REPORT FOR THE HEARING
delivered in Case 50/88 *

Legal background to the main proceedings ...

Article 6(2) of the Sixth Directive, [1] in Title V (Taxable transactions), provides as follows:

'The following shall be treated as supplies of services for consideration:

(a) the use of goods forming part of the assets of a business for the private use of the taxable person or of his staff or more generally for purposes other than those of his business where the value-added tax on such goods is wholly or partly deductible;

...

Member States may derogate from the provisions of this paragraph provided that such derogation does not lead to distortion of competition'.

Article 11(A)(1), in Title VIII (Taxable amount), provides as follows:

'1. The taxable amount shall be:

(c) In respect of supplies referred to in Article 6(2) the full cost to the taxable person of providing the services.'

As regards exemptions, Article 13(B), in Title X, provides:

'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 the exemptions and of preventing any possible evasion, avoidance or abuse:

...

(c) Supplies of goods used wholly for an activity exempted under this Article and Article 28(3)(b) when these goods have not given rise to the right to deduction, or of goods on the acquisition or production of which, by virtue of Article 17(6), value-added tax did not become deductible.'

* Language of the case: German

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)

Article 17, in Title XI (Deductions), defines the scope of the right to deduct. It provides in particular:

'2. In so far as the goods and services are used for the purpose 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;

...

5. As regards goods and services to be used by a taxable person both for transactions covered by paragraphs 2 and 3, in respect of which value-added tax is deductible, and for transactions in respect of which value-added tax is not deductible, only such proportion of the value-added tax shall be deductible as is attributable to the former transaction.

...

6. 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.'

The Council has not yet determined pursuant to Article 17(6) what is not business expenditure, in respect of which there is thus no right to deduct.

Finally, Article 32 of the Sixth Directive provides for the later adoption by the Council of a common system applicable to second-hand goods:

'The Council, acting unanimously on a proposal from the Commission, shall adopt before 31 December 1977 a Community taxation system to be applied to used goods, works of art, antiques and collectors' items.

Until this Community system becomes applicable, Member States applying a special system to these items at the time this Directive comes into force may retain that system.'

No common system has yet been adopted on the basis of that provision.

Paragraph 1 of the German Law on turnover tax (Umsatzsteuergesetz 1980) provides as follows:

'*Taxable transactions*

(1) The following transactions are subject to turnover tax:

1. . . .

2. Private use within the territory. Private use occurs when a businessman:

(a) . . .

(b) in the course of his business makes other supplies of the kind defined in Paragraph 3(9) for purposes other than those of his business.'

Paragraph 3 provides:

'*Supply of goods and other supplies*

. . .

9. Other supplies are supplies which are not supplies of goods. They may also consist in abstention from an act or toleration of an act or a situation.'

Under Paragraph 1(1)(2)(b) of the Umsatzsteuergesetz private use of an item belonging to a business is subject to turnover tax. Furthermore, the residual part of the VAT attaching to a second-hand item sold to a taxable person by an individual not subject to VAT is not deductible by the taxable person, even if the item is purchased for the undertaking of the taxable person.

Facts and procedure

The plaintiff in the main proceedings is a lawyer. He purchased second-hand from a private individual a company car which he also employs for his private use.

The Finanzamt München III charged the plaintiff VAT on the depreciation of the car in proportion to the private use which the plaintiff made of it. The plaintiff challenged the assessment notice before the Finanzgericht München. He argues that, since he was unable to deduct input VAT on the car, to charge VAT on the depreciation in proportion to his private use of the car would entail a double levying of turnover tax, which would be contrary to the system. The plaintiff claims that only the actual running costs of the car and not its depreciation should be taken into account in assessing private use.

The Finanzgericht considers that a literal interpretation of the Umsatzsteuergesetz raises certain doubts with regard to the Sixth Directive inasmuch as the Directive makes taxation of the private use of goods forming part of the assets of a business subject to the condition that the

value-added tax on such goods be wholly or partly deductible.

The national court therefore stayed the proceedings and referred the following questions to the Court for a preliminary ruling:

'I — How should Article 6(2) of the 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 (hereinafter referred to as "the Sixth Directive") — be interpreted?

