OPINION OF ADVOCATE GENERAL JACOBS

delivered on 14 December 2000 [1]

1. In the present two cases the German Bundesfinanzhof (Federal Finance Court) requests the Court to interpret Articles 5(6), 5(7)(c), 11(A)(1)(b) and 20(1)(b) of the Sixth VAT Directive. [2]

The relevant provisions of the Directive

2. Under Article 5(6) of the Directive VAT is to be paid on the application by a taxable person of goods forming part of his business assets for his private use. That charge to tax is however subject to the condition that 'the value added tax on the goods in question or the component parts thereof was wholly or partly deductible'.

3. At issue in the present cases is the tax treatment of the application by a trader of a motor car for his private use where, although he initially acquired the car without being able to deduct input tax, he subsequently deducted tax on the expenditure incurred in connection with improvements to or the maintenance or use of the car in question.

4. Article 2 of the Directive subjects to VAT supplies of goods or services for consideration by a taxable person acting as such.

5. According to Article 5(6) 'shall be treated' as supplies made for consideration

'[t]he 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...'.

1 — Original language: English.

2 — Sixth Council Directive of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover tax — Common system of value added tax: uniform basis of assessment, OJ 1977 L 145, p. 1.

6. Article 6(2)(a) contains a similar rule:

'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...'

7. Article 5(7)(c) allows Member States to adopt a supplementary provision.

'Member States may treat as supplies made for consideration:

...

(c) ... the retention of goods by a taxable person or his successors when he ceases to carry out a taxable economic activity where the value added tax on such goods became wholly or partly deductible upon their acquisition... .'

8. Article 11(A)(1)(b) defines the taxable amount in respect of the supplies referred to in Article 5(6) and 5(7). That taxable amount 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 as [at] the time of supply'.

9. Under Article 20(1)(b) the initial deduction is to be adjusted where after the return is made some change occurs in the factors used to determine the amount to be deducted.

10. The purpose of Article 5(6) of the Directive is to ensure equal treatment as between a taxable person who applied goods forming part of the assets of his business for private use and an ordinary consumer who bought goods of the same type. In pursuit of that objective that provision prevents a taxable person who has been able to deduct VAT on the purchase of goods used for his business from escaping the payment of VAT when he applies those goods for his private use and from thereby enjoying advantages (resulting from the right of deduction) to which he is not entitled by comparison with an ordinary consumer who buys goods and pays VAT on them. [3]

3 — Case C-20/91 *De Jong* v *Staatssecretaris van Financiën* [1992] ECR I-2847.

11. It follows from the system and the wording of the Directive that Article 5(6) creates a deemed (fictitious) supply of goods and concerns the outright transfer of goods out of the business. The parallel provision of Article 6(2)(a) creates by contrast a deemed supply of services and concerns the private use of goods which continue to form part of the business. [4]

German legal background

12. The main proceedings concern the years 1991 and 1992 and are thus governed by the Umsatzsteuergesetz (Turnover Tax Law) 1991. Paragraph 1(1)(2) thereof subjected the private use of goods and services (*Eigenverbrauch*) to tax. Paragraph 1(1)(2)(a) defined as one of the cases of *Eigenverbrauch* the application (*Entnahme*) of business goods for other than business purposes.

13. The applicable German law was thus in substance similar to Article 5(6) of the Directive, with one exception: Article 5(6) subjects the charge to tax to the condition that 'the value added tax on the goods in question or the component parts thereof was wholly or partly deductible' whilst the applicable German law did not contain such a condition.

14. Despite that difference the German authorities applied the condition in question on the basis of the direct effect of Article 5(6). The transfer of a business car to private use was, for example, not taxed where the car had been acquired without deduction of tax from a private individual. [5]

15. In that connection the question arose whether Article 5(6) allowed taxation where the trader in question, after the initial non-deductible acquisition, deducted tax on expenses incurred in connection with improvements to or the maintenance or use of the goods transferred to private use. At the centre of that debate was the meaning of the concept of 'component parts' in Article 5(6) of the Sixth Directive.

16. On that issue the Federal Ministry of Finance published on 13 May 1994 a

4 — See my Opinion in Case *De Jong* v *Staatssecretaris van Financiën*, cited in note 3, at paragraph 5.

5 — The German legislation has in the meantime been modified and now expressly subjects the taxation of the transfer by a trader of business goods to non-business purposes to the condition that the input tax on the goods in question or the component parts thereof was wholly or partly deductible: see Paragraph 3(1b) of the Umsatzsteuergesetz in its amended version.

notice [6] which rapidly became known as the windscreen-wiper decree (*Scheibenwischererlass*). The notice lays down the following principles. If the trader was entitled to deduct VAT not in respect of the goods themselves but for component parts added later, the transfer of the goods to non-business use is subject to VAT. For the sake of simplicity a transfer of goods to non-business use may not be subject to VAT where the expenditure (net of VAT) on improvements to and repairs, maintenance and care of the goods transferred does not exceed 20% of the initial cost of acquisition. If such expenditure exceeds 20% of the initial cost of acquisition, it can be assumed without further investigation that components have been added to the goods. As examples of the expenditure to be taken into account the notice mentions expenditure on the inspection of a car, on a car wash, for the replacement of the clutch and of the brake-shoes, and on the acquisition of new windscreen-wiper blades. [7]

