JUDGMENT OF THE COURT (Fifth Chamber)

14 June 2001 *

In Case C-345/99,

Commission of the European Communities, represented by E. Traversa and H. Michard, acting as Agents, with an address for service in Luxembourg,

applicant,

v

French Republic, represented initially by K. Rispal-Bellanger and S. Seam, and, subsequently, J.-F. Dobelle and S. Seam, acting as Agents, with an address for service in Luxembourg,

defendant,

* Language of the case: French.

supported by

United Kingdom of Great Britain and Northern Ireland, represented by G. Amodeo, acting as Agent, assisted by G. Barling QC, with an address for service in Luxembourg,

intervener,

APPLICATION for a declaration that, by applying to vehicles used by taxable persons carrying on the activity of driving instructors the condition that, in order for such persons to be able to exercise their right to deduct the value added tax charged on the initial acquisition of those vehicles, they must be used exclusively for that activity, the French Republic has failed to fulfil its obligations under Article 17(2) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1), in the version resulting from Council Directive 95/7/EC of 10 April 1995 amending Directive 77/388 and introducing new simplification measures with regard to value added tax — scope of certain exemptions and practical arrangements for implementing them (OJ 1995 L 102, p. 18),

THE COURT (Fifth Chamber),

composed of: A. La Pergola, President of the Chamber, D.A.O. Edward, P. Jann, S. von Bahr (Rapporteur) and C.W.A. Timmermans, Judges,

Advocate General: L.A. Geelhoed,
Registrar: R. Grass,

having regard to the report of the Judge-Rapporteur,

after hearing the Opinion of the Advocate General at the sitting on 22 February 2001,

gives the following

Judgment

1 By application lodged at the Court Registry on 17 September 1999, the Commission of the European Communities brought an action under Article 226 EC for a declaration that, by applying to vehicles used by taxable persons carrying on the activity of driving instructors the condition that, in order for such persons to be able to exercise their right to deduct the value added tax (hereinafter 'VAT') charged on the initial acquisition of those vehicles, they must be used exclusively for that activity, the French Republic has failed to fulfil its obligations under Article 17(2) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1), in the version resulting from Council Directive 95/7/EC of 10 April 1995 amending Directive 77/388 and introducing new simplification measures with regard to value added tax — scope of certain exemptions and practical arrangements for implementing them (OJ 1995 L 102, p. 18, hereinafter 'the Sixth Directive').

2 By order of the President of the Court of 24 March 2000, the United Kingdom of Great Britain and Northern Ireland was granted leave to intervene in support of the form of order sought by the French Republic.

The Community legislation

3 Article 17(2)(a) of the Sixth Directive provides:

'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.'

4 Article 17(6) of the Sixth Directive provides:

'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.'

5 None of the proposals put to the Council by the Commission under the first subparagraph of Article 17(6) of the Sixth Directive was adopted by the Council.

The French legislation

6 On 1 January 1979, the date of entry into force of the Sixth Directive, all private vehicles were excluded generally from the right to deduct VAT under French legislation.

7 As of 1 January 1993, the French VAT regime was amended so as to grant a right to deduction in respect of certain vehicles or machines.

8 In that regard, Article 273fA of the code général des impôts (General Taxation Code) in the version resulting from Act 91-716 of 26 July 1991 (JORF of 27 July 1991, p. 9955, hereinafter 'the General Taxation Code'), provides:

'The value added tax charged on purchases, imports, intra-Community acquisitions, supplies and services effected as of 1 January 1993 is no longer excluded from the right to deduction in respect of vehicles or machines used exclusively for driving instruction.'

Facts and pre-litigation procedure

9 The Commission claims that the requirement of exclusive use for driving instruction laid down in Article 273fA of the General Taxation Code, is incompatible with Article 17(2) of the Sixth Directive, which provides for a right to deduct the input tax for which a taxable person is liable, subject to no condition other than that the goods and services be used for the purposes of that person's taxable transactions.

10 By letter of 18 June 1998, the Commission gave the French Government formal notice that it should submit its observations within two months.

11 The French authorities replied to that letter of formal notice by letter of 13 October 1998, stating that they did not share the Commission's view: a

Member State which wishes to limit the extent of a national exclusion from a right to deduct, in accordance with Community law under Article 17(6) of the Sixth Directive, is entitled to define the cases in which that exclusion is no longer to be applied.

12 As it did not agree with the position of the French Government, the Commission sent a reasoned opinion to the French Republic on 10 March 1999 calling upon it to adopt the requisite measures in order to comply with that opinion within two months.

13 By letter of 1 June 1999, the French authorities reiterated their point of view and informed the Commission that they did not intend to take any action in response to the reasoned opinion.

