OPINION OF MR ADVOCATE GENERAL JACOBS
delivered on 30 April 1991 *

My Lords,

1. This case has been referred to the Court by the Munich Finance Court and concerns the interpretation of the Community legislation on value added tax, in particular certain provisions of the Sixth Council Directive 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 (Directive 77/388, Official Journal 1977 L 145, p. 1). The Finance Court seeks a ruling on two main issues:

(1) whether a person who initially acquires capital goods (in this case a motor car) wholly for private use, but subsequently uses the goods for business purposes, may claim a partial deduction of input tax in subsequent years by way of annual adjustments under the rules set out in Article 20(2) of the Sixth Directive; and

(2) whether national tax authorities are entitled to treat such goods as being used wholly for private purposes where business use is very limited.

2. The facts of the case appear to be as follows. In 1985 and 1986, the taxpayer, a Mr Lennartz, worked partly as an employed person and partly as a self-employed tax consultant. He submitted annual VAT declarations in both years in respect of his self-employed activity. In 1985, Mr Lennartz purchased a car for DM 20 206.15 (including VAT of DM 2 828.86). He initially used the car mainly for private purposes, using it only to the extent of 8% for business purposes. On 1 July 1986, he opened a tax consultancy office in Munich and brought the motor car into the business. On his 1986 turnover tax declaration he claimed an input tax deduction in respect of the car of DM 282.98 (which he computed on the basis of 6/60ths of 2 828.86) under Paragraph 15a of the 1980 Umsatzsteuergesetz, which is the German provision implementing Article 20(2) of the Sixth Directive.

3. The tax authority decided that Mr Lennartz was to be regarded as having initially bought the car wholly for private use and was not therefore entitled to make adjustments under Paragraph 15a when the car was subsequently used for business

* Original language: English.

purposes. The finding that the car was initially used wholly for private purposes was based on an administrative practice of the German tax authorities whereby business use of goods is generally disregarded where such use amounts to less than 10% of total use.

4. It appears that Mr Lennartz did not, in 1985, claim an initial deduction of the input tax incurred on the acquisition of the car. His appeal in this case is against the decision of the tax authorities refusing his claim for a subsequent adjustment under Paragraph 15a in 1986.

5. In order to assist it in determining the appeal, the Finance Court has asked for a preliminary ruling on the following questions:

'1. Is Article 20(2) of the Sixth Directive applicable to all capital goods which

(a) were supplied by one taxable person to another taxable person and at some point within a period of five years, including the year in which the goods were acquired, are used by the recipient for the purposes of his taxable transactions,
or is it also necessary for the capital goods in question to have been

(b) used from the time of acquisition for the purposes of the taxable or exempted transactions (business purposes) of the taxable person, or

(c) allocated at the time of acquisition for the purposes of the business of the taxable person?

2. If alternative (b) is correct:

Does the application of Article 20(2) of the Sixth Directive to capital goods which are used by a taxable person both for business purposes and for other, in particular private, purposes (mixed use) depend on their having been used to a specific minimum extent for business purposes in the year in which they were acquired and, if so, how is that minimum extent to be defined?

3. If alternative (c) is correct:

Is the allocation of the capital goods a matter for the taxable person's discretion or does it presuppose that the taxable person

(a) acquires them with the intention of using them for business purposes and, if so, must that use be intended to begin

(i) immediately from the time of acquisition, or

(ii) from some point within the year of acquisition, or

(iii) from some point before the expiry of a period of five years, including the year of acquisition,

and/or

(b) actually uses the capital goods for business purposes and, if so, does it matter whether such use begins

(i) from the time of acquisition, or

(ii) within the year in which the capital goods were acquired, or

(iii) within the period of five years, including the year in which the goods were acquired?

As far as Questions 3(a) and (b) are concerned:

Where the capital goods are used for mixed purposes, must the intended use or actual use (or both) for business purposes attain a specific minimum proportion and, if so, how is that minimum to be defined?'

Rules on the deduction of input tax

6. It may be helpful if I begin by explaining briefly the purpose of Article 20(2) of the Sixth Directive and its place within the scheme of that directive, in particular its relationship with the rules on the deduction of input tax incurred on the purchase of goods and services.

7. Article 2 of the First VAT Directive of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes (Directive 67/227, Official Journal, English Special Edition 1967, p. 14) provides that:

'The principle of the common system of value added tax involves the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged.

On each transaction, value added tax, calculated on the price of goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of value added tax borne directly by the various cost component . . .'

8. The rules giving effect to the principle of deduction provided for in the second paragraph of that article were originally laid down in the Second Council Directive of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes — Structure and procedures for application of the common system of value added tax (Directive 67/228, Official Journal, English Special Edition 1967, p. 16), in particular in Article 11 of that directive. The Sixth Directive, which superseded the Second Directive, laid down rather more detailed rules, which are set out in Title XI (Articles 17 to 20).

9. Article 17(1) of the Sixth Directive provides that:

'The right to deduct shall arise at the time when the deductible tax becomes chargeable.'

10. The chargeable event and the time when tax becomes chargeable are dealt with in Article 10, under which the normal rule is that:

'The chargeable event shall occur and the tax shall become chargeable when the goods are delivered or the services are performed . . .' (Article 10(2)).

11. Article 17(2) provides that:

'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;

. . .'