17. The Bundesfinanzhof held by contrast in a judgment of 30 March 1995 [8] that expenditure on the maintenance or the use of goods which gave rise to deduction cannot affect the taxation of the application for private use of the goods themselves. That was because expenditure on the maintenance or the use of goods did not in general lead to the acquisition or the creation of 'component parts' of goods within the meaning of Article 5(6) of the Directive. In its judgment the Bundesfinanzhof referred extensively to the Court's judgment in *Kühne*. [9] In that case the Court held that no charge to tax arose under Article 6(2)(a) in respect of private use by a taxable person of a motor car acquired second-hand without deduction of tax from a private individual, notwithstanding the fact that the taxable person had deducted tax on the costs incurred in connection with the maintenance and use of the goods. The tax rules applicable to the supply of business goods were to be distinguished from those concerning the taxable expenses incurred for their use and maintenance.

The main proceedings and the questions referred

Case C-322/99

18. Mr Fischer operated a business dealing in second-hand (vintage) cars. In 1989 he purchased for his business an 'RR-Bentley' at a price of DEM 28 000 from a private vendor and thus without the possibility of deducting input tax. In 1990 he had extensive repairs to the bodywork and respraying work carried out for which he paid DEM 10 800 plus DEM 1 512 VAT. He applied to deduct the VAT included in

6 — BStBl. 1994 I, p. 298.

7 — A recent notice from the Federal Ministry of Finance of 8 June 1999 no longer contains that 'simplification' rule: BStBl. 1999 I, p. 581.

8 — BFHE 177, 541.

9 — Case 50/88 *Kühne* v *Finanzamt München III* [1989] ECR 1925.

that invoice. On 31 December 1992 he ceased trading and transferred some of the unsold vintage cars, including the 'RR-Bentley', to his private assets.

19. The Finanzamt (Tax Office) Burgdorf ruled the transfer of the Bentley to be a transfer of business assets to private use which was subject to tax. It used as the basis of assessment the *Teilwert* (notional value) of DEM 20 000 and accordingly levied VAT of DEM 2 800.

20. Mr Fischer, relying on Article 5(6) of the Directive, lodged an official complaint and then brought a successful action before the Finanzgericht (Finance Court).

21. In its appeal to the Bundesfinanzhof the Finanzamt pleads breach of Paragraph 1(1)(2)(a) of the Umsatzsteuergesetz 1991 and, in doing so, relies on the following arguments. Under Article 5(6) of the Directive a transfer to private use may be subject to tax where the value added tax on the goods in question or the component parts thereof was wholly or partly deductible. Even if Mr Fischer did not claim deduction of tax on the purchase of the car, he did so in respect of the extensive bodywork repairs and respraying work carried out. According to the case-law of the Bundesfinanzhof, expenditure on the maintenance and use of goods does not lead to 'component parts thereof' within the meaning of Article 5(6). The underlying assumption is that such expenditure is usually consumed during the course of the business use of the goods and does not therefore result in any final consumption at the moment of the transfer to private use. That is not so in the case of measures which result in a lasting increase in the value of the goods (and thus of their value when transferred to private use). They should be treated as tax-deductible component parts which have been added to the goods. In such cases the system requires that the transfer of the goods to private use be subject to tax to prevent their final consumption from being free of tax. In the present case the extensive work on the car is equivalent to subsequent acquisition and manufacturing costs and therefore justifies taxation of the transfer of the 'RR-Bentley' to Mr Fischer's private use.

22. The Bundesfinanzhof referred the following questions for a preliminary ruling:

'(1) Do subsequent bodywork repairs and respraying work (on which VAT was deducted) carried out on a car (on the acquisition of which VAT was not deductible) mean, on application of the car for private use,

(a) that the car must be viewed as *goods* on which VAT was *partly* deductible under Article 5(6) of the Directive, or

(b) that the subsequent expenditure is to be viewed as *component parts*, on which VAT was deductible, of the goods?

(2) If Question (1) is answered in the affirmative, what are the business goods applied for private use which are to be taxed under Article 5(6) of the Directive:

(a) the car including the work carried out on it (bodywork repairs and respraying) or

(b) only the work carried out (bodywork repairs and respraying)?

(3) If Question (2) is answered in the affirmative: Is the basis of assessment under Article 11A(1)(b) of the Directive therefore the purchase price of the car (or an equivalent car) together with the cost of the repairs each determined as at the time of application for private use, or only the price of the repairs carried out (on which VAT was deducted)?

(4) What is the relationship between Article 5(6) and Article 5(7)(c) of the Directive?

(5) If the answer to Question (1) is to the effect that the subsequent (tax-deductible) work carried out (bodywork repairs and respraying) is not subject to tax on application of the goods (car) for private use under Article 5(6) of the Directive, is the deduction of input tax on these services to be adjusted under Article 20(1)(b) of the Directive?'

