OPINION OF ADVOCATE GENERAL STIX-HACKL

delivered on 31 May 2001 [1]

I — Subject of the proceedings

1. In the present action, the Commission seeks a declaration that, by providing that an employer who is a taxable person for the purpose of value added tax ('VAT') may deduct part of an allowance paid to an employee for business use of a private vehicle, the Kingdom of the Netherlands has failed to fulfil its obligations under Article 17(2)(a) and Article 18(1)(a) of 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 Sixth Directive'). [2]

II — Legal framework

A — *Community law*

2. The concept of independence used in the definition of a taxable person in Article 4(4) of the Sixth Directive excludes from the tax, amongst others, persons who are bound to their employer by a contract of employment.

3. Article 5(1) of the Sixth Directive defines a supply of goods as the transfer of the right to dispose of tangible property as owner.

4. Article 17(2)(a) reads:

'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'.

1 — Original language: German.

2 — OJ 1977 L 145, p. 1.

5. Article 18(1)(a) provides:

'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)'.

6. Article 18(3) provides:

'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.'

7. Article 22(3)(a) and (c) read:

'(a) Every taxable person shall issue an invoice, or other document serving as invoice in respect of all goods and services supplied by him to another taxable person, and shall keep a copy thereof.

Every taxable person shall likewise issue an invoice in respect of payments on account made to him by another taxable person before the supply of goods or services is effected or completed.'

'(c) The Member States shall determine the criteria for considering whether a document serves as an invoice.'

B — *National law*

8. Article 23 of the Uitvoeringsbesluit Omzetbelasting of 12 August 1968 ('the Turnover Tax Implementation Regulations 1968') provides:

'Without prejudice to Article 15(2) and (5) of the [Law on Turnover Tax 1968], where an employee uses a car belonging to him in connection with his employer's business and receives an allowance from his employer for that purpose, a percentage of the allowance, fixed by the Minister, may be deducted by the employer in so far as the allowance does not fall within income for income tax purposes.'

9. Article 16 of the Uitvoeringsbeschikking Omzetbelasting of 30 August 1968 ('the Turnover Tax Implementation Order 1968') provides:

'The fraction which an employer is entitled to deduct of the allowance referred to in Article 23 of the [Turnover Tax Implementation Regulations 1968] is 12%, or less if and so far as expenses are not incurred within the Netherlands.'

10. According to the submissions of the Netherlands Government, the rate of 12%, which has applied since 1992, corresponds to the average of the VAT included in the various cost components in respect of the possession and use of motor vehicles.

11. The Netherlands Government explains that a fixed rate was chosen in order to avoid the practical difficulties involved in calculating exact amounts. Account is taken of fixed costs, for example general depreciation, insurance, motor vehicle tax, garaging and bodywork maintenance, and also of journey costs, namely depreciation related to the use of the vehicle and the costs of fuel, oil, tyres and repairs.

12. The Netherlands Government adds that VAT is not levied on some of these cost components, for example on motor vehicle tax and on insurance premiums. The costs that are exempt from VAT make up about 20% to 21.5% of the costs connected with a vehicle. The fraction is somewhat higher in the case of diesel vehicles. If one proceeds on the basis of a proportion amounting to 20%, then, with a general rate of VAT of 17.5% a rate of 12.28% is produced. If one assumes a proportion amounting to 21.5%, a rate of 12.08% is produced. The Netherlands Government explains, finally, that in order to take account of the number of diesel vehicles, which make up 10% of all vehicles, a flat rate of 12% was fixed.

13. Under the Wet op de loonbelasting 1964 ('the Law on Income Tax 1964') and its implementing regulations, the allowance is part of an employee's salary in so far as it exceeds NLG 0.60 per kilometre.

14. The deduction of VAT in relation to the allowance is verified by means of the accounts of the employer, who is obliged by a series of provisions of general tax law and income tax law to keep separate accounts for the allowance. The supporting documents need not be in any particular form. However, they have to contain information as to the business trips undertaken,

the places visited by the employee and the distances travelled (periodic notification by employees).

