JUDGMENT OF THE COURT (Sixth Chamber)

5 October 1999 *

In Case C-305/97,

REFERENCE to the Court under Article 177 of the EC Treaty (now Article 234 EC) by the Court of Appeal (England and Wales) (United Kingdom) for a preliminary ruling in the proceedings pending before that court between

Royscot Leasing Ltd and Royscot Industrial Leasing Ltd,

Allied Domecq plc,

T.C. Harrison Group Ltd

and

Commissioners of Customs & Excise,

on the interpretation of Article 11(4) of Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes — Structure and procedures for application of the common system of value added tax (OJ, English Special Edition 1967, p. 16) and of Article 17(6) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of

* Language of the case: English.

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),

THE COURT (Sixth Chamber),

composed of: G. Hirsch (Rapporteur), President of the Second Chamber, acting for the President of the Sixth Chamber, J.L. Murray and R. Schintgen, Judges,

Advocate General: P. Léger,
Registrar: H. von Holstein, Deputy Registrar,

after considering the written observations submitted on behalf of:

— Royscot Leasing Ltd, Royscot Industrial Leasing Ltd and Allied Domecq plc, by A. Thornhill QC and K. Prosser QC, instructed by Ashurst Morris Crisp, Solicitors,

— T.C. Harrison Group Ltd, by S. Allcock QC and A. Hitchmough, Barrister, instructed by Dibb Lupton Broomhead, Solicitors,

— the United Kingdom Government, by S. Ridley, of the Treasury Solicitor's Department, acting as Agent, G. Barling QC and R. Hill, Barrister,

— the Danish Government, by J. Molde, Head of Division in the Ministry of Foreign Affairs, acting as Agent,

— the Greek Government, by G. Kanellopoulos, Deputy Legal Adviser to the State Legal Council, and A. Rokofyllou, Adviser in the Ministry of Foreign Affairs, acting as Agents,

— the French Government, by K. Rispal-Bellanger, Head of the Subdirectorate for International Economic Law and Community Law in the Legal Affairs Directorate of the Ministry of Foreign Affairs, and G. Mignot, Secretary for Foreign Affairs in that Directorate, acting as Agents,

— the Irish Government, by M.A. Buckley, Chief State Solicitor, acting as Agent, A. Ó Caoimh SC, D. Moloney BL and D. Sherlock, Deputy Revenue Solicitor,

— the Finnish Government, by H. Rotkirch, Ambassador, Head of the Legal Service in the Ministry of Foreign Affairs, and T. Pynnä, Legal Adviser in that Ministry, acting as Agents,

— the Swedish Government, by E. Brattgård, Departementsråd in the Department of Foreign Trade of the Ministry of Foreign Affairs, acting as Agent,

— the Commission of the European Communities, by E. Traversa and H. Michard, of its Legal Service, and F. Riddy, a national official on secondment to the Commission's Legal Service, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Royscot Leasing Ltd, Royscot Industrial Leasing Ltd and Allied Domecq plc, T.C. Harrison Group Ltd, the United

Kingdom Government, the Greek Government, the Irish Government, the Finnish Government, and the Commission, at the hearing on 19 November 1998,

after hearing the Opinion of the Advocate General at the sitting on 21 January 1999,

gives the following

Judgment

1 By order of 29 July 1997, received at the Court on 26 August 1997, the Court of Appeal (England and Wales) referred for a preliminary ruling under Article 177 of the EC Treaty (now Article 234 EC) four questions on the interpretation of Article 11(4) of Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes — Structure and procedures for application of the common system of value added tax (OJ, English Special Edition 1967, p. 16, hereinafter 'the Second Directive') and of Article 17(6) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1, hereinafter 'the Sixth Directive').

2 Those questions have arisen in proceedings between three groups of appellants — Royscot Leasing Ltd and Royscot Industrial Leasing Ltd (hereinafter 'Royscot'), T.C. Harrison Ltd (hereinafter 'Harrison'), and Allied Domecq plc (hereinafter 'Domecq') — and the Commissioners of Customs & Excise (hereinafter 'the Commissioners') concerning the Commissioners' refusal to allow those companies to deduct the value added tax (hereinafter 'VAT') payable on the purchase of motor cars.

The Community legislation

3 Article 11(1) of the Second Directive introducing the right of deduction provides as follows:

'Where goods and services are used for the purposes of his undertaking, the taxable person shall be authorised to deduct from the tax for which he is liable:

(a) the value-added tax invoiced to him in respect of goods supplied to him or in respect of services rendered to him;

(b) ...'

Article 11(4) provides as follows:

'Certain goods and services may be excluded from the deduction system, in particular those capable of being exclusively or partially used for the private needs of the taxable person or of his staff.'