Case C-323/99

23. Mr Brandenstein is a self-employed tax adviser and auditor. On 8 November 1985 he purchased a car from a private vendor for DEM 33 600. There was no separate statement of VAT in the invoice. Until 1991

the car was exclusively part of Mr Brandenstein's business assets. During that period he spent a total of DEM 16 028.54 (including VAT) on servicing, minor repairs, changing tyres, the installation of a catalytic converter in 1987 and the replacement of the windscreen in 1991. In each case he claimed deduction of input tax. In 1991 he transferred the car to his private use.

24. In its VAT notice for 1991, the Finanzamt Düsseldorf-Mettmann deemed the transfer of the car to private use to be taxable under Paragraph 1(1)(2)(a) of the Umsatzsteuergesetz 1991. It used as the basis of assessment the sum which the plaintiff had declared as the value of the transfer to private use for the purposes of tax on profits (DEM 7 500) and levied VAT of DEM 1 050.

25. Mr Brandenstein lodged an official complaint and argued that the transfer to private use of business goods, on the purchase of which VAT was not deductible, should not be taxed. In support of his argument he referred to Court's judgment in *Kühne*[10] and to the case-law of the Bundesfinanzhof.

26. The Finanzamt dismissed the complaint. It referred to the notice from the Federal Ministry of Finance of 13 May 1994.[11] The transfer of the car to private use was subject to VAT because the expenditure (net of VAT) on improvements, repairs, maintenance and care amounted to more than 20% of the initial costs of acquisition of DEM 33 600.

27. The action brought by Mr Brandenstein before the Finanzgericht (Finance Court) against that decision was successful. In the grounds of its judgment, the Finanzgericht stated that the requirements for not being subject to tax under Article 5(6) of the Sixth Directive were met because Mr Brandenstein's expenditure on the car whilst it formed part of his business assets neither altered nor extended its potential use, nor substantially increased its value.

28. In its appeal on a point of law before the Bundesfinanzhof the Finanzamt essentially argues that Mr Brandenstein either added to the car 'component parts' within the original meaning of that expression which — at least in part — were not consumed before the transfer to private use, or independently (or additionally) acquired 'goods'. According to the Finanzamt 'component parts' are parts of a natural ensemble (*natürliche Sacheinheit*) or of a composite object which have lost their self-standing distinctiveness (*Selbstän-*

10 — Cited in note 9.

11 — See paragraph 16 above.

digkeit) through combination with one another.

29. The Bundesfinanzhof referred the following questions for a preliminary ruling:

'1. Is [Article 5(6) of the Sixth Directive] applicable where, although VAT on the goods themselves was not deductible, VAT was deductible on the services or supplies which the taxable person ordered or received in respect of those goods after their acquisition?

2. What does the term "component parts" mean in the context of this provision?

3. How is the basis of assessment to be determined for an application of business assets for private use, where VAT is wholly or partly deductible, not on the goods disposed of, but on some of their components?

4. Is the deduction of input tax which a taxable person has claimed in respect of services or supplies for goods on the purchase of which VAT was not deductible to be adjusted under Article 20 of Directive 77/388/EEC if the first sentence of Article 5(6) of Directive 77/388/EEC is not applicable?'

30. Cases C-322/99 and C-323/99 were joined for the purposes of the oral hearing and the judgment by order of 6 July 2000.

31. Written observations have been submitted in both cases by the German Government and the Commission and in Case C-322/99 by the Greek Government. At the oral hearing Mr Brandenstein, the German Government and the Commission were represented.

Taxation under Article 5(6)

32. The first question in Case C-322/99 and the first and second questions in Case C-323/99 raise the issue whether a charge to tax under Article 5(6) arises where, although VAT on the acquisition of the car was not deductible, VAT was deducted on work carried out on the car after the acquisition.

33. In the event of an affirmative reply to the first question the referring court wishes to know by its second question in Case C-322/99 whether under Article 5(6) a charge to tax arises with regard to the goods in question and the component parts taken as a whole or only with regard to the newly added component parts.

34. The cars which Mr Fischer and Mr Brandenstein applied for their private use are 'tangible property' within the meaning of Article 5(1) of the Directive and must as a consequence be classified as 'goods' for the purposes of Article 5. They may therefore be the subject of a deemed supply under Article 5(6).

35. It is common ground that before their application for private use those cars formed exclusively [12] part of the two plaintiffs' business assets. It is also common ground that VAT on the acquisition of the cars was not deductible.

36.The issue is whether the application of those cars for private use may none the less be taxed because Mr Fischer and Mr Brandenstein deducted VAT on work carried out on the cars after their acquisition. It will be recalled that they deducted VAT on 'extensive bodywork repairs and respraying work' (Case C-322/99) and on 'servicing, minor repairs, changing tyres, installation of a catalytic converter and replacement of a windscreen' (Case C-323/99).

37. The answer to that question depends on the interpretation of the phrase in Article 5(6) 'where the value added tax on the goods in question or the component parts thereof was wholly or partly deductible'.

