffer a disadvantage, since unlike the latter it would give rise to no right on the part of the exporter to make a corresponding deduction of "input" tax (although the exports themselves would not be taxed).

10. It is clear, it seems to me, that the principle established in the previous cases concerning illegal transactions is not confined to imports or domestic trade: the illegal export of goods which have no legitimate use outside strictly controlled channels would be just as alien to the provisions of the Sixth Directive as are the illegal import or domestic trade in such products. As we have seen, although exports are not in any case subject as a general rule to VAT, export transactions falling within the scope of the Directive give rise to a right to deduct the corresponding "input" tax. Such a right would not therefore arise in the case of the illegal export of products such as counterfeit currency or prohibited drugs which, by the very nature of the products concerned, cannot be lawfully traded under the laws of any Member State.

11. In my view, however, there is no compelling reason to extend the range of transactions which can fall outside the scope of the Sixth Directive, even where the transactions in question involve exports rather than imports or domestic trade. It seems to me that in either case the fundamental principle is that of fiscal neutrality, according to which legal and illegal trade should as far as possible be treated equally for VAT purposes. That principle is subject to only limited exceptions arising in cases where, by virtue of the nature of the products concerned, there is no competition between legal and illegal sectors: see the Court' s judgment in the Mol case, cited above in paragraph 7, at paragraphs 17 and 18 of the judgment.

12. As the Commission suggests, the prohibition at issue in the present case can be distinguished from those at issue in previous cases involving illegal trade, in that those cases concerned products commerce in which was intrinsically illegal, whereas the present case concerns products, namely computer hardware and software, which are as a general rule the subject of legitimate transactions. Accordingly, there is not an absolute ban on the export of such goods to third countries, although as in the present case there may be a prohibition on their export to certain specified destinations. In my view, there is no reason to extend the exception established in the previous cases to cover a case in which exports of a product are prohibited in respect of particular destinations, even where the prohibitions in question are imposed by all the Member States acting in concert. Thus, where goods can as a general rule be legitimately traded both within and without the Community, the export of the goods to a prohibited destination is not in itself a transaction which must be considered alien to the scheme of the Directive.

13. As I have already mentioned, the result of admitting the transactions in question to be within the scope of the Sixth Directive is that the exporter will be able to deduct a corresponding amount of "input" tax from his total liability to VAT. At first sight it might appear anomalous that a trader who has exported in contravention of an export embargo should be able to take advantage of such a right to deduct. However, like the exemption from VAT enjoyed by exports, that right can be explained by the will of the Community legislature not to impose on consumers in non-member States any burden of VAT, which is a tax intended to be borne exclusively by consumers within the Community. Where "input" tax cannot be deducted in respect of a particular transaction, it will normally be passed on to the consumer as an element of the purchase price. The right to deduct "input" tax should not be seen as a benefit to the exporter, but simply as a consequence of the principle that a State should not impose tax on goods whose destination lies outside its territory. It is true that, if deduction of "input" tax were disallowed in the case of an illegal export, the burden may in practice fall upon the exporter. However, it remains the case that VAT is not intended to be levied in respect of goods which leave the Community. An exporter who has been found to contravene export restrictions imposed by a Member State can in any event be adequately penalized by sanctions imposed under the appropriate national provisions, without it being necessary to impose additional penalties by way of an increased liability to VAT.

14. I conclude therefore that the transactions at issue in the present case fall within the scope of the Sixth Directive. It must therefore be considered whether the exemption provided by Article 15(1) of the Directive extends also to exports which are made in contravention of a Community-

wide embargo.