14 In those circumstances, the Commission decided to initiate the present proceedings.

The alleged failure to fulfil obligations and the findings of the Court

15 According to the Commission, Article 17(6) of the Sixth Directive merely authorises Member States to retain all national provisions excluding the deductibility of VAT existing on the date of entry into force of that directive, that is to say on 1 January 1979. It does not, however, authorise amendments to such exclusions by the subsequent introduction of a right to deduction subject to conditions. If a Member State amends its legislation subsequently, it can do so only in accordance with the provisions of Article 17(2) of the Sixth Directive, in other words by introducing a right to deduct VAT subject to no condition other than that the goods and services be used for the purposes of the taxable transactions of the taxable person.

16 The Commission argues that it is not for a Member State itself to lay down the rules applicable in respect of the right to deduct VAT. Only the Community legislature has competence to do so. The condition imposed by the French Republic on the right to deduction, that is to say that a vehicle be used exclusively for driving instruction, is outside the remit of the Sixth Directive. If a Member State considers it necessary to set up special regimes, it should use the procedures established under Article 27 of the Sixth Directive and request authorisation to introduce a special derogation in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance. The French Republic failed to do so in the present case.

17 The French Government, supported by the United Kingdom Government, contends that the national provision at issue does not introduce a new exclusion regime, which would be prohibited by Article 17(6) of the Sixth Directive, but is merely a derogation from an existing exclusion. As the original total exclusion from the right to deduct VAT in respect of vehicles used for driving instruction was consistent with Article 17(6) of the Sixth Directive, it follows, as a matter of logic, that the authorisation of a right to deduct such VAT under certain conditions is also consistent with Community law.

18 It should be borne in mind that Article 17(2) of the Sixth Directive sets out in express and specific terms the principle of the right to deduct the amounts invoiced as VAT for goods supplied or services rendered to a taxable person, in so far as such goods or services were used for the purposes of that person's taxable transactions.

19 The principle of the right to deduct VAT is none the less subject to the derogation in Article 17(6) of the Sixth Directive and, in particular, its second subparagraph. The Member States are thereby authorised to retain their existing legislation in regard to exclusion from the right of deduction until such time as the Council has

adopted the provisions envisaged by that article (Case C-305/97 *Royscot and Others* [1999] ECR I-6671, paragraph 29).

20 However, since none of the proposals put to the Council by the Commission under the first subparagraph of Article 17(6) of the Sixth Directive was adopted by the Council, it should be pointed out that the Member States may retain their existing legislation in regard to exclusion from the right to deduct VAT until such time as the Community legislature has established a Community system of exclusions and brought about the progressive harmonisation of national VAT legislation (*Royscot and Others*, cited above, paragraph 31).

21 In order to assess whether the amendment of the national legislation at issue is compatible with the provisions of the Sixth Directive, reference should be made to the judgment in Case C-136/97 *Norbury Developments* [1999] ECR I-2491, which concerned another transitional provision of the Sixth Directive, namely Article 28(3)(b) concerning VAT exemptions. In that judgment, the Court held that amendments made to the legislation of a Member State which did not increase the scope of VAT exemption but, rather, reduced it, did not breach the terms of that article. Whilst that article precludes the introduction of further exemptions or an increase in the scope of exemptions existing before the entry into force of the Sixth Directive, it does not prevent their reduction, since their abolition is the objective of Article 28(4) of the Sixth Directive (see *Norbury Developments*, cited above, paragraph 19).

22 The same reasoning can be applied in the interpretation of Article 17(6) of the Sixth Directive. Thus, where the legislation of a Member State, after the entry into force of the Sixth Directive, is amended so as to reduce the scope of existing exemptions and thereby brings itself into line with the objective of the Sixth Directive, that legislation must be considered to be covered by the derogation provided for by the second subparagraph of Article 17(6) of the Sixth Directive and is not in breach of Article 17(2).

23 In the present case, the national legislative amendment replaces a total exclusion of private cars from the right to deduct VAT with authorisation for partial deduction, that is to say in respect of vehicles and machines used exclusively for driving instruction.

24 It follows that the amendment so made to the French legislation has the effect of reducing the scope of existing exemptions and bringing that legislation into line with the general regime of deduction set out in Article 17(2) of the Sixth Directive.

25 Accordingly, it must be held that by applying to vehicles used by taxable persons carrying on the activity of driving instructors the condition that, in order for such persons to be able to exercise their right to deduct the VAT charged on the initial acquisition of those vehicles, they must be used exclusively for that activity, the French Republic has not failed to fulfil its obligations under Article 17(2) of the Sixth Directive. Consequently, the action for failure to fulfil obligations must be dismissed as unfounded.

Costs

26 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the French Republic has applied for the Commission to be ordered to pay the costs and the Commission has been unsuccessful, it must be ordered to pay the costs. Furthermore, in accordance with the first paragraph of Article 69(4) of the Rules of Procedure, Member States and institutions which intervene in proceedings are to bear their own costs.

On those grounds,

THE COURT (Fifth Chamber),

hereby:

1. Dismisses the application;

2. Orders the Commission of the European Communities to pay the costs;

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

La Pergola Edward Jann

von Bahr Timmermans

Delivered in open court in Luxembourg on 14 June 2001.

R. Grass

Registrar

A. La Pergola

President of the Fifth Chamber