38. As the referring court rightly explains, [13] there are two ways to read that phrase both of which might lead to taxation under Article 5(6). In situations such as those in the main proceedings it might be argued

— that VAT on the 'goods in question' was 'partly' deductible, or

12 — In a different factual context the Bundesfinanzhof requests in Case C-415/98 *Bakcsi* v *Finanzamt Fürstenfeldbruck* a preliminary ruling *inter alia* on the question whether a trader can assign goods exclusively to his private assets where he uses those goods partly for business purposes: see the Opinion of Advocate General Saggio of 13 April 2000.

13 — See the two alternatives suggested in the first question in Case C-322/99, above at paragraph 22.

— that VAT on 'the component parts thereof' was deductible.

39. I will assess whether one of those alternative readings applies in the present cases.

Was VAT on the 'goods' in question 'partly' deductible?

40. According to the Greek Government, in Case C-322/99 VAT on the 'goods in question' was 'partly' deductible within the meaning of Article 5(6) of the Directive. It considers that the bodywork repairs and respraying work carried out on Mr Fischer's 'RR-Bentley' were very extensive as can be seen from their considerable costs (in comparison with the initial purchase price). Those costs must therefore be viewed as having contributed to the total costs of the acquisition of the car in question.

41. More generally, in the Greek Government's view, the concept of 'goods' in Article 5(6) refers not only to their initial acquisition but also to all types of later expenditure which increases the value of those goods in the long run. Only expenditure on the maintenance and use of goods which does not have any lasting influence on their value can be disregarded when assessing whether VAT on the 'goods' in question was 'partly' deductible. The suggested interpretation is therefore compatible with the judgments in *Kühne* [14] and in *Mohsche*. [15] There the Court held that Article 6(2) of the Directive subjected taxation of the private use of business goods to the condition that the goods themselves, and not the expenditure on their maintenance or use, had given rise to deduction.

42. I agree however with the Commission and the German Government which both maintain that Article 5(6) of the Directive may not be interpreted in that way.

43. First, the alternative 'partly deductible' seems designed to cover only situations in which the goods in question were allocated partly to the taxable person's business activities and partly to his private activities. A good example is provided by *Armbrecht* [16] in which a trader chose at the moment of the acquisition of a property to assign only a part thereof to his business and to reserve the rest for his private use. Only in those cases is it entirely correct to speak of 'partly' deductible input tax. In the present cases, by contrast, the initial acquisition of the second-hand cars did not

14 — Cited in note 9.

15 — Case C-193/91 *Finanzamt München III* v *Mohsche* [1993] ECR I-2615.

16 — Case C-291/92 *Finanzamt Uelzen* v *Armbrecht* [1995] ECR I-2775.

give rise to any deduction at all, whilst subsequent work on the cars gave rise to several 'full' deductions.

44. Secondly, I consider that the expression 'VAT on the goods in question' refers to input tax on the initial acquisition or production of those goods only and not to input tax on subsequent expenditure on the goods. That is because input tax on subsequent expenditure is covered, in so far as is relevant for the application of Article 5(6), by the expression 'tax on... the component parts thereof' (see paragraphs 45 to 77 below).

Was VAT on 'component parts thereof' deductible?

45. The debate before the Court has concentrated on the meaning of the expression 'component parts thereof' in Article 5(6) of the Directive.

46. The German Government considers essentially that expenditure of all kinds (including expenditure on supplies of services) which either maintains or increases the value of those goods gives rise to the applicability of the concept of 'component parts'.

47. The Commission considers, by contrast, that 'component parts' can arise only through supplies of goods and not through supplies of services. Furthermore, supplies of goods of limited value which do not clearly increase the value of the goods in question cannot be regarded as giving rise to 'component parts'.

— May 'component parts' be added after the initial acquisition?

48. A preliminary question is whether the concept of 'component parts thereof' is limited to parts already present at the moment of the initial acquisition or includes also parts added later.

49. I agree with the German Government and the Commission which both consider that 'component parts' may be added after the initial acquisition of the goods in question.

50. Even if the Finnish, Greek, German, Netherlands, Swedish and Danish language versions of Article 5(6) use 'time-neutral' expressions similar to the English 'component parts', it follows from the French ('les éléments le composant'), Spanish ('los elementos que lo componen'), Italian ('gli elementi che lo compongono') and Portu-

guese ('aos elementos que os compõem') versions that the relevant moment for establishing whether VAT on component parts was deductible is the moment of the application for private use and not the moment of the initial acquisition. The wording of Article 5(6) supports therefore the view that component parts may be added after the initial acquisition.

51. Furthermore, Article 5(6) is intended, as already stated, [17] to prevent a taxable person who has been able to deduct VAT on the purchase of goods used for his business from escaping the payment of VAT when he applies those goods for his private use. In view of that objective, preexisting component parts and component parts added after the initial acquisition may not be treated differently. In both situations VAT on component parts was deductible in view of an envisaged later use of the goods for the trader's taxable transactions and in both cases a trader who applies the goods for his private use should be prevented from enjoying a deduction advantage to which he is no more entitled than an ordinary consumer who buys goods and pays VAT on them. [18]

52. Accordingly, the concept of 'component parts' encompasses parts added after the initial acquisition.

17 — See paragraph 10 above.

18 — See Case C-20/91, cited in note 3.

— May supplies of services give rise to 'component parts'?