The VAT exemption on exports

15. As I have already mentioned, the defendant Finanzamt took the view that VAT should be charged on the transactions in question, notwithstanding the exemption for exports provided by Article 15(1) of the Directive. The Commission, on the other hand, submits that the exemption must be taken to apply to such transactions. It seems to me that that submission is correct. Once it is accepted that the transactions cannot fall outside the scope of the Sixth Directive, it becomes very difficult to maintain that they should not be exempt, given the clear provisions of Article 15(1). As the Commission points out, to allow the exemption would accord with the principle of fiscal neutrality, which as we have seen is a principle which is subject to only very limited exceptions: see paragraph 11 above. To treat the illegal transactions at issue in the present case as exempt is of course to treat them in exactly the same way as lawful exports. There is moreover no basis either in the wording or objectives of the Directive for a different treatment of illegal exports.

16. It seems to me, therefore, that to refuse to allow such transactions an exemption would be to use the VAT system for an extraneous purpose, namely that of imposing penalties for the breach of national export restrictions. It is wrong as a matter of principle to use fiscal law which has been harmonized by the Community for the purpose of imposing such penalties, which are primarily a matter for the criminal law of the Member State concerned. In its case-law the Court has repeatedly emphasized that its rulings on the application of tax provisions to illegal transactions do not in any way affect the power of Member States to prosecute or to penalize breaches of their national laws: see for example Witzemann, cited above in paragraph 7, at paragraph 22 of the judgment. To use fiscal law for the purpose of imposing penalties not only subverts the proper application of fiscal law; it might also be thought to distort the application of criminal law, since it may result in the imposition of penalties additional to those imposed by the criminal courts. Moreover it offends against the principle that penalties may not be imposed in the absence of a clear and unambiguous legal basis: see Case 117/83 Koenecke v BALM [1984] ECR 3291, at paragraph 11 of the judgment.

17. Even if the imposition of tax is not regarded as a penalty, a corresponding principle of fiscal law requires that tax should not be imposed in the absence of a specific legislative basis. As we have seen, there is no basis in the Sixth Directive for taxing goods exported outside Community territory; on the contrary, the Directive clearly states that such goods are to be exempt from taxation.

18. Supplies of goods falling within Article 15(1) or (2) of the Directive are therefore exempt from VAT, even where the supply is made in breach of national export restrictions. It makes no difference, in my view, that the illegality in the present case consisted in the breach of export prohibitions imposed by all the Member States acting in concert, so that the exports would have been unlawful in any Member State. Even if the prohibition were based on Community law, that would not in itself be a sufficient reason for refusing exemption to exports made in breach of the prohibition, in the absence of any Community provision for a refusal in such circumstances. It follows that the first question referred by the Finanzgericht is to be answered in the negative.

Knowledge of the breach

19. In view of the conclusion I have reached, it is not necessary to consider whether it must be established that the exporter was aware of the breach in question. For, even if the exporter' s knowledge were sufficient for the breach of the export prohibition to amount to a criminal offence under national law, that would not in my opinion be sufficient to deny the transaction an exemption under Article 15(1) of the Directive.

20. If however the first question referred were to be answered in the affirmative, it would be necessary to consider whether the exemption could still be refused where the breach of the export restrictions had been committed without the knowledge of the exporter. Such a situation might for instance arise where the goods were dispatched to a destination which was permitted under the applicable national law, but diverted by a third person in the course of shipment. Any offence under national law would then have been committed by the latter, and not by the exporter responsible for any payment of VAT.

21. In my opinion, it is difficult to see how an exemption from VAT could be refused in such a case. As the Commission points out, the refusal of an exemption would have the effect of imposing a penalty for a breach of the prohibition on export. I have already suggested that such a use of the VAT system is not permissible: see paragraphs 15 and 16 above. Even if the exemption provisions of the Sixth Directive could be used for such a purpose, however, it seems to me that any such penalty would have to conform to the principle of proportionality laid down by Community law.