12. In addition to the right to deduct input tax incurred in respect of taxable transactions provided for in Article 17(2), Article 17(3) allows taxable persons a right of deduction in respect of certain other transactions, which are not relevant in these proceedings.

13. Article 17(5) provides that:

'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 transactions.'

The normal method for determining that proportion is laid down in Article 19 and involves the use of a fraction representing the ratio between the annual turnover attributable to transactions in respect of which VAT is deductible and, broadly, total

turnover. However, Article 17(5) allows Member States to authorize or compel taxable persons to use a variety of special methods for determining the deductible proportion.

14. Article 20 of the directive concerns the adjustment of deductions which have been made. Article 20(1) provides that:

'The initial deduction shall be adjusted according to the procedures laid down by the Member States, in particular:

(a) where that deduction was higher or lower than that to which the taxable person was entitled;

(b) where after the return is made some change occurs in the factors used to determine the amount to be deducted, in particular where purchases are cancelled or price reductions are obtained; . . . .'

15. Article 20(2), which lays down more specific rules for adjustments in respect of capital goods, provides that:

'In the case of capital goods, adjustments shall be spread over five years including that in which the goods were acquired or manufactured. The annual adjustment shall be made only in respect of one-fifth of the tax imposed on the goods. The adjustment shall be made on the basis of the variations in the deduction entitlement in subsequent years in relation to that for the year in which the goods were acquired or manufactured.

By way of derogation from the preceding subparagraph, Member States may base the adjustment on a period of five full years starting from the time at which the goods are first used.

In the case of immovable property acquired as capital goods the adjustment period may be extended up to ten years.'

16. Article 20(3) deals with the situation where capital goods are disposed of during the adjustment period. Article 20(4) provides that:

'For the purposes of applying the provisions of paragraphs 2 and 3, Member States may:

— define the concept of capital goods,

— indicate the amount of the tax which is to be taken into consideration for adjustment,

— adopt any suitable measures with a view to ensuring that adjustment does not involve any unjustified advantage,

— permit administrative simplifications.'

17. Article 20(5) permits Member States, subject to consultation of the VAT Committee pursuant to Article 29, to choose not to apply Article 20(2) and (3) where the practical effect of doing so would be insignificant.

18. The effect of the above rules may be illustrated by the following example.

Let us suppose that in year one a bank purchases a computer for ECU 100 000 plus ECU 10 000 VAT. During the year the computer is used to the extent of 40% for taxable transactions or transactions giving rise to the right of deduction under Article 17(3) and 60% for exempt lending transactions for which there is no right of deduction.

Since the computer is used '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', the apportionment rules in Article 17(5) apply. Let us assume that the bank has agreed with the tax authority to base its input tax calculation on the use of the computer, pursuant to a special method of apportionment laid down under Article 17(5), rather than on turnover under Article 19.

In that case the bank will be able to deduct, in year one, 40% of the total VAT incurred on the acquisition of the computer (i.e. ECU 4 000).

Let us assume that in year two the proportion of use for transactions in respect of which VAT is deductible increases to 50% of total use. In that case the bank will be entitled, on the assumption that the goods fall within the scope of national rules enacted under Article 20(2), to adjust its deduction and claim additional input tax of 10% (50% minus 40%) x 1/5 x ECU 10 000 (i.e. ECU 200) to take account of the extra 10% of use in year two for transactions in respect of which VAT is deductible.

If, on the other hand, in year three the use of the computer for transactions in respect of which VAT is deductible falls to 20% of total use, the bank will suffer a clawback in year three of 20% (40% minus 20%) x 1/5 x ECU 10 000 (i.e. ECU 400).

19. Thus, a taxable person who purchases capital goods which are subject to adjustment rules enacted under Article 20(2) makes an immediate deduction of the full amount of the proportion of input VAT deductible in the year of acquisition under the rules in Article 17. He is thereafter obliged to make annual adjustments to the initial deduction based on the variation in the deductible proportion throughout the five- or 10-year adjustment period.

20. Against that background, I now turn to the questions put by the national court.

Question 1(a)

21. By this part of the first question, the national court is in effect asking whether the input tax adjustment rules in Article 20(2) of the Sixth Directive apply where the taxable person initially acquires goods wholly for private use but subsequently uses them for business purposes at some point during the five-year adjustment period.

22. The Commission and the French, German and United Kingdom Governments all agree that Article 20(2) does not apply in such circumstances. That view seems correct. Where a private individual (i.e. a person who is not carrying on an independent economic activity and hence is not a taxable person for the purposes of Article 4(1) of the directive) buys goods for private (non-business) use, he has no right of deduction under Article 17(2) of the directive, since that provision confers the right of deduction only on taxable persons. If the individual in question later sells the goods to a taxable person, no VAT is chargeable on the supply because the supply is not made by a taxable person acting as such (Article 2). The result is that part of the original VAT borne by the individual on the purchase of the goods (or all of the VAT if the goods have not depreciated in value) remains in the value on resale; consequently a taxable person purchasing goods from a private individual bears an irrecoverable VAT cost. There is in the Sixth Directive no concept of temporary or partial final consumption applicable to goods which re-enter the economic circuit (see in particular the Court's judgment of 5 December 1989 in Case 165/88 *Oro Amsterdam Beheer* v *Inspecteur der Omzetbelasting*. See also the Commission's amended proposal of 11 January 1989 for a Council directive concerning special arrangements for second-hand goods, works of art, antiques and collectors' items (Official Journal 1989 C 76, p. 10)).