53. The issue is whether 'component parts' can only arise through supplies of goods or also through supplies of services. That question might be relevant in Case C-322/99 where Mr Fischer deducted VAT on 'extensive bodywork repairs and respraying work' on the 'RR-Bentley' and in Case C-323/99 where Mr Brandenstein deducted VAT on 'servicing' and 'minor repairs'.

54. The German Government considers on the basis of a teleological interpretation of Article 5(6) of the Directive that both supplies of services and supplies of goods might give rise to component parts. In its view, the aim of Article 5(6) is to prevent a taxable person's private consumption (in the form of a transfer of business assets to his private assets) from escaping tax. An application of business goods for private use leads to private consumption if those goods or the value which is embodied in them have not been fully consumed while they were part of the taxable person's business assets. The same follows indirectly from Article 11(A)(1)(b) which establishes

as the relevant taxable amount the purchase price of the goods determined at the time of the transfer to private use. Taxation under Article 5(6) thus depends on the physical condition in which the goods in question leave the sphere of the undertaking and become part of the taxable person's private assets. The physical condition of the goods at the time of the transfer depends in turn on whether work for the improvement or maintenance of the goods in question has been carried out on them. Since supplies of services (e.g. bodywork repairs) might in economic terms have the same positive long-term effects on the physical condition and value of the goods in question as supplies of goods (e.g. the supply of a new engine) the concept of component parts should be interpreted as including supplies of services which increase or maintain the value of the goods in question. In that connection the German Government points also to the practical difficulties of distinguishing between supplies of services and supplies of goods. Work carried out on goods after their initial acquisition typically involves mixed supplies of services and goods (e.g. the replacement of a windscreen).

55. In my view, the unambiguous wording of Article 5(6) and the system of the Directive do not allow such an extensive interpretation of the concept of component parts.

56. The French (les éléments le composant), Spanish (los elementos que lo componen) and Italian (gli elementi che lo compongono) versions of the Directive use words which might perhaps be translated into English as 'component elements'. The German (Bestandteile) and Dutch (bestanddelen) versions use words closer to the expression actually used in the English version of the Directive, namely 'component parts'. Despite that minor difference between 'elements' and 'parts' the terminology used in all language versions suggests that 'component parts' within the meaning of Article 5(6) must be physical and tangible objects which are integrated into the goods in question. I cannot see how services which do not entail supplies of goods (e.g. a car wash, or bodywork repairs) can lead to 'elements' or 'parts' of goods within the meaning of Article 5(6) of the Directive.

57. That is confirmed by a systematic interpretation of Article 5(6). In all the language versions the concept of component parts is directly linked to the first alternative in Article 5(6), namely the 'goods in question'. For example in the English version VAT must have been deductible on the component parts 'thereof'. Consequently, if 'goods' are defined under Article 5(1) as tangible property, 'component parts thereof' must be of the same nature. A supply of services is by contrast defined as a transaction which does not

constitute a supply of goods (Article 6(1) of the Directive).

58. Furthermore, I do not share the fears underlying the German Government's position, namely that the exclusion of supplies of services from the concept of component parts will lead to a significant amount of untaxed private consumption and thus to tax avoidance. Either the services in question do not result in a lasting increase in the value of the goods (e.g. a car wash) and are therefore consumed within the business before the transfer to private use; or, where the services in question result in a lasting increase in the value of the goods in question (e.g. extensive bodywork repairs) the initial deduction can be adjusted under Article 20(1)(b) of the Directive (see paragraphs 84 to 93 below).

59. Finally, it is true that work carried out on a car often involves mixed supplies of services and goods. But that does not mean that supplies of services cannot be distinguished from supplies of goods. In order to determine whether a given transaction constitutes a supply of goods or a supply of services its characteristic features must be identified. [19] Where a supply of goods is only one element of a transaction in which the provision of services largely predominates the transaction in question must be regarded as a supply of services. [20] Servicing, for example, might require the supply of screws, oil-filters or spark plugs. Respraying work requires the supply of paint. In those cases where work on a car involves some ancillary and minor supplies of goods which are inextricably linked to the services in question that work must be viewed as a supply of services within the meaning of Article 6(1) of the Directive and cannot therefore be regarded as giving rise to the applicability of the concept of 'component parts'.

60. Accordingly, supplies of services (including those which necessarily entail ancillary and minor supplies of goods) cannot give rise to 'component parts' within the meaning of Article 5(6).

— What categories of supplies of goods lead to 'component parts'?

61. If only supplies of goods may give rise to 'component parts' within the meaning of Article 5(6), the question arises whether all such supplies must be taken into account. In Case C-323/99 for example Mr Brandenstein deducted VAT on 'changing tyres, the installation of a catalytic converter and

19 — Case C-231/94 *Faaborg-Gelting Linien* v *Finanzamt Flensburg* [1996] ECR I-2395, paragraph 12 of the judgment.

20 — Ibidem, paragraph 14 of the judgment.

the replacement of a windscreen'. Similar questions arise in connection with the replacement of a battery or the installation of a more powerful engine or a car telephone.