4 By virtue of Article 37 of the Sixth Directive, that directive replaced the Second Directive.

5 Article 17(2) of the Sixth Directive, as amended by Article 28f, inserted in the Sixth Directive by Council Directive 91/680/EEC of 16 December 1991

supplementing the common system of value added tax and amending Directive 77/388/EEC with a view to the abolition of fiscal frontiers (OJ 1991 L 376, p. 1), and amended by Council Directive 95/7/EC of 10 April 1995 amending Directive 77/388/EEC 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), provides as follows:

'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 within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person;

(b) ...'

6 A system for excluding the right to deduct is set out in Article 17(6) of the Sixth Directive, which provides 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.'

7 The Community rules provided for in Article 17(6) have not yet been adopted.

The national legislation

8 Since 1973 the United Kingdom has, by a succession of statutory instruments ('the Cars Orders'), prohibited the deduction of VAT on the purchase of motor cars. Article 4 of the VAT (Cars) Order 1972 provides as follows:

'Tax on the supply or importation of a motor car shall not be deducted as input tax ... except where:

(a) the supply is a letting on hire; or

(b) the motor car is supplied or imported for the purpose of its conversion into a vehicle which is not a motor car; or

(c) the motor car is unused and is supplied or imported for the purpose of being sold.'

The main proceedings and the questions submitted for preliminary ruling

9 Royscot carries on a leasing business whereby it purchases cars and leases them on to its customers at a rent which includes VAT. Royscot does not take possession of the cars, which are delivered by the manufacturer directly to the lessees. It is therefore not possible for Royscot or its employees to make use of the cars for private purposes.

10 Harrison is the representative member of a VAT group, certain members of which carry on three different businesses. The first business is a long-term car leasing business which is the same as that of Royscot. The second business is a short-term car hire business. When not hired out, these cars are available for private use by employees outside working hours at no charge. The third business is a franchise-based motor dealership business. The franchise agreement requires that a fleet of 'demonstrator' cars should be available for the use of prospective customers and staff. Certain employees are permitted to use demonstrator cars for their private use at no charge.

11 Domecq is the representative member of a VAT group, certain members of which carry on retail businesses. They employ travelling salesmen and technical operatives who need to use motor cars in order to perform their duties. These employees are also permitted to have a reasonable amount of private use of the cars, for which they have to pay a fee. Domecq also purchases motor cars for the business and private use of senior employees pursuant to their contracts of employment. Employees in possession of such cars are not charged anything for private use.

12 Royscot, Harrison and Domecq submitted claims seeking deduction of the VAT payable on the purchase of the motor cars, on the ground that Article 11(4) of the Second Directive and Article 17(6) of the Sixth Directive do not permit the

United Kingdom to introduce and retain an exclusion from the right of deduction, such as that contained in the Cars Orders.

13 The claims by Royscot and Domecq are in respect of periods covered by the Sixth Council Directive, while Harrison's claim relates to a period dating back to 1973, when the Second Directive was in force.

14 The Commissioners rejected those claims on the ground that the deduction was prohibited by the Cars Orders. Royscot, Harrison and Domecq appealed to the VAT and Duties Tribunal, which dismissed the appeals. After the High Court had also dismissed their appeals they appealed to the Court of Appeal, which decided to stay proceedings and to refer the following questions to the Court for a preliminary ruling:

'1. Did Article 11(4) of the Second Council Directive of 11 April 1967 authorise Member States to introduce or retain, and does the second subparagraph of Article 17(6) of the Sixth Council Directive of 17 May 1977 authorise Member States to retain, national laws which exclude, without limit, the right to deduct VAT payable on the purchase of motor cars to be used by a taxable person for the purposes of his taxable transactions?

2. In particular, may the right to deduct be excluded:

(a) even though the cars are essential tools of the business in the sense that the business by definition would not exist without the cars (eg, the car-leasing business of the Royscot companies, and the car-leasing and car-hire businesses of the T.C. Harrison Group)?

(b) even though the cars are never available for any private use by the taxable person or his staff (eg, the car-leasing businesses of the Royscot companies and of the T.C. Harrison Group)?

(c) even though the taxable person could not carry on his business at all without the cars (eg, "demonstrator" cars acquired by a member of the T.C. Harrison Group in its dealership business)?

(d) even though the taxable person's employees could not perform their duties without the cars (eg, the travelling salesmen employed by the Allied Domecq Group)?

(e) notwithstanding (a), (c) or (d) above, on the ground that the taxable persons' employees are permitted to make some, subsidiary, private use of the cars outside working hours?

3. Is it material to question 2(e) above to consider whether:

(a) an apportionment of the expenditure on the cars can be made between the business use and the private use?

(b) the permission to make private use of the cars is a taxable transaction for VAT purposes because the taxable person charges the employees a fee for that use?

4. Did the authorisation granted to Member States by the second subparagraph of Article 17(6) lapse at the end of the four-year period referred to in the first subparagraph?'