23. As the French and United Kingdom Governments state, there is no reason to distinguish from that situation the case of a taxable person who originally acquires goods in his private capacity and then transfers them to business use. In such circumstances the goods leave the economic circuit when the individual acquires them as a final consumer and uses them for private consumption. The goods subsequently re-enter the economic circuit when they are transferred to the business. The Sixth Directive clearly envisages that a taxable person may act in a separate, private capacity and hence as a final consumer. Article 2 confines the scope of VAT to the supply of goods or services effected for consideration 'by a taxable person *acting as such*' (my emphasis). Article 17(2) must therefore be read as conferring the right of deduction on a taxable person only when he acts in that capacity.

24. Moreover, when a taxable person acquires goods in his private capacity he will not comply with the administrative and accounting requirements governing the exercise of the right to deduct laid down

pursuant to Articles 18 and 22 of the Sixth Directive. As the French Government points out, the requirement to provide an invoice in Article 22(3)(a) applies only to goods and services supplied to another taxable person. More generally, if a taxable person acquires goods in his private capacity, he is not under any obligation (indeed it would be inappropriate for him) to enter the goods in his VAT records pursuant to Article 22(2) or to include the purchase in his periodic VAT return under Article 22(4).

25. With more specific reference to Article 20(2), that provision merely establishes, as the United Kingdom Government points out, the machinery for calculating adjustments to the initial deduction. It cannot transform tax borne in relation to non-business activities into deductible tax under Article 17. Under Article 17(1) the right to deduct arises at the time when the deductible tax becomes chargeable, as defined by Article 10. It is the capacity in which the person acts at that time which determines whether he has the right of deduction.

26. It is true that, in Case 50/87 *Commission* v *France* [1988] ECR 4797, which concerned the right of deduction of a lessor of immovable property, the Court stated that:

'... Article 20 of the Sixth Directive provides for a system of adjustment. Where, because of the amount of the rent, the lease must necessarily be regarded as involving a concession and not as constituting an economic activity within the meaning of the directive, the deduction initially made is adjusted and the time-limit for that adjustment may be extended up to 10 years.'

However, the Court cannot in my view have meant that Article 20(2) was applicable where goods were initially acquired by a taxable person other than for the purposes of his business. In such circumstances any initial deduction wrongly made should be cancelled in full.

Question 1(b) and (c)

27. By these parts of the first question, the national court asks whether, if business use at some point during the adjustment period is not enough to give rise to a right of adjustment, the goods must, in order for such a right to arise:

— be used from the time of acquisition for the purposes of taxable or exempt transactions (part (b)); or

— be allocated at the time of acquisition to the taxable person's business (part (c)).

28. The essential issue, in terms of the language of the Sixth Directive, is whether, for the application of Article 20(2), it is sufficient for the person concerned to acquire the goods in his capacity as a taxable person or whether there must, in addition, be immediate use of the goods for taxable or exempt transactions.

29. The German Government expressly opts for the requirement set out in part (b) of the question, namely use for taxable or exempt transactions from the date of acquisition. The Commission seems to suggest that the goods must be allocated to the business and be used at least in part for taxable transactions. The United Kingdom Government considers that Article 20(2) of the directive only applies to goods that are used for the purposes of the recipient's business from the time of acquisition. The French Government considers that Article 20(2) applies if the goods are acquired by a taxable person acting as such. Thus, the French rules grant a right of deduction where capital goods initially allocated to the business but not used for the purposes of transactions giving rise to the right of deduction are subsequently used for such transactions within the adjustment period.

30. In order to reach a conclusion on this point, reference should be made to the Court's judgment in Case 268/83 *Rompelman* v *Minister van Financiën* [1985] ECR 655. The issue in that case was whether a person who acquired the future title to commercial premises under construction with the declared intention of letting the premises and making taxable supplies was, at that preparatory stage, acting as a taxable person with a right of deduction.

31. The Court began by considering Articles 4 and 17 of the Sixth Directive and concluded that:

'the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of value added tax therefore ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way' (paragraph 19).

32. With more particular reference to the question put to it, the Court then stated:

'... the principle that VAT should be neutral as regards the tax burden on a business requires that the first investment expenditure incurred for the purposes of and with the view to commencing a business must be regarded as an economic activity. It would be contrary to that principle if such an activity did not commence until the property was actually exploited, that is to say until it began to yield taxable income. Any other interpretation of Article 4 of the Sixth Directive would burden the trader with the cost of VAT in the course of his economic activity without allowing him to deduct it in accordance with Article 17 and would create an arbitrary distinction between investment expenditure incurred before actual exploitation of immovable property and expenditure incurred during exploitation. Even in cases in which the input tax paid on preparatory transactions is refunded after the commencement of actual exploitation of immovable property, a financial charge will encumber the property during the period, which may sometimes be considerable, between the first investment expenditure and the commencement of exploitation. Anyone who carries out such investment transactions which are closely connected with and necessary for the future exploitation of immovable property must therefore be regarded as a taxable person within the meaning of Article 4' (paragraph 23).