62. The German Government considers that all supplies which have not been consumed while the goods and component parts formed part of the taxable person's business assets should in principle lead to taxation under Article 5(6). Consequently supplies of goods which may be classified as maintenance expenditure might also give rise to 'component parts', the only condition being that those supplies may be used and consumed over a certain period of time.

63. The Commission suggests by contrast, as already stated, a narrower interpretation of the concept of 'component parts'. In its view, only supplies which clearly increase the value of the goods in question give rise to component parts. Supplies of goods of a comparatively limited value should not be taken into account.

64. If I understand those two divergent positions correctly, the German Government would regard for example a new battery as a 'component part', whilst the Commission would probably not. Both the Commission and the German Government would probably accept that a new engine must be viewed as a component part.

65. Nothing in the wording of Article 5(6) indicates whether or not VAT deductions on parts of relatively little value should trigger taxation under that provision.

66. I agree therefore with the Commission that the content of the concept of 'component parts' cannot be determined without having regard to the legal consequences of Article 5(6) of the Directive. It is thus necessary to address forthwith the issue raised by the second question in Case C-322/99, namely whether, in the event that Article 5(6) is applicable, a charge to tax arises with regard to the goods in question and the component parts taken as a whole or only with regard to the newly added component parts.

67. Article 5(6) states that the application of 'goods' for private use or 'their' application for other than business purposes must be treated as supplies made for consideration, 'where' the value added tax on the goods in question 'or' the component parts thereof was deductible. It follows from that unambiguous wording that the application of the goods in question and not just of

parts of those goods is subject to tax. Moreover the formulation of the condition ('where' and not 'in so far as', 'or' and not 'and') indicates that deduction of VAT on component parts suffices to trigger taxation of the transfer to private use of the goods and their component parts taken together and that the authors of the Directive did not intend to set up *pro rata* taxation.

68. Both the Commission and the German Government point out that on a literal interpretation Article 5(6) may therefore lead to double taxation. A second-hand car acquired without the possibility of deducting VAT from a private person carries VAT in it which normally was borne by a final consumer at the moment of an earlier acquisition. If VAT-deductible work on that car such as the installation of a new engine gives rise to a 'component part' within the meaning of Article 5(6), the transfer of the car to private use triggers the taxation of the car as a whole. Consequently, everything in the car except the new engine will be taxed a second time. Those submitting observations are also aware that such double taxation is in principle contrary to the general objective of fiscal neutrality inherent in the system of value added tax. [21]

21 — Case C-45/95 *Commission* v *Italy* [1997] ECR I-3605, paragraph 15 of the judgment.

69. It seems that in such cases the most desirable solution would be that VAT should be charged on the residual value of those items on which VAT was originally deducted. That would agree with the principle of neutrality and would ensure equal treatment of taxable and non-taxable persons.

70. The clear wording and the legislative history suggest however that the legislature deliberately accepted that risk of double taxation and presumably did so for practical reasons. For example in the German version of the initial Commission proposal the conditional sentence in question started with 'insoweit' (in so far). [22] Such a formulation could have been interpreted as setting up pro rata taxation. The final version of the Directive uses however 'wenn' (where).

71. We are thus faced with a dilemma in respect of the interpretation of the concept of 'component parts' in Article 5(6). Either that concept is interpreted narrowly, which might conflict with the specific objective of Article 5(6), namely to prevent a taxable person from enjoying deduction advantages to which he is not entitled by comparison with an ordinary consumer. Or that concept is interpreted broadly, which might

22 — Commission Proposal for a Sixth Council Directive on the harmonisation of legislation of Member States concerning turnover taxes — Common system of value added tax: uniform basis of assessment, submitted by the Commission on 29 June 1973, OJ 1973 C 80, p. 1.

conflict with the general objective of fiscal neutrality.

72. In my view, a first step in resolving this dilemma is to distinguish 'component parts' clearly from independent goods. Where two goods are brought together without definitely losing their physical and economic distinctiveness they should not be considered as component parts. That is compatible both with the wording of Article 5(6) and with the objective of fiscal neutrality. If for tax purposes the two goods remain independent, their transfer(s) to private use must be seen as two independent taxable events. With regard to each of those events the condition under Article 5(6), namely that VAT on the goods in question was deductible, must be satisfied. Double taxation in respect of goods on which VAT was not deductible is thereby precluded.

73. I consider therefore for example that the replacement of tyres or the installation of a car telephone or a car radio does not create 'component parts' of the car in question. Since those goods may easily be separated from the car and be the object of independent transactions they do not definitely lose their physical and economic distinctiveness. The transfer to private use of a car with a car radio or a car telephone must therefore be viewed for VAT purposes as several applications for private use of independent goods and for each of those applications the requirements of Article 5(6) must be satisfied.

74. The second element of the solution is in my view to exclude from the concept of 'component parts' supplies of goods which do not result in a lasting increase in the value of the 'goods in question' but simply contribute to maintaining their value. It seems disproportionate to accept double taxation of the 'goods in question' where the risk of the taxable person enjoying deduction advantages does not exist because the value of the newly added parts is consumed while they form part of the business assets, or where the deduction advantage realised on transfer of the goods in question to private use is small in comparison with the disadvantages of double taxation.