22. In the case of a quantitative restriction on intra-Community trade or on Community transit imposed by a Member State pursuant to Article 36 of the Treaty, it is clear that both the restriction and any penalties imposed for its breach must be proportionate to the aim pursued: see Case C-367/89 Aimé Richardt [1991] ECR I-4621, at paragraphs 22 to 24 of the judgment. It is true that the Court' s judgment in the Aimé Richardt case concerned the rules governing Community transit, and not those governing exports from the Community to third countries. (2) Such exports are governed by the common commercial policy of the Community, and in particular by Council Regulation (EEC) No 2603/69 establishing common rules for exports (Official Journal, English Special Edition 1969 (II), p. 590), as last amended by Council Regulation (EEC) No 3918/91 (Official Journal 1991 L 372, p. 31). Article 1 of Regulation No 2603/69 provides that the exportation of products to third countries shall not be subject to any quantitative restriction other than those which are applied in conformity with the provisions of the regulation. At paragraph 3.1 of its written observations, the Commission appears to suggest that a Member State may none the less in certain circumstances rely upon Article 36 of the Treaty in order to prohibit the exportation of products to third countries. It is clear however that Article 36 may only be invoked in respect of a restriction either upon trade within the Community or upon Community transit. On the other hand, Article 11 of Regulation No 2603/69 permits Member States to subject exports to third countries to quantitative restrictions on grounds set out in the same terms as those mentioned in Article 36 of the Treaty, in particular on grounds of public policy or public security.

23. In the light of the Court' s judgment in Case C-62/88 Greece v Council [1990] ECR I-1527, there is I think no doubt that the scope of the common commercial policy of the Community includes all measures which regulate trade between the Community and non-member States (with the exception of matters excluded by virtue of Articles 223 and 224 of the Treaty), even where such measures pursue an aim which is not in itself commercial, such as the protection of health or the safeguard of public security: see paragraphs 16 to 18 of the judgment, and compare also Council Regulation (EEC) No 428/89 of 20 February 1989 concerning the export of certain chemical products (Official Journal 1989 L 50, p. 1), a measure based on Article 113 of the Treaty controlling the export of products which could be used for the production of chemical weapons.

24. It follows that, in regulating exports to non-member States on such grounds, Member States must be regarded as exercising powers conferred by Article 11 of Regulation No 2603/69, and that, in adopting the restrictions presently at issue on the export of computer equipment to countries of the former Eastern bloc, Germany must be regarded as having acted pursuant to that provision. As in the case of a restriction adopted pursuant to Article 36 of the Treaty, therefore, any penalty imposed in respect of a breach of the restrictions must be proportionate to the aims pursued (although, as I suggested in my Opinion in the Aimé Richardt case, it should not be assumed that the principle of proportionality produces the same effects in relation both to Article

36 of the Treaty and to Article 11 of the regulation: see paragraph 29 of the Opinion). In such circumstances, a decision to grant or withhold the exemption from VAT accorded by Article 15(1) of the Sixth Directive would have to take into account all the relevant factors, including the degree of responsibility for the breach on the part of the exporter who is liable for the tax: compare Aimé Richardt, cited above, at paragraph 25 of the judgment. On the view I take, however, the question does not arise, since in my view it is not permissible to derogate from the exemption accorded by Article 15(1) for the purposes of enforcing national restrictions on the export of goods to third countries.

Conclusion

25. I am accordingly of the opinion that the questions referred by the Finanzgericht Muenchen should be answered as follows:

Article 15(1) of the Sixth Council Directive 77/388/EEC must be interpreted as meaning that value added tax may not be charged on the export of goods to a third country by the vendor, notwithstanding that the export is made in breach of a prohibition on exports of those goods to that destination and that a similar prohibition is imposed under the national laws of all the Member States.

(*) Original language: English.

(1) - On COCOM restrictions and Community law, see Inge Govaere and Piet Eeckhout On dual use goods and dualist case law: the Aimé Richardt judgment on export controls in Common Market Law Review 29 (1992), pp. 941-965.

(2) - On the relation between the rules governing Community transit and those governing export from the Community, see the discussion in Govaere and Eeckhout, cited above in note 1, at pp. 944-53.