33. There are, in my view, two conclusions to be drawn from that decision. First, a person acquiring goods for the purposes of an economic activity within the meaning of Article 4 does so in his capacity as a taxable person even if the goods are not immediately used for generating supplies of goods or services. Secondly, if the taxable person has purchased the goods for the purpose of making taxable (rather than, for example, exempt) supplies, he will be entitled to an immediate deduction under Article 17.

34. In my view a distinction must be drawn between those two requirements, namely acquisition of goods as a taxable person and taxable use. The former is a more fundamental requirement, inasmuch as the acquisition of capital goods wholly for purposes other than those of the business does not fall within the scope of the common VAT system or, consequently, the deduction mechanism. The use (taxable or otherwise) to which the goods are put, or are intended to be put, within the business determines the extent of the initial deduction to which the taxable person is entitled under Article 17 and the extent of any adjustments in subsequent periods.

35. One consequence of that analysis is that Article 20(2) may operate — and on this point I agree with the French Government's observations — even where a taxable person acquires goods initially for the purposes of economic transactions which, under Article 17(2) and (3), do not give rise to the right of deduction (e.g. exempt supplies) but, in subsequent years within the adjustment period, uses the goods for transactions in respect of which VAT is deductible. Thus, with reference to the example given earlier of a computer purchased by a bank, let us suppose that in year one the computer is used entirely for exempt supplies in respect of which there is no right of deduction, but that in years two to five it is used to the extent of 80% for taxable supplies. Whilst the bank has no right of deduction in year one, it has none the less purchased the goods for the purposes of its business and is entitled to make adjustments to take account of the predominantly taxable use in years two to five.

36. It also follows that immediate use of the goods for taxable or exempt supplies is not in itself a condition for the subsequent application of Article 20(2). Thus, if in the above example the bank were unable to use the computer until year two owing to defects in the software, this would not — and ought not to — preclude subsequent adjustments to take account of changes of use. Support for this view is to be derived from the second subparagraph of Article 20(2), which specifically allows Member States to delay the commencement of the adjustment period to the time at which the goods are first used.

37. Thus, in the context of this case the relevant test is whether Mr Lennartz, when he acquired the goods, had the specific intention of using the goods for the purposes of his business or whether, at that time, he intended to use them wholly for purposes other than those of his business. In the latter case Article 20(2) does not apply.

However, it should be noted that, for reasons which I shall explain later in this Opinion, Article 20(2) may be applicable in the case of partial private use.

38. I do not consider it necessary to examine the view put forward by the German Government that the term 'capital goods' itself covers only goods acquired for the purposes of the business. The conditions for the application of Article 20(2) lead in any event to the same result.

39. In my view, therefore, adjustments to the initial deduction may be made under Article 20(2) only where capital goods were allocated to the business at the time of acquisition (part (c) of the national court's first question); provided that that condition is fulfilled, adjustments may be made even if there was no immediate use of the goods for taxable or exempt transactions. Consequently, it is necessary to consider the national court's third question.

Question 3

40. By this question the national court is in substance seeking guidance on the criteria to be used in determining whether a person acquires goods in his capacity as a taxable person. In particular it asks whether the person must

(a) acquire the goods with the intention of using them for business purposes

(i) immediately from the time of acquisition;

(ii) within the year of acquisition; or

(iii) within the five-year adjustment period;

and/or

(b) actually use the goods for business purposes within those periods.

41. I have already pointed out, in connection with the national court's first question, that a person acquires goods in his capacity as a taxable person where he does so with the specific intention of using those goods for the purposes of his business. The tax authorities must therefore satisfy themselves that, as a matter of fact, the taxable person had such an intention at the time when the goods were acquired. In its judgment in *Rompelman*, already cited, the Court stated that it was 'for the person applying to deduct VAT to show that the conditions for deduction are met and in particular that he is a taxable person. Therefore Article 4 does not preclude the revenue authorities from requiring the declared intention to be supported by objective evidence such as proof that the premises which it is proposed to construct are specifically suited to commercial exploitation' (paragraph 24).

42. The national tax authorities must establish that the goods are intended for genuine business use. The extent of the evidence required to satisfy the national tax authorities must depend, *inter alia*, on the

nature of the goods concerned. Thus, where, to use the Court's words in the *Rompelman* case, the goods are 'specifically suited to commercial exploitation', little additional evidence is likely to be required. On the other hand, where a person acquires goods which are equally suited to private use (such as a motor car), acquisition specifically for business purposes will be much more difficult to substantiate if the goods are not so used immediately.

43. The national court asks whether the year of acquisition or the five-year period commencing with the acquisition might be relevant in this connection. The five-year period is mentioned presumably because it corresponds to the five-year adjustment period provided for by Article 20(2) of the Sixth Directive. In my view, those periods are simply convenient periods upon which it was chosen to base the operation of the system of deduction and of adjustments in respect of capital goods. They are not, as such, relevant to the question whether goods are acquired for business use. That view is consistent with the discretion allowed to Member States in choosing the various periods. Article 20(2), in particular, allows the adjustment period for immovable property to be extended up to 10 years, presumably to take account of the longer useful life of such property.

44. A further point to note in this connection is that, where a tax authority accepts that goods have been purchased for taxable business use and allows an immediate deduction of input tax, it will always be open to it to demand repayment of the tax by way of an adjustment under Article 20(1)(a) of the Sixth Directive if it subsequently transpires that the goods were not acquired for business use.