75. I agree therefore with the Commission that the deduction of VAT on the replacement of a windscreen wiper or an empty car battery should not lead to taxation of the car as a whole when it is transferred to private use, whilst the installation of a more powerful engine or of a catalytic converter for the purpose of modernising the car might do so. That solution also has the advantage of leading to a similar result to that in *Kühne*.[23]

23 — See paragraph 17 above.

76. Although in some cases the above solution will lead to double taxation contrary to the system of the Directive, that consequence must be seen in the context of the wider problems arising under the Directive on the sale of second-hand goods, notably where goods bought from a private individual are subsequently re-sold by a trader in the course of his business. [24]

77. It follows from the foregoing considerations that the provisions of Article 5(6) relating to 'component parts' apply only where 'goods' are supplied within the meaning of Article 5(1) (not services), where those goods become an integral part of the 'goods in question' by losing their physical and economic distinctiveness and where there is a lasting increase in the total value. It follows also from the above that where those conditions are fulfilled a charge to tax arises in respect of the application for private use of the goods in question and the component parts taken as a whole and not only with regard to the component parts.

Taxable amount under Article 11(A)(1)(b)

78. By the third questions in each case the referring court wishes to know whether, if in situations such as those in the main proceedings there is a supply within the meaning of Article 5(6), the taxable amount under Article 11(A)(1)(b) must be determined by reference to the purchase price of the car and the component parts taken together or only of the component parts.

79. In my view, it follows from a combined reading of Article 11(A)(1)(b) with Article 5(6) and from the interpretation of Article 5(6) given above that the taxable amount must be determined by reference to the purchase price of the car and the component parts taken together. According to the first and main alternative of Article 11(A)(1)(b) the taxable amount in respect of supplies referred to in Article 5(6) shall be the purchase price of 'the goods' determined at the time of supply. For the determination of the taxable amount Article 11(A)(1)(b) thus refers back to the goods which are subject to taxation under Article 5(6). As I have stated above, [25] according to its clear wording Article 5(6) subjects to tax the goods and their component parts taken together.

80. Accordingly, if in situations such as those in the main proceedings a charge to

24 — See Case 165/88 *ORO Amsterdam Beheer and Concerto* v *Inspecteur der Omzetbelasting* [1989] ECR 4081; and the Opinion of Advocate General Saggio in *Bakesi*, cited in note 12.

25 — See paragraphs 66 and 67 above.

tax arises under Article 5(6), the taxable amount under Article 11(A)(1)(b) of the Directive must be determined by reference to the price of the goods and their component parts taken together.

Relationship between Articles 5(6) and 5(7)(c)

81. By the fourth question in Case C-322/99 the referring court wishes to know what the relationship is between, on the one hand, Article 5(6), and, on the other hand, Article 5(7)(c) which relates to the retention of goods by a taxable person when he ceases to carry out a taxable economic activity.

82. Article 5(7)(c) allows Member States to introduce a special provision for situations in which a taxable person ceases trading.

83. In the present case it is however common ground that Germany has not made use of the possibility afforded by Article 5(7)(c). I therefore agree with the Commission that in the absence of such a special provision the taxation of the application for private use of goods after the cessation of trading is governed exclusively by Article 5(6). It is therefore not necessary to give an interpretation of Article 5(7)(c).

Adjustments of deductions under Article 20

84. The fifth question in Case C-322/99 and the fourth question in Case C-323/99 raise the novel issue whether the initial deduction for expenditure for work carried out on the cars in question may be adjusted under Article 20 of the Directive, if according to the Court's interpretation no charge to tax arises under Article 5(6).

85. It will be recalled that, in my view, tax-deductible supplies of services and supplies of goods which do not result in a lasting increase in the value of the goods in question cannot be viewed as 'component parts' and that there is therefore no deemed supply under Article 5(6) when the goods concerned by those supplies are put to private use. It will also be recalled that in Case C-322/99 Mr Fischer deducted VAT on extensive bodywork repairs and respraying work and in Case C-323/99 Mr Brandenstein deducted VAT on servicing, minor repairs and the replacement of the windscreen.

86. Under Article 20(1)(b) the initial deduction is to be adjusted 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; however, adjustments shall not be made in cases of transactions remaining totally or partially unpaid and of destruction, loss or theft of property duly proved or confirmed, nor in the case of applications for the purpose of making gifts of small value and giving samples specified in Article 5(6). However, Member States may require adjustment in cases of transactions remaining totally or partially unpaid and of theft.'

87. According to the referring court all the work carried out on the cars in question after their initial acquisition constituted expenditure for the purposes of Mr Fischer's and Mr Brandenstein's taxable transactions within the meaning of Article 17(2) of the Directive. Therefore they both enjoyed at the time when the work was carried out a right of immediate and integral deduction of tax. Then, however, the business objectives in question were not fully realised with regard to the cars in question since Mr Fischer ceased trading altogether and Mr Brandenstein put his car to private use. In the referring court's view it might therefore be argued that, if the VAT-deductible work carried out on the cars after their acquisition is not to be taxed under Article 5(6) (together with the transfer of the cars to private use), the application of the cars for private use must be regarded as a change of factors within the meaning of Article 20(1)(b) of the Directive and therefore lead to an adjustment of the initial deductions.