III — Pre-litigation procedure and procedure before the Court

15. The Commission takes the view that the deduction, from the VAT payable by an employer, of part of the allowance paid to employees for use of their motor vehicle for the purposes of the employer's business infringes the Sixth Directive, and it therefore initiated against the Kingdom of the Netherlands the procedure under Article 169 of the EC Treaty (now Article 226 EC) for failure to fulfil obligations. In the light of the response by the Netherlands Government to its letter of formal notice, the Commission sent a supplementary letter of formal notice on 17 October 1996. As the further written response of 16 December 1996 did not dispel the doubts of the Commission, it delivered a reasoned opinion to the Kingdom of the Netherlands on 22 September 1997, calling on it to take the necessary measures within two months. In a letter of 28 November 1997 the Netherlands Government replied that the Netherlands legislation did not infringe the Community provisions relating to VAT and that for that reason the request of the Commission did not need to be met.

16. As the Commission adhered to its view, it brought an action against the Kingdom of the Netherlands before the Court by application dated 11 September 1998, registered at the Court Registry on 14 September 1998. By order of 3 May 1999, the President of the Court granted the United Kingdom of Great Britain and Northern Ireland leave to intervene in support of the Kingdom of the Netherlands.

17. The Commission claims that the Court should:

1. declare that, by providing, in breach of Article 17(2)(a) and Article 18(1)(a) of the Sixth Directive, that an employer who is a taxable person for the purposes of VAT may deduct part of an allowance paid to an employee for business use of a private motor vehicle, the Kingdom of the Netherlands has failed to fulfil its obligations under the Treaty;

2. order the Kingdom of the Netherlands to pay the costs.

IV — Analysis of the pleas in law raised by the Commission

18. While the first plea in law concerns Article 17(2) of the Sixth Directive, and therefore the conditions for existence of the right to deduct input tax, the second plea relates to Article 18(1) of the Sixth Directive and therefore the conditions for exercise of that right.

A — *First plea in law: Breach of Article 17(2)(a) of the Sixth Directive*

Arguments of the parties and of the intervener

19. The Commission proceeds on the basis of the fundamental consideration that the system of input tax deductions in principle applies only to supplies of goods or services by one taxable person to another taxable person. This is also clearly stated in Article 17(2)(a) of the Sixth Directive.

Article 23 of the Turnover Tax Implementation Regulations 1968 is not compatible with that system, because the supplies of goods or services affected by it are made neither for business purposes nor to traders, but are made to a final consumer, namely, the employee as the owner of a vehicle, which he uses also, or even mainly, for private purposes.

The deductible part of the allowance is therefore not tax on a transaction between taxable persons, but corresponds to the VAT on supplies of goods or services to a final consumer.

20. The Netherlands Government justifies the availability of a deduction on the basis that the VAT system is meant to give relief to every taxable person in order to ensure that all economic activities, whatever their purpose or results, are taxed in a wholly neutral way. [3]

In the present case, the reimbursement of the expenses borne by the employee in respect of the vehicle relates exclusively to transactions which serve the employer and therefore affect the ultimate price of the product or the service. Accordingly, the corresponding portion of the VAT has to be deductible.

3 — Judgment in Case 268/83 *Rompelman* [1985] ECR 655, paragraph 19.

If a deduction were not given, there would be double taxation, resulting, first, from the VAT paid by the employee in respect of the vehicle expenses, and second, from the VAT on the ultimate price, which reflects those expenses. This infringes the principle of fiscal neutrality, the prohibition against double taxation and the principle of charging only the final consumer.

21. In this connection, the Commission points to the clear and unambiguous wording of Article 17 of the Sixth Directive. In its view, moreover, tax law requires generally that its field of application and other rules be clearly defined, as it would otherwise be applied differently in the Member States.

The Commission also founds its submissions on the judgment in *Intiem*, [4] in which the Court upheld a trader's ability, provided for by a national provision, to deduct VAT charged to him from the VAT payable by him. In this connection, the Commission refers to three essential differences between the Netherlands legislation at issue and what are, in its opinion, the essential conditions which the Court considered had to be met in order for a national provision relating to deductibility to be compatible with the Sixth Directive. First, there is in the present proceedings no agreement between the taxable employer and another taxable person concerning the supply of goods to the employee at the expense of the taxable employer and for that reason there is also no supply, in the legal sense, to the employer. Second, the supplies are not made to the employee exclusively for business purposes. Third, the goods are not charged directly by the taxable supplier to the taxable employer. On the other hand, the deduction of input tax does not depend on whether the goods are delivered physically to the employer. [5]

22. The Netherlands Government, in contrast, regards the judgment in *Intiem* as confirmation that, in interpreting Article 17(2) of the Sixth Directive, economic reality is to be given priority. What is decisive is that the employees uses his private vehicle for the purposes of the employer's business. Otherwise, economically identical situations would be treated differently, which would run counter to the case-law of the Court [6] and lead to distortions of competition between undertakings.