45. Thus, the answer to the national court's third question is that the taxable person must acquire the goods with the specific intention of using them for business purposes (Question 3(a)). Whether a taxable person has that intention at the time when the goods are acquired is a question of fact to be determined by the tax authorities having regard to all the circumstances of the case. The Sixth Directive does not specify a period within which the goods should actually be used for making business supplies. However, a failure to use the goods for making such supplies immediately or within a reasonable period of their acquisition may, depending on the circumstances and in particular the nature of the goods in question, be taken into account by the tax authorities in determining whether a person acquired the goods as a taxable person and hence whether an initial deduction may be made under Article 17 or, if already made, should be adjusted (that is to say, cancelled) under Article 20(1)(a).

The 10% rule

46. In the final part of the third question, the national court asks whether, where goods are used for mixed purposes, the

intended or actual use for business purposes must attain a specific proportion of total use, and if so, how that proportion is to be determined.

47. This question arises because of the practice of the German tax authorities of presuming that goods have been acquired wholly for purposes other than those of the business where the proportion of non-business use exceeds 90% and hence use for the purposes of the business represents less than 10%. In its written reply to the question put by the Court before the hearing and in its oral observations at the hearing, the German Government emphasized that those percentages are not applied rigidly but constitute an 'evidential criterion' to be used in determining whether or not there is business use. It none the less appears from the order for reference that, by virtue of that rule, Mr Lennartz was treated as using the car wholly for private purposes in the period from its acquisition in 1985 to 1 July 1986, when he opened his tax consultancy office, notwithstanding the fact that, in 1985, business use of the car amounted to 8%. In my view, it is therefore necessary, for the purpose of answering the national court's question, to assume that, at least in certain circumstances, the German measure may lead to the refusal of the right to deduct in cases of genuine, albeit limited, business use.

48. At the hearing, the German Government contended that the proceedings before the national court were limited to the question of Mr Lennartz's entitlement to make adjustments under Article 20(2) of the Sixth Directive. Since he made no claim for an initial deduction in 1985 under Article 17(2), the assessment for that year is now said to be final. Consequently, in the German Government's view, the questions submitted should be answered on the basis that Mr Lennartz had no right of deduction on the acquisition of the car.

49. The order for reference appears to support the German Government's statement that Mr Lennartz's appeal is restricted to a claim for an adjustment under Article 20(2). Moreover, the German Government is correct in its view that the validity of the German *de minimis* limit is relevant, not to Mr Lennartz's entitlement to adjustments under Article 20(2), but to his right to an initial deduction under Article 17(2) in 1985. As I shall explain later, changes in the proportion of business use are dealt with by another mechanism (see paragraph 56 et seq. below) and not by means of the adjustment procedure in Article 20(2).

50. Consequently, if the 10% rule were invalid, Mr Lennartz would benefit from the invalidity only if he were able to make a retrospective claim to an initial deduction under Article 17(2) pursuant to the German legislation laid down in accordance with Article 18(3) of the directive. This provides that: 'Member States shall determine the conditions and procedures whereby a taxable person may be authorized to make a deduction which he has not made in accordance with the provisions of paragraphs 1 and 2'. However, since the

national court expressly raises the question of the requirement of a minimum proportion of business use, albeit in the context of a series of questions concerning the application of Article 20(2), I feel compelled to consider this issue.

51. The essential question is therefore whether, under the Community VAT legislation, a person acquires goods as a taxable person and has the right to deduct input tax incurred in respect of those goods even where the use of those goods for business purposes is at the outset relatively small (for example, 8%).

52. The views expressed in the observations submitted to the Court differ on this issue. In its observations and in its reply to a written question asked by the Court, the German Government states that a deduction is permissible even where the goods are used mainly for non-business purposes. However, in its view, where the proportion of use for business purposes is so insignificant that it has minimal economic significance, the person must be presumed to have acquired the goods wholly for purposes other than those of the business, with the result that no right of deduction arises. In the light of the economic considerations underlying the VAT legislation, minimal utilization for the purpose of the business cannot, it is said, lead to full deduction.

53. The United Kingdom states that it wishes to refrain from commenting on this issue. However, it adds that the Sixth Directive does not contain any express provision dealing with the situation where goods and services are acquired partly for business purposes and partly for non-business purposes and does not provide for apportionment between the two purposes when determining the amount of tax in respect of which the right to deduct arises. It states that it is implicit in Article 17 that the right to deduct arises only in relation to business activities. Thus, in its view, the directive does not prevent Member States from determining whether and to what extent there should be apportionment when there is mixed business and non-business use of goods and services, and from providing for the method of calculating such apportionment.

54. The Commission considers that actual use of the goods, albeit minimal, for taxable transactions gives rise to the right of deduction in full and to subsequent adjustment in accordance with Article 20(2).

