JUDGMENT OF THE COURT (Fifth Chamber)

14 June 2001 *

In Case C-40/00,

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

applicant,

v

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

defendant,

APPLICATION for a declaration that by reintroducing from 1 January 1998 a total prohibition on the right to deduct value added tax on diesel used as fuel for

* Language of the case: French.

vehicles on the purchase of which no value added tax is deductible after having, on several occasions, introduced a partial right to deduct 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 11 February 2000, the Commission of the European Communities brought an action under Article 226 EC for a declaration that by reintroducing from 1 January 1998 a total prohibition on the right to deduct value added tax (hereinafter 'VAT') on diesel used as fuel for vehicles on the purchase of which no VAT is deductible, after having, on several occasions, introduced a partial right to deduct, 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').

The Community legislation

2 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.'

3 Article 17(6) 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.'

4 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

5 From 1 January 1979, the date of entry into force of the Sixth Directive, until 30 June 1982, diesel used as fuel for the operation of vehicles and machines on the purchase of which no VAT was deductible was excluded from the right to deduct VAT.

6 Between 1982 and 1991, that prohibition on the deduction of VAT underwent several changes. The authorised rate of deduction was increased gradually from 10% in 1982 to 90% in 1991; it was reduced to 50% during the course of 1991.

7 The right to deduct VAT charged on diesel used as fuel for the operation of vehicles or machines on the purchase of which no VAT was deductible was again

abolished completely from 1998. In that regard, Article 15 of Act No 97-1269 of 30 December 1997, adopting the finance law for 1998 (JORF of 31 December 1997, p. 19261), amended Article 298(4)(1) of the code général des impôts (General Taxation Code) as follows:

'There shall be no deduction of value added tax on purchases, imports, intra-Community acquisitions and supplies of and services relating to:

— ...

— the diesel used as fuel listed in Table B of Article 265 of the General Taxation Code used for vehicles and machines excluded from the right to deduct and for hired vehicles and machines where the hirer cannot deduct the tax charged on the hire, apart from those used for testing for the purposes of the manufacture of engines or motorised machines;

...'

Facts and pre-litigation procedure

8 Taking the view that the re-introduction of an exclusion from the right to deduct VAT was incompatible with Article 17(2) of the Sixth Directive, the Commission

initiated proceedings for failure to fulfil obligations, by sending, on 24 July 1998, a letter of formal notice to the French Republic asking it to submit its observations within two months.

9 On 30 October 1998 the French authorities replied to that letter of formal notice stating that they did not share the Commission's point of view. The French authorities essentially argued that they were free to make changes to the right to deduction provided they did not extend the limitation that existed on the date of entry into force of the Sixth Directive in France, that is to say on 1 January 1979.

10 The Commission sent a reasoned opinion to the French Republic on 19 July 1999.

11 The French authorities did not comply with the reasoned opinion within the prescribed period and, on 10 December 1999, sent a reply in which they maintained their position.

12 It is against that background that the Commission brought this action.

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

13 The Commission submits that the French legislation at issue which reintroduces an exclusion from the right to deduct VAT charged on diesel used as fuel for vehicles and machines on the purchase of which no VAT is deductible is not

covered by the derogation provided for by Article 17(6) of the Sixth Directive and is in breach of Article 17(2) of that directive. The Commission argues that Article 17(6) does not allow a Member State subsequently to revive a system of derogations which has been abandoned, albeit partially, by reintroducing a total exclusion from the right to deduct VAT on certain expenses. Contrary to the contentions of the French authorities, the Member States do not have full discretion to adapt and change, according to their own criteria, a national system of derogations subject only to the proviso that they do not adversely affect the position obtaining at the time of the entry into force of the Sixth Directive.

14 According to the French Government, Article 17(6) of the Sixth Directive does not preclude a Member State's amending the exclusions existing on the date of entry into force of that directive provided that those amendments do not increase the rate of exclusion beyond the proportion initially set or extend existing exclusions to categories of goods or services not affected at the time of such entry into force. The legislation at issue is therefore compatible with the Sixth Directive.

15 Moreover, the French Government contends that the legislative amendment at issue was made for environmental reasons. It also contends that the Commission had been informed of previous measures which had the effect of reducing the authorised rate of deduction of VAT for the fuel concerned and that those measures elicited no comment from the Commission, which created the impression that they were consistent with the Sixth Directive.

16 According to the judgment delivered today in Case C-345/99 *Commission* v *France* [2001] ECR I-4493, paragraph 22, where, after the entry into force of the Sixth Directive, the legislation of a Member State 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 is 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).

17 On the other hand, national legislation does not constitute a derogation permitted by the second subparagraph of Article 17(6) of the Sixth Directive if its effect is to inrease, after the entry into force of the Sixth Directive, the extent of existing exclusions, thus diverging from the objective of that directive.

18 The same is true of any amendment subsequent to the entry into force of the Sixth Directive which increases the extent of exclusions applicable immediately before that amendment.

19 It is common ground that the French law at issue, in excluding altogether a right to deduct VAT, amends the French legislation in such a way as to diverge from the objective of the Sixth Directive. It is of little importance that the amendment does not extend the scope of the exclusions that applied when the directive came into force.

20 Accordingly, that law is not covered by the derogation provided for in the second subparagraph of Article 17(6) and so breaches Article 17(2) of that directive.

21 The argument of the French Government that the legislation at issue was adopted for environmental reasons cannot justify legislation which breaches the Sixth Directive.

22 The French Government also seeks to justify the legislation at issue by pointing out that the Commission failed to take action against the French Government at the time of previous legislative amendments reducing the authorised rate of deduction of VAT charged on diesel used as fuel for vehicles and machines on the purchase of which no VAT is deductible.

23 However, according to settled case-law, it is for the Commission to judge at what time it will bring an action for failure to fulfil obligations (see *inter alia* Case C-317/92 *Commission* v *Germany* [1994] ECR I-2039, paragraph 4).

24 Accordingly, it must be held that by reintroducing from 1 January 1998 a total prohibition on the right to deduct value added tax on diesel used as fuel for vehicles on the purchase of which no value added tax is deductible, after having introduced a partial right to deduct, the French Republic has failed to fulfil its obligations under Article 17(2) of the Sixth Directive.

Costs

25 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 Commission has applied for the French Republic to be ordered to pay the costs and the latter has been unsuccessful, it must be ordered to pay the costs.

On those grounds,

THE COURT (Fifth Chamber),

hereby:

1. Declares that by reintroducing from 1 January 1998 a total prohibition on the right to deduct value added tax on diesel used as fuel for vehicles on the purchase of which no value added tax is deductible, after having introduced a partial right to deduct, 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, 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.

2. Orders the French Republic to pay the 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