23. On this point, the Commission explains that the situations in the present case and in *Intiem* are indeed economically similar, but must be distinguished for the purposes of tax law. Moreover, tax law must generally

4 — Judgment in Case 165/86 *Intiem* [1988] ECR 1471, paragraph 16.

5 — *Intiem* (cited in footnote 4), paragraph 14.

6 — Judgment in Joined Cases C-308/96 and C-94/97 *Madgett and Baldwin* [1998] ECR I-6229.

strike a balance between considerations of fairness on the one hand and the functioning of the tax system on the other, and must also include measures to protect against abuses.

24. The United Kingdom Government, as intervener in support of the Netherlands Government, points out that the present proceedings concern in a very general way the right of a taxable employer to deduct the VAT element of expenses which are incurred where an employee acts in the course of the employer's business. This concerns, for example, accommodation and subsistence expenses as well as taxi fares incurred in travel required for business purposes or the purchase of a tool by an employee.

According to the United Kingdom Government, economic reality must be the guide: in reality the business obtains the fuel through its employee, who for his part acts on behalf of the business, without the ownership of the vehicle used playing any role.

As regards invoicing the taxable employer directly, the United Kingdom Government describes the practice, widespread in the United Kingdom, whereby employees are granted mileage allowances. This practice is justified because it saves the undertaking from checking and retaining many invoices. Any other solution would lead to a distortion of competition in that it would penalise undertakings which — perhaps because they are small — could not enter into agreements with other taxable persons relating to the supply of fuel.

25. The Commission counters this with the argument that in the present case the employees acquire the fuel in their own name and on their own account. The absence of ability or opportunity to enter into supply agreements does not in any way alter the wording of Article 17(2) of the Sixth Directive and the fact that it is infringed by the national legislation at issue.

Finally, the Commission rejects the view of the United Kingdom Government that excluding any reimbursement of expenses means that even fuel which employees use to fill up vehicles that are not suitable at all for private use would have to be treated as supplied to final consumers.

26. Generally, the Commission counters the views of the United Kingdom Government and of the Netherlands Government with the final argument that they amount to a *contra legem* interpretation of Article 17(2) of the Sixth Directive.

Analysis

27. In order to decide this question of law, a few of the principles of the VAT system must first be recalled.

28. The principle of fiscal neutrality, which has been addressed by all the parties, is to be noted. This principle means, first, that taxation occurs irrespective of the number of steps in the economic process. A second element of this principle is that the tax is to be borne by the final consumer.

29. The Netherlands legislation complies with the principle of fiscal neutrality in so far as the employee is not himself entitled to a deduction of input tax, although he initially has to bear the expenses, including the VAT.

30. Nor, under the Netherlands system, is there a tax charge within the chain of undertakings.

31. The question then arises whether this chain is broken by the activity of the employee and whether, even if it is, a deduction may be allowed.

32. In this respect, the Commission rightly draws the — general — conclusion *a contrario* that 'tax is no longer deductible when the chain of transactions has come to an end'. [7]

33. It does indeed end in the situations to which the Netherlands provision applies. The provision applies where an employee, using his vehicle for business purposes, acts in his own name and on his own account, and therefore not in the name and on the account of the employer, that is to say, the taxable person.

34. The Netherlands provision might none the less be permissible if it rested on a fiction that the employee in such cases is to be regarded as a trader and if the Sixth Directive also provided for an employee to be deemed to be a trader in such a situation. However, a corresponding provision, such as Article 28a(4) of the Sixth Directive relating to the supply from time to time of a new means of transport, is absent from the Sixth Directive.

7 — Judgment in Case 89/81 *Hong Kong Trade* [1982] ECR 1277, paragraph 9.