55. The French Government subscribes to the Commission's view and states that, in principle, even minimal utilization for business purposes, for example 1%, gives rise to the right to full deduction of input tax, although the private use of the goods will be subject to tax. However, it adds that full deduction of input tax in such circumstances is not realistic since it involves technical difficulties and confers unjustified advantages where the goods are hardly used for the purposes of the business. For that reason, France obtained authorization from the Council, pursuant to Article 27(1) of the Sixth Directive, to introduce special measures derogating from the provisions of the directive. The Council decision (Decision 89/488 of 28 July 1989, Official

Journal 1989 L 239, p. 22) authorizes the French Government, until 31 December 1992, to refuse the right to deduct input VAT on goods or services where the percentage of private use of those goods or services exceeds 90% of their total use. The French Government adds that national legislation refusing the right of deduction could be retained under Article 17(6) or Article 27(5) of the directive by Member States already possessing such legislation.

56. The provisions dealing with private use are contained in Articles 5 and 6 of the Sixth Directive. Article 5(6) provides that:

'The application by a taxable person of goods forming part of his business assets for his private use or that of his staff, or the disposal thereof free of charge or more generally their application for purposes other than those of his business, where the value added tax on the goods in question or the component parts thereof was wholly or partly deductible, shall be treated as supplies made for consideration . . . '

Article 6(2) 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;

(b) supplies of services carried out free of charge by the taxable person for his own private use or that of his staff or more generally for purposes other than those of his business.

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

57. Article 11 contains provisions for the valuation of such supplies. Thus Article 11 A 1(b) provides that the taxable amount in respect of supplies referred to in Article 5(6) is to be 'the purchase price of the goods or of similar goods or, in the absence of a purchase price, the cost price, determined at the time of supply'. Article 11 A 1(c) provides that the taxable amount in respect of supplies referred to in Article 6(2) is to be 'the full cost to the taxable person of providing the services'.

58. Article 6(2)(a), in conjunction with Article 11 A 1(c), therefore envisages that, where a taxable person acquires an asset which he uses partly for private purposes, he will be deemed to make a taxable supply of services for a consideration equal to the full cost of providing those services. Thus, under the scheme of the directive, a person who uses an asset partly for the purposes of taxable business transactions and partly for private purposes and, on the acquisition of

the asset, recovered the input VAT wholly or in part, is deemed to use the asset wholly for the purposes of his taxable transactions within the meaning of Article 17(2). The provisions on the apportionment of input tax contained in Article 17(5), which apply to goods and services to be used by a taxable person both for transactions in respect of which VAT is deductible and for transactions in respect of which it is not deductible, do not therefore apply. Consequently, such a person has, in principle, the right to full and immediate deduction of the input tax incurred on the acquisition of the assets.

59. Support for this view may be found in the Commission's commentary, in its proposal for the Sixth Directive (Bulletin of the European Communities, Supplement 11/73), on Article 5(6) (or Article 5(3)(a) as it was in the proposal), which is the equivalent provision, in Article 5 ('supplies of goods'), to Article 6(2)(a). The Commission stated: 'The same aim [avoidance of unjustified advantages for taxable persons] could have been attained by means of adjustments to deductions already made, but the technique of treating these transactions as taxable supplies was chosen for reasons of impartiality and simplicity'. Thus, the output tax charge was specifically chosen as an alternative to a restriction on the right to deduct input tax. Although the last sentence of Article 6(2) permits Member States, within certain limits, to derogate from the private use mechanism laid down in that paragraph, that sentence is not applicable here for reasons which I shall explain later (see paragraph 75).

60. The question remains whether it might none the less be permissible for a Member State to limit the right of deduction where the business use of the asset forms a minimal part of its total use. At the hearing, the Commission emphasized that the fundamental nature of the right of deduction precluded any restrictions of that right other than those expressly laid down in the directive. That view is consistent with the statements made by the Court in its previous decisions. An example is Case 50/87 *Commission* v *France*, cited above. There the Court, quoting its judgment in *Rompelman*, stated, with reference to the provisions of Article 4(1) and (2) and Article 17(1) and (2) of the directive, that:

'The combined effect of the rules referred to above is that, in the absence of any provision empowering the Member States to limit the right of deduction granted to taxable persons, that right must be exercised immediately in respect of all the taxes charged on transactions relating to inputs.

Such limitations on the right of deduction have an impact on the level of the tax burden and must be applied in a similar manner in all the Member States. Consequently, derogations are permitted only in the cases expressly provided for in the directive' (paragraphs 16 and 17).

The Court concluded that, since the French legislation did not allow total and

immediate deduction in certain cases, it was incompatible with the Sixth Directive.

61. I have already pointed out that, under the scheme of the Sixth Directive, a taxable person acquiring goods partly for taxable business use and partly for private use is deemed to use the goods wholly for the purposes of taxable supplies and therefore in principle has the right to full and immediate deduction of input tax incurred on the acquisition of the goods (the private use element being accounted for by means of an output tax charge). The directive contains no *de minimis* provision excluding the right of deduction where business use falls below a certain threshold. Yet the directive specifically incorporates provisions allowing Member States to ignore non-deductible VAT for the purposes of Article 17 where the amount thereof is insignificant (Article 17(5)(e)) and to refuse to refund or carry forward an excess of input tax over output tax where the amount of the excess is insignificant (Article 18(4)). I consider that, in view of the clear, albeit rather complex, mechanism laid down in the directive and the absence of any similar *de minimis* provisions allowing Member States to refuse the right of deduction in cases of limited private use, there are no grounds for construing Article 17 as implicitly containing such a rule. That view is supported by the text of the abovementioned Council decision of 28 July 1989, in which the Council, 'by way of derogation from the provisions of Article 17(2)', permitted France to refuse to allow deduction in cases where private use exceeded 90%. Moreover, as I shall explain later, Article 27(1) of the Sixth Directive, under which that decision was adopted, enables the type of problem encountered by the German tax authorities to be remedied.