88. The German Government contends that as a matter of principle Article 20 cannot apply in cases of application of goods for private use. It argues that the rules on deemed supplies in Articles 5 and 6 of the Directive constitute a complete and exhaustive legal regime governing the private use of goods and services which precludes the parallel and/or cumulative application of the rules on adjustments of deductions under Article 20(1)(b).

89. I agree however with the Commission that in principle the Directive allows the application of goods for private use to be viewed as a change of factors within the meaning of Article 20(1)(b). That follows from a comparison of the actual text of that provision with the corresponding provision of the Commission proposal.[26] Under Article 20(1)(c) of the proposal adjustments were expressly excluded in all cases specified in Article 5(3) of the proposal

26 — Cited in note 22.

which contained the different categories of application of goods to non-business purposes. The text of Article 20(1)(b) as enacted, in that it excludes from the possibility of adjustment only two categories of application for private use, which are specifically mentioned in Article 5(6) of the Directive, namely applications for purposes of making gifts of small value and giving samples, thereby allows the Member States to provide for adjustments in respect of other types of application. The issue is therefore not so much whether as a matter of principle adjustments of deductions under Article 20 are possible, but in which situations Article 5(6) leaves room for such adjustments.

90. I consider, on the one hand, that in so far as at least one VAT-deductible 'component part' within the meaning of Article 5(6) was added, the application of Article 20 is precluded. In those cases all VAT deductions for work carried out on the goods in question are, where appropriate, automatically 'corrected' through the mechanism of a deemed supply under Article 5(6). As stated above Article 5(6) subjects the goods in question and their component parts taken together to tax. According to Article 11(A)(1)(b) the taxable amount is determined by reference to the purchase price of the goods in question at the time of supply. That price is in turn also affected by VAT-deductible work carried out on those goods (including those supplies of services and goods which did not lead to new component parts). In so far as the value created by VAT-deductible work is still present in the value of the goods in question at the moment of their transfer to private use, unjustified deductions are thus compensated by taxation under Article 5(6).

91. On the other hand, where subsequent VAT-deductible work has not given rise to 'component parts', the rules on adjustment of deductions may provide an appropriate safety net in order to prevent a taxable person from enjoying unjustified deduction advantages. It must be remembered that the rules on adjustment of deductions pursue a similar objective to the legal fiction of Article 5(6), namely to prevent a taxable person who has benefited from the right to deduct from enjoying unjustified economic advantages. The method in Article 5(6) of a deemed supply was merely chosen for 'reasons of neutrality and simplicity'. [27] I consider therefore that in principle tax deductions on supplies of services and supplies of goods which have not given rise to component parts may be adjusted under Article 20 on the occasion of the transfer of the goods concerned to private use.

27 — See the statement of reasons which accompanied the proposal for the Sixth Directive, *Bulletin of the European Community*, Supplement 11/73, p. 10.

92. When adjusting those deductions one has however to take into account that the value of the supplies of services and goods in issue may have been consumed within the business before the transfer to private use takes place. In so far as those tax-deductible supplies have been consumed within the business, they can no longer be transferred to private use and on the occasion of the transfer to private use there is therefore no change of factors requiring an adjustment of deductions. Since the two types of supplies concerned, namely supplies of services and supplies of goods which do not result in a lasting increase in the value of the goods concerned, will by their very nature often be consumed before the transfer of the goods to private use, an adjustment of deductions will in many cases not be necessary.

93. Accordingly, under Article 20(1)(b) of the Directive deductions on work carried out on goods after their acquisition may be adjusted on the occasion of the transfer of those goods to private use if on the basis of the supplies in question the provisions of Article 5(6) relating to 'component parts' are not applicable. Adjustments are however possible only in so far as the value of the work in question has not been consumed within the business before the goods were transferred to private use.

Conclusion

94. For the above reasons the questions referred should in my view be answered as follows:

(1) The provisions of Article 5(6) of the Sixth VAT Directive relating to 'component parts' apply only where 'goods' are supplied within the meaning or Article 5(1) (not services), where those goods become an integral part of

the 'goods in question' by losing their physical and economic distinctiveness and where there is a lasting increase in the total value of the goods.

(2) Where tax-deductible component parts have been integrated into goods, charge to tax in respect of the application for private use arises with regard to the goods and the component parts taken as a whole.

(3) Where charge to tax under Article 5(6) arises as a consequence of the integration into goods of tax-deductible component parts, the taxable amount under Article 11(A)(1)(b) of the Directive must be determined by reference to the price of the goods and their component parts taken together.

(4) In the absence of a special national provision implementing Article 5(7)(c) of the Directive the taxation of the application for private use of goods after the cessation of trading is governed exclusively by Article 5(6) of the Directive.

(5) Deductions on work carried out on goods after their acquisition may be adjusted under Article 20(1)(b) of the Directive on the occasion of the transfer of those goods to private use if on the basis of the supplies in question the provisions of Article 5(6) relating to 'component parts' are not applicable. Adjustments are however possible only in so far as the value of the work in question has not been consumed within the business before the goods were transferred to private use.