35. Irrespective of that, the fact that the employee receives the services or goods with the intention of using them at least in part for business purposes, that is to say for the taxable employer, is not decisive either under the Sixth Directive. Admittedly, the VAT system is based on the principle that it is not the third party supplier who is to bear the tax burden but the person whose need is satisfied, that is to say, the final consumer. Yet this — general — principle can be observed only to the extent that it is given effect in Community law. This principle is, however, not fully upheld in Community law, as is shown, for example, by the legal position in respect of so-called occasional traders who are not taxable persons even though they are third party suppliers.

36. As regards the submission that there is a risk of double taxation, it is true that the VAT system has the objective of avoiding double taxation, as the Netherlands Government rightly emphasises. However, this does not mean that the Sixth Directive does not in specific cases none the less tolerate double taxation. The VAT that is not deductible then becomes a cost factor.

37. In general, the fact that the objective of precluding double taxation has not yet been achieved [8] shows in any event only that the common system of VAT is 'the result of a gradual harmonisation of national legislation' [9] and that this harmonisation 'is still only partial'. [10]

38. In order for double taxation to be entirely eliminated, action by the Community legislature is therefore needed — as in other cases. [11] Until then, however, Article 17(2)(a) of the Sixth Directive is to be applied in its existing form, that is to say with the possibility of double taxation. [12]

39. Community law as currently in force therefore does not allow for a deduction such as that provided for by the Netherlands legislation. For the sake of completeness, however, it must be pointed out that there are tax arrangements that would make a deduction possible, for example acquisition in the name and on the account of the employer.

8 — Judgment in Case C-165/88 *ORO Amsterdam Beheer and Concerto* [1989] ECR 4081, paragraph 23.

9 — *ORO Amsterdam Beheer* (cited in footnote 8), paragraph 21.

10 — Ibid., paragraph 21.

11 — See, for example, the insertion of Article 26a (special arrangements applicable to, *inter alia*, second-hand goods). On the need to avoid double taxation, see the preamble to Council Directive 94/5/EC of 14 February 1994 supplementing the common system of value added tax and amending Directive 77/388/EEC — Special arrangements applicable to second-hand goods, works of art, collectors' items and antiques (OJ 1994 L 60, p. 16).

12 — Cf. *ORO Amsterdam Beheer* (cited in footnote 8), paragraph 24.

On that point, the judgment in *Intiem*, to which much consideration has been given, must be examined and reference made to the three criteria brought out by the Commission, on the basis of which a deduction of tax may be made by the employer as a taxable person. [13]

40. If the Netherlands legislation under consideration here is compared with the criteria developed in the case-law, what emerges, however, is the following. First, a deduction of input tax is granted without any need for an agreement between the employer and the taxable supplier. Also, the supplies of goods are not effected on the account of the employer. The documents filed by the Netherlands Government prove moreover that the goods and services supplied to the employee are not used exclusively for business purposes; instead, they serve private purposes too. Nor, finally, is it necessary in order for input tax to be deducted under the Netherlands legislation that the employer receive an invoice by which VAT is charged to him.

41. Lastly, it is necessary to rebut the view of the Netherlands Government, based on the judgment in *Madgett and Baldwin*, that in interpreting Article 17(2) of the Sixth Directive economic reality is to be given precedence over the wording of the provision.

13 — In this regard, see point 21.

It is true that in that judgment the Court opted for an interpretation that diverged from the wording, but the case concerned the allocation of a taxable person to a particular occupational category and the application of the exception which applied to that category. The present proceedings, however, do not concern the 'formal classification of the trader'; [14] for here there is no doubt that the employees are not taxable businesses.

42. It must as a matter of principle further be found that a literal interpretation of Article 17(2)(a) of the Sixth Directive is consistent with an interpretation based on its legislative history. There is no express reference to 'another trader' in either the corresponding provision previously contained in the Second Directive (Article 11) or in the proposal of the Commission for the subsequent Article 17(2) of the Sixth Directive.

43. However, as the Court held in *Genius Holding*, the Council, in drafting Article 17(2)(a) of the Sixth Directive, departed both from the wording of Article 11(1)(a) of the Second Directive and from that of Article 17(2)(a) of the Commission's proposal. [15]

14 — *Madgett and Baldwin* (cited in footnote 6), paragraph 21.

15 — Judgment in Case C-342/87 *Genius Holding* [1989] ECR 4227, paragraph 12.