62. I conclude that Member States are not entitled to limit the right of deduction, even where business use of the goods in question is very limited, unless they can rely on one of the derogations contained in the directive. It is to those derogations that I now turn.

Authority to derogate from the right of deduction

63. Article 27 of the Sixth Directive, which forms part of Title XV ('Simplification procedures'), contains two procedures for the authorization of measures derogating from the directive, both of which are in principle capable of applying to the contested national legislation.

64. Article 27(5) provides that:

'Those Member States which apply on 1 January 1977 special measures of the type referred to in paragraph 1 above may retain them providing they notify the Commission of them before 1 January 1978 and providing that where such derogations are designed to simplify the procedure for charging tax they conform with the requirement laid down in paragraph 1 above.'

65. Article 27(1), which lays down a procedure for obtaining authorization for new measures, provides:

'The Council, acting unanimously on a proposal from the Commission, may authorize any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance. Measures intended to simplify the procedure for charging the tax, except to a negligible extent, may not affect the amount of tax due at the final consumption stage.'

66. It does not appear that the German measure was notified under Article 27(5). In Annex 1 of its First Report dated 14 September 1983 on the application of the common VAT system submitted in accordance with Article 34 of the Sixth Directive (COM(83) 426 final), the Commission published a list of measures notified to it under Article 27(5). In that annex there is no mention of the 10% rule at issue in this case. Nor has the German Government suggested that such notification was given.

67. As regards Article 27(1), it is apparent from the German Government's reply to the Court's written question that it did not seek authorization under that provision because, in its view, the contested legislation does not derogate from the directive. As I have explained, I consider that view to be incorrect.

68. It is therefore necessary to consider the effect of failure to notify a derogating measure. In Case 5/84 *Direct Cosmetics* v *Commissioners of Customs & Excise* [1985] ECR 617, the Court said that:

'By virtue of the third paragraph of Article 189 of the Treaty, Member States are bound to observe all the provisions of the Sixth Directive in so far as a derogation has not been established in accordance with Article 27. The tax authorities of a Member State may not therefore rely, as against a taxable person, on a provision derogating from the scheme of the directive and enacted in breach of the duty of notification imposed on Member States by Article 27(2) without disregarding that Member State's obligation under Article 189' (paragraph 37).

69. Since the measure in question in these proceedings was neither notified to the Commission under Article 27(5) nor authorized by a Council decision under Article 27(1), the German Government may not rely on that measure to the detriment of taxable persons.

70. Consequently, it is not, strictly speaking, necessary to consider whether such a measure would be capable of authorization under Article 27(1). However, if that provision were to constitute an appropriate basis for authorizing national rules such as those at issue in the main action, this would support the view that such rules should be regarded as derogating from Article 17, as I consider to be the case. I will therefore

comment briefly on the scope of Article 27(1).

71. In my view, Article 27(1) is designed to cover, *inter alia*, problems of the kind encountered by the French and German tax authorities. The general rules of the Sixth Directive, including the right of full and immediate deduction and the mechanism for dealing with private use, are intended to reconcile the interests of administrative simplicity with the objectives of the common VAT system, in particular that of neutrality. It would clearly have been difficult, if not impossible, to envisage all the technical difficulties or forms of avoidance or evasion which the tax authorities throughout the Community might encounter. Moreover, a Community approach may not be appropriate if the commercial practice in question is producing significant distortions in one Member State only. It was therefore appropriate to allow Member States to seek individual authorization for measures dealing with particular problems.

72. Difficulties may also arise from the fact that certain matters were left unresolved by the Sixth Directive, which results in a certain lack of coherence in the VAT system in its current form. For example, it would seem that the difficulties encountered by the German tax authorities might have been partly reduced if the Council had adopted the proposal for the Twelfth Directive on the harmonization of laws of the Member States relating to turnover taxes — Common system of value added tax: expenditure not eligible for deduction of value added tax (Official Journal 1983 C 37, p. 8; Official Journal 1984 C 56, p. 7). Under that proposal, deduction of input tax on a number of major categories of expenditure whose use for business purposes is difficult to verify would have been specifically disallowed, thus restricting the categories of expenditure to which the general mechanism for private use applied.

73. In the particular case of motor cars, a number of Member States other than Germany in fact retained rules under Article 17(6) (which I shall consider later in this Opinion) restricting wholly or in part the deductibility of input tax on business purchases of motor vehicles. If, notwithstanding the existing provisions, full deduction in marginal cases continued to represent a general problem for tax authorities, it might be appropriate to consider an amendment to the general scheme of the directive. In its Second Report of 20 December 1988 on the application of the common VAT system (COM(88) 799 final) the Commission, at p. 57, in fact expressed its preference for a Community approach to resolving problems encountered by Member States rather than the use of the Article 27 procedure. This would prevent a proliferation of individual authorizations under Article 27(1), thereby allaying a concern expressed by the German Government in these proceedings. However, in the absence of a Community solution, Article 27(1) is in my view an appropriate instrument for resolving some of the problems referred to above. One of the essential features of the procedure laid down by that provision is

that it ensures that the Community authorities and the Member States are kept fully informed of measures to be taken.