(1) Does the conditional clause "where the value-added tax on such goods is wholly or partly deductible"

(a) exclude the taxation of private use only in cases where input tax is not deductible on account of use of the goods for exempt transactions in the business (Paragraph 15(2) of the Umsatzsteuergesetz) or on account of use of the goods for purposes other than those of the taxable transactions of the taxable person (Article 17(2) of the Sixth Directive), or

(b) does it also exclude such taxation when input tax is not deductible for other reasons, for example because of acquisition from a non-taxable person?

If Question (1)(b) is answered in the affirmative:

(2) Is value-added tax on goods partly deductible within the meaning of Article 6(2)(a) of the Sixth Directive when a taxable person may not deduct value-added tax for the supply of the goods to him but may do so for supplies of services or goods which he has made use of or received from other businesses for the maintenance (repairs, servicing, etc.) or for the use (fuels, lubricants, etc.) of the goods?

(3) If Question (2) is answered in the negative:

(a) does the second sentence of Article 6(2) allow Member States to make derogations only in the sense of refraining wholly or partly from taxing the use of goods within the meaning of Article 6(2)(a), or

(b) are they also authorized to tax such use irrespective of whether the value-added tax on the goods used is wholly or partly deductible?

II — If Question (3)(a) is answered in the affirmative:

(1) Did the German legislature incorrectly transpose the Sixth Directive into national law in so far as, by Paragraph 1(1)(2)(b) of the Umsatzsteuergesetz 1980, it levies value-added tax on the use of goods forming part of the assets of a business even when the value-added tax on such goods is not wholly or partly deductible?

If Question (1) is answered in the affirmative:

(2) May a taxable person rely on Article 6(2)(a) of the Sixth Directive as interpreted by the European Court of Justice in the courts responsible for financial matters in the Federal Republic of Germany?

III — If Question I(1)(a), (2) or (3)(b) is answered in the affirmative or Question II(1) or (2) is answered in the negative:

How should Article 11(A)(1)(c) of the Sixth Directive be interpreted? Does the cost consist of all the expenses incurred by the taxable person for the service or only of (where appropriate a proportion of) the sums disbursed by him for supplies of goods and services to the extent that the value-added tax on these is deductible?'

The order of the Finanzgericht München referring the questions for a preliminary ruling was registered at the Court on 16 February 1988.

In accordance with Article 20 of the Protocol on the Statute of the Court of Justice of the European Communities, written observations were submitted by the Commission of the European Communities, represented by its Legal Adviser Henri Etienne, and by the Portuguese Republic, represented by Luís Fernandez and Arlindo Correia.

Upon hearing the report of the Judge-Rapporteur and the views of the Advocate General, the Court, by a decision of 26 October 1988, assigned the case to the Sixth Chamber pursuant to Article 95 of the Rules of Procedure and opened the oral procedure without any preparatory inquiry.

Written observations submitted to the Court

The Commission observes that the essential characteristic of the common system of value-added tax is to ensure that the final consumer bears the tax. The neutrality of the system with regard to taxable undertakings is guaranteed in particular by the mechanism for deduction of input tax (Article 17 of the Sixth Directive). The system also provides that the final consumer must not be subjected to double taxation.

These principles must also be observed when the goods in question belong to the business of the taxable person and are used

for private purposes, that is to say by the final consumer. It is more difficult to observe the rules of the system when a second-hand item is incorporated into the assets of a taxable undertaking.

The Commission stresses that the directives in force ensure only partial harmonization of the system of value-added tax. The Council has not yet decided under Article 17(6) of the Sixth Directive what expenditure for purposes other than those of the business is not eligible for deduction and there is a lacuna as regards the fiscal treatment of second-hand goods brought back into the economic circuit.

In the Commission's view the right to deduct is a precondition of taxation. The reliefs and derogations provided for in Article 17 of the Sixth Directive reinforce or extend the possibilities of deduction and never limit them.

Whilst it is true that Article 17(7) does provide an exception to that rule, entitlement to deduction may, under that provision, be limited only for reasons outside the system and not for reasons pertaining to it.

Article 17(5) and (6) provide for the possibility of taxing private use by the technique of non-deductibility. Article 17(6) confirms that the Community legislature has excluded any possibility of cumulative taxation as regards the private use of goods forming part of the assets of a business.