44. The Council departed from the Commission's proposal in particular in providing that the goods or services must be supplied or be going to be supplied 'by another taxable person'.

45. Finally, it is also apparent from the relevant case-law of the Court that Article 17 of the Sixth Directive cannot be interpreted contrary to its wording. [16]

46. It follows from all the foregoing considerations that the Netherlands legislation concerning deduction of part of the allowance infringes Article 17(2) of the Sixth Directive. For that reason, the Commission's first plea in law is well founded.

B — *Second plea in law: Breach of Article 18(1)(a) of the Sixth Directive*

Arguments of the parties and of the intervener

47. According to the Commission, the national legislation is incompatible with Article 18(1)(a) of the Sixth Directive inasmuch as, under that provision, exercise of the right to deduct input tax is conditional upon the possession of an invoice drawn up in accordance with Article 22(3) of the Sixth Directive, that is to say, an invoice which has been issued by one taxable person to another taxable person, a requirement which is not prescribed by the Netherlands rules.

The Commission refers moreover to the danger of abuse which could result from the particular features of those rules.

48. The Netherlands Government rejects this allegation, arguing in particular that the maximum limit of the mileage allowance constitutes protection against abuse. It submits, furthermore, that the reference in Article 18(1)(a) of the Sixth Directive to Article 22(3) thereof does not mean that the invoice must be issued by one taxable person to another taxable person. Rather, it is apparent from Article 22(3)(c) that documents other than invoices are permissible in order to prove that an item of expenditure has in fact been incurred for the purposes of the business.

The Netherlands Government further emphasises that the (only) function of the invoice is evidential. The right to a deduction of input tax also exists where there is no invoice. Thus, Article 18(3) of the Sixth

16 — Judgment in Case C-43/96 *Commission* v *France* [1998] ECR I-3903, paragraph 16, concerning the interpretation of Article 17(6) of the Sixth Directive.

Directive authorises the Member States to determine the conditions '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'.

In Netherlands law, there are alternative means of proof available, for example those arising from the accounting provisions applicable to employers. The accounting obligations owed by the taxable person provide a sufficient guarantee against abuses.

Finally, the purpose of the Sixth Directive takes precedence over a provision that creates purely formal requirements, an interpretation which is also supported by the principle of proportionality.

49. The United Kingdom Government takes the view that Article 18(3) of the Sixth Directive authorises the Member States to determine the conditions under which a deduction is possible where there is no invoice. [17]

17 — With regard to this view of the United Kingdom Government, see point 24.

Analysis

50. As the Commission rightly submits, breach of Article 17(2)(a) of the Sixth Directive entails a breach of Article 18(1)(a). As there are not two taxable persons involved, but just the employer and his employee, there likewise cannot be an invoice within the meaning of Article 22(3).

51. As regards the means of proof, Article 22(3)(c) does admittedly authorise the criteria to be laid down that shall determine whether a document may be considered an invoice. However, this means a document within the meaning of Article 22(3)(a), that is to say, a document which serves as an invoice and is issued by one taxable person in respect of supplies of goods to another taxable person. The Netherlands provision also does not prescribe a document that satisfies these requirements.

52. The reliance placed by the Netherlands Government on Article 18(3) of the Sixth Directive is misconceived in so far as this provision concerns exercise of the right to deduct input tax. The way in which such a

right is exercised is irrelevant if it has not even arisen. The Member States cannot, by determining 'conditions and procedures' within the meaning of Article 18(3) of the Sixth Directive, alter the requirements for the existence of the right to deduct input tax.

53. Thus, the Commission's second plea in law is also well founded.

V — Costs

54. Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to pay the costs if they have been applied for in the successful party's pleadings. As the Kingdom of the Netherlands has been unsuccessful, it should be ordered to pay the costs. Under Article 69(4) of the Rules of Procedure, Member States which intervene in the proceedings are to bear their own costs. Therefore, the United Kingdom should bear its own costs.

VI — Conclusion

55. I accordingly propose that the Court should:

(1) declare that by providing, in breach of Article 17(2)(a) and Article 18(1)(a) of 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, that an employer who is a taxable person for the purposes of VAT may deduct part of an allowance paid to an employee for business use of a private motor vehicle, the Kingdom of the Netherlands has failed to fulfil its obligations under the Treaty;

(2) order the Kingdom of the Netherlands to pay the costs;

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