74. There can be no doubt that the difficulties mentioned by the French and German Governments are a source of legitimate concern for national tax authorities. Moreover, a measure subjecting the right of deduction to a threshold of 10% business use does not, on the face of it, seem unreasonable or disproportionate to the aims in view. In that connection it should be noted that, in its observations, the French Government indicated that, under the French rules, the fact that the deduction of input tax is initially disallowed under the 10% rule does not preclude subsequent adjustment under Article 20(2) in later years if there is more substantial business use. In my view, it was entirely appropriate that France should restrict the scope of the derogation in that way, since it seems questionable whether the refusal of subsequent adjustments under Article 20(2) would have been necessary to attain the aims of the measure. However, it does not seem necessary to consider this point further in the context of these proceedings since, in the absence of a Council decision authorizing the measure, the German Government cannot rely on Article 27(1).

75. Reference should also be made to the last sentence of Article 6(2) of the Sixth Directive which, as I have already mentioned, permits Member States to derogate from the private use mechanism laid down in that paragraph, provided that any such derogation does not lead to distortion of competition. In my view, Member States may not rely on that sentence to justify national rules which do not merely replace the output tax mechanism with a restriction on the right to deduct input tax, but which also prevent the deduction of input tax incurred on genuine business expenditure.

76. There is a further provision which falls to be considered in this context, namely Article 17(6) of the Sixth Directive. That provision reads as follows:

'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.'

77. Notwithstanding the fact that the Commission, as long ago as 25 January 1983, submitted to the Council the abovementioned proposal for a Twelfth

Directive with a view to harmonizing disallowable expenditure, the Council has not yet acted.

78. In its written observations, the French Government suggests that a measure such as that notified by France under Article 27(1) of the directive could have been retained under Article 17(6) by Member States having such legislation at the time when the directive came into force. I do not consider, however, that Article 17(6) is capable of justifying retention of such a rule. At first sight, the scope of the expression 'all exclusions provided for under their national laws' in the second subparagraph of Article 17(6) appears sufficiently wide to encompass even general restrictions on the right of deduction. However, a reading of the first subparagraph suggests that the discretion retained by Member States relates more specifically to the matters upon which agreement could not be reached, namely the categories of expenditure in respect of which an input tax restriction was appropriate. Support for that view is to be derived from the proposal for the Sixth Directive, referred to above, which contained a provision (also Article 17(6)) defining precise categories of expenditure in respect of which input tax was disallowable, and from the proposal for the Twelfth Directive, which again defines non-deductible expenditure by reference to categories of expenditure.

79. Moreover, as a measure derogating from a fundamental principle of the common VAT system, namely the right of deduction, Article 17(6) falls to be strictly construed. In my view, therefore, Article 17(6) was not capable of justifying the retention of a general measure, applicable to all categories of expenditure, designed to overcome the administrative difficulties of verifying whether there was genuine business use in marginal cases.

80. Finally, for the sake of completeness, I should mention two other provisions of the Sixth Directive. First, Article 20(4) of the Directive provides that Member States may:

'— adopt any suitable measures with a view to ensuring that adjustment does not involve any unjustified advantage,

— permit administrative simplifications.'

81. Secondly, Article 22(8) provides that:

'Without prejudice to the provisions to be adopted pursuant to Article 17(4), Member States may impose other obligations which they deem necessary for the correct levying and collection of the tax and for the prevention of fraud.'

82. In my view, a measure such as the German rule may not be based on either of these provisions. Article 20(4) applies solely to adjustment under Article 20 of deductions which have already been made

and does not concern the general right of deduction under Article 17. The German measure is intended to remedy difficulties arising from the application of the general right of deduction under Article 17(2) rather than from the capital goods adjustment rules enacted under Article 20(2). Secondly, with regard to the proviso concerning administrative simplifications, a Member State may not rely on a provision empowering it to permit administrative simplifications to justify a measure limiting a person's right of deduction. Article 22, which is entitled 'Obligations under the internal system' and is contained in Title XIII ('Obligations of persons liable for payment'), is confined to the administrative and accounting obligations incumbent upon taxable persons. Thus, the 'other obligations' which Member States may impose under Article 22(8) are limited to obligations of that type.

Conclusion

83. Accordingly, I am of the opinion that the questions referred by the Munich Finance Court should be answered as follows:

(1) (a) Article 20(2) of the Sixth VAT Directive applies only where a person acquires capital goods in his capacity as a taxable person, that is to say, with the specific intention of using the goods for the purposes of his economic activity within the meaning of Article 4 of the directive.

(b) Whether, in a particular case, a taxable person has such an intention is a question of fact to be determined by the national authorities having regard to all the circumstances of the case, including the nature of the goods concerned and the period between the acquisition of the goods and their use for the purpose of the taxable person's business.

(2) A taxable person who uses goods for the purposes of an economic activity has the right on the acquisition of those goods to deduct input tax in accordance with the rules laid down in Article 17, however small the proportion of business use. A rule or administrative practice imposing a general restriction on the right of deduction in cases where there is limited, but none the less genuine, business use constitutes a derogation from Article 17 of the Sixth Directive and is valid only if the procedural and substantive requirements of Article 27(1) or Article 27(5) of the directive are met.