The taxable person is thus subject to tax on private use only by means of non-deductibility of the supplies to him. Once the Council has fulfilled its obligations, Article 6(2)(a) will only have a very limited application. In this respect the Commission refers to the proposal for a Twelfth Council Directive. [2]

The taxation technique provided for in Article 6(2)(a) may not lead to a result different from that brought about by the application of Article 17(6).

Despite the lacunae in the Community legislation in force, the application of Article 6(2)(a) does not fall totally within the power of the Member States. They must take into account the objectives envisaged by the harmonization undertaken in the field of value-added tax, in particular the prohibition on double taxation. [3]

If even a partial right to deduct falls within Article 6 it is within the purview of Article 17(7).

2 — 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 (OJ 1983, C 37, p. 8), as amended on 20 February 1984 (OJ 1984, C 56, p. 7). The proposal deals in particular with the deductibility of the purchase price and other costs of motor cars.

3 — See the judgment of 3 October 1985 in Case 249/84 *Profant* [1985] ECR 3237

It is thus only in certain very specific cases that it is possible to continue to tax private use where the possibility of deduction has been reduced. What is involved here is a derogation for historical reasons from the general pro rata rule applicable to taxable persons who do not carry out solely taxable transactions, set out in Article 17.

In this context, the concept of a partial right to deduct does not include the expenses flowing from the private use of the item.

The actual use of an item must therefore be analysed independently of the taxable transaction which it involves. In the case of a car these are supplies of goods or services necessary to maintain the car in a good state of repair (repairs, servicing, etc.) or to allow it to be used (in particular fuel).

That implies in this case that the depreciation attributable to the private use of the item, which corresponds to the supply of the vehicle, cannot be equated with the other expenses, which are deductible.

The possibility of derogation made available to the Member States in the last subparagraph of Article 6(2) merely allows them to exempt from tax the private use of certain goods, not to broaden the conditions under which this taxation may apply. That much is apparent from the condition to which the derogation is subject, namely that it must not lead to distortion of competition. Therefore the derogation may be used only for the purpose of tax relief in order to ensure correct taxation.

It is unnecessary to answer the question whether the right granted to the Member States under the second paragraph of Article 32 to retain any special system which they apply to used goods permits them to provide that an item reintroduced into the economic circuit gives rise to an entitlement to deduct the tax burden which it carries.

In any case, any special rules cannot justify double taxation of the final consumer, since such a derogation is not provided for.

The special treatment applicable to the taxation of second-hand goods does not justify the double taxation of private use.

The Commission therefore concludes that taxation on the grounds of private use of the proportion of the depreciation costs of a vehicle in respect of which input tax has not been deducted is not compatible with the provisions of the Sixth Directive. Consequently, the condition placed by Article 6(2)(a) on treatment of private use of goods forming part of the assets of a business as supplies of services for consideration — namely, deductibility of input tax — is not fulfilled when the legislation in question does not provide for deductibility.

Having regard to its content, Article 6(2)(a) constitutes a sufficiently precise criterion. It

is true that the deductibility of the value-added tax on a vehicle purchased from a private individual is subject to the adoption by the legislature of an implementing measure, which would probably be based on the directive to be adopted by the Council under Article 32. A private individual may not therefore plead the deductibility directly before the courts.

However, in challenging the taxation of the private use of a motor vehicle a private individual may argue that the precondition to that taxation, in other words the deductibility of input tax, has not been fulfilled because of a failure to act on the part of the national legislature or the Community, and that the tax cannot therefore be levied.

In legal proceedings an individual may rely on this prohibition, which clearly flows from the Community system since the provision providing for the prohibition needs no implementing measure and the prohibition of any double taxation provided for by the Community system on value-added tax is a clear and simple concept.

If the Court comes to a different conclusion on the point then the question of interpretation of Article 11(1)(c) of the Sixth Directive relating to the taxable amount in respect of private use must be addressed.

This provision makes no distinction between deductible and non-deductible expenses (such as salaries, which may not be deducted). If it is necessary to apply national legislation concerning the taxable amount and to interpret that legislation on the basis of the directive, which must also be interpreted in the light of the general goal of the prohibition of any double taxation of private use, then this provision must be interpreted as meaning that expenses which, because of their non-deductibility, give rise to double taxation incompatible with the system in force may not be regarded as expenses within the meaning of the provision in question.

The Portuguese Republic observes that it may be concluded *a contrario* from Article 6(2)(a) that when tax on an item purchased by a taxable person for his business is not wholly or partly deductible its use for purposes other than those of the business may not be taxed as private use.

In this case, therefore, the question of when an item is deductible must be dealt with.

The right to deduct only arises if the goods are used for taxed or exempt transactions giving rise to the right to deduct; this is a fundamental rule flowing from Article 17 of the Sixth Directive.

A taxable person's right to deduct also presupposes the taxation of a transfer or a service of which he has been the recipient. There is no question of 'an absence of the right to deduct' when the acquisition has been made from an individual or from an exempted taxable person. There is no deduction because there has been no taxable transaction.

It is clear that this logical mechanism allows disguised taxation in certain cases and therefore double taxation which is contrary to the system.

The fact that a proposal for a Seventh Directive (applicable to used goods acquired by a taxable person from a private individual or a taxable person who is not entitled to make a deduction), which has not yet been adopted by the Council, was considered necessary to resolve the problem of double taxation brought about by the acquisition of an item which has already been subject to tax shows that the general rule is indeed that which has been set out.

If the Sixth Directive did not concern itself with this disguised taxation flowing from the fact that the item left the tax circuit and was reintroduced into it later, in a situation where there is full double taxation when the object in question is resold, why would it be concerned with disguised taxation which only concerns the tax corresponding to the depreciation of the item acquired and subsequently used for the private purposes of the taxable person?

When the Sixth Directive refers to the 'right to deduct' it is referring not to the 'objective' situation concerning VAT, that is to say whether or not tax has previously been levied on the goods acquired, but to the subjective right of the trader at the moment of acquisition, which is directly determined pursuant to Article 17 of the Sixth Directive on the basis of the economic activity pursued by the trader.

The non-taxation of the private use of goods excluded from the right to deduct under Article 17(6) appears self-evident, having regard to the rationale of that provision.

The exclusion of the right to deduct is determined by the presumption that, taking into account their nature, the goods have been used for purposes other than those of the business, which prevents Article 17(2) from being applied. The possibility of such exclusion (which is also the subject matter of harmonization in the proposal for a Twelfth Directive) is granted because of the natural difficulty in many cases of detecting taxable use for the purposes of Article 6(2). Thus, once the right to deduct has been eliminated by a particular Member State there is no further need for taxation on private use.

However, the Portuguese Republic observes that this interpretation is also consistent with the general principle set out above that the Sixth Directive is not concerned with disguised taxation resulting from the fact that an acquisition is not taxed because it is made from a private individual or an exempt person. Here, in the cases falling within Article 17(6), the transaction has been taxed and all that has been excluded is the right to deduct to which a purchaser who is a taxable person would normally be entitled. It is not therefore the fiscal situation of the item resulting from any earlier transaction but the acquirer's direct right to deduct that is at issue.

Consequently, as regards Question I(1) in the order making the reference, part (a)

should be answered in the affirmative and part (b) in the negative.

There is no need to reply to Questions I(2) and (3) and II(1) and (2), in view of the manner in which the different hypotheses are connected.

In reply to Question III the Portuguese Republic stresses that Article 11(A)(1)(c) of the Sixth Directive did not adopt the normal value of the transaction as the taxable amount, as it did for transactions falling within Article 6(3), although that would have probably been the most coherent solution in respect of a tax on consumption. The 'cost price', that is to say the expenses incurred by the taxable person in his private use of the item forming part of the assets of the business, was the amount preferred, perhaps for reasons of simplification.

If, in this case, not all the expenses were taken into consideration the tax might not be fiscally neutral, since there would be different taxable amounts in respect of the same benefit (the use of the item forming part of the assets of the business for private purposes).

Article 11(A)(1)(c) of the Sixth Directive should be interpreted as meaning that the cost includes all the costs incurred by the taxable person in respect of the use (supply of services), not merely the price (taken into account on a pro rata basis) paid by the taxable person for supplies of goods or services in respect of which there has been a right to deduct.

T. F. O'Higgins
Judge-Rapporteur