The first and second questions

15 By its first and second questions, which it is appropriate to examine together, the Court of Appeal is asking essentially whether Article 11(4) of the Second Directive authorised Member States to introduce or retain, and whether Article 17(6) of the Sixth Directive authorises them to retain, general exclusions from the right to deduct the VAT payable on the purchase of motor cars used by a taxable person for the purposes of his taxable transactions, even though

— those cars were essential tools in the business of the taxable person concerned, or

— those cars could not, in a specific case, be used for private purposes by the taxable person concerned.

16 Royscot, Harrison and Domecq submit that Article 11(4) of the Second Directive limits the exclusions to those cases in which the motor vehicles are capable of being used for the private needs of the taxable person or his staff. That provision, they argue, must be interpreted in the light of the fundamental principle set out in Article 11(1) conferring the right of deduction. Consequently, Article 11(4) also does not apply to goods which are essential tools in the business of the taxable person or to those cases in which it is possible to determine the portion of input VAT payable on the basis of Article 11(2).

17 With regard to Article 17(6) of the Sixth Directive, Royscot, Harrison and Domecq argue that the standstill clause in that provision does not authorise the retention of such exclusions as were not justified by Article 11(4) of the Second Directive. Furthermore, Article 17(6) of the Sixth Directive, construed in context, authorises Member States to retain only exclusions relating to expenditure which contains, or may contain, a non-business element which cannot be distinguished from the business element on the basis of the determination provided for under Article 17(5) of the Sixth Directive.

18 On the other hand, the United Kingdom, Danish, French, Irish, Finnish and Swedish Governments submit that it follows clearly from the wording of Article 11(4) of the Second Directive that Member States were entitled to exclude from the deduction system expenditure relating to the purchase of goods such as motor cars, and to retain such exclusions by virtue of Article 17(6) of the Sixth Directive.

19 The Commission submits that, by reason of the importance which the right of deduction has within the system of VAT, Article 11(4) of the Second Directive and Article 17(6) of the Sixth Directive do not authorise Member States to exclude from the right of deduction expenditure on the essential tools of the business of the taxable person. During the hearing, the Commission submitted that it follows from the judgment in Case C-43/96 *Commission* v *France* [1998] ECR I-3903 that the United Kingdom had in fact been initially authorised to retain the exclusions from the right of deduction in question. However, the Commission argues, the United Kingdom lost that right following an amendment of national law which was contrary to the standstill clause in Article 17(6) of the Sixth Directive.

20 As the Court has already held in paragraphs 18 and 19 of *Commission* v *France*, cited above, it must be inferred from its wording and origin that the second subparagraph of Article 17(6) of the Sixth Directive is to be construed as meaning that the expression 'all the exclusions' comprises expenditure which is strictly business expenditure. That provision accordingly authorises Member States to retain national rules which deny taxable persons the right to deduct not only VAT

on means of transport which constitute the very tool of their trade but also VAT relating to the motor vehicles which are not, in any particular case, capable of being used privately.

21 Admittedly, as Royscot, Harrison and Domecq, among others, have pointed out, Article 17(6) of the Sixth Directive presupposes that the exclusions which Member States may retain pursuant to that provision were lawful under the Second Directive, which predated the Sixth Directive.

22 However, it should be borne in mind that, while Article 11(1) of the Second Directive introduced the right of deduction, Article 11(4) provided that Member States could exclude certain goods and services from the deduction system.

23 It follows from its wording, which is clear and unambiguous, that Article 11(4) authorised Member States to exclude from the right of deduction even expenditure which is strictly business-related. It cannot be inferred from the second part of Article 11(4) of the Second Directive, which provides that the exclusions may relate in particular to certain goods and services capable of being used exclusively or partially for private needs, that Member States could exclude only expenditure in respect of such goods and services. On the contrary, by using the term 'in particular', the legislature expressed its clear intention not to limit the authorised exclusions to expenditure for goods and services capable of being used for private purposes.

24 Admittedly, as Royscot, Harrison and Domecq submit, Article 11(4) of the Second Directive did not confer on Member States an unlimited discretion to exclude all and any goods and services from the system of the right of deduction and thereby negate the system established by Article 11(1) of that directive.

25 However, in excluding from the right of deduction certain goods such as motor cars, the United Kingdom has not impaired the general system of the right of deduction, but has made use of an authorisation deriving from Article 11(4) of the Second Directive. This is *a fortiori* the case inasmuch as cars are goods which, by their nature, are capable of being used exclusively or partially for the private needs of the taxable person or of his staff.

26 The answer to the first and second questions must therefore be that Article 11(4) of the Second Directive authorised Member States to introduce or retain, and Article 17(6) of the Sixth Directive authorises them to retain, general exclusions from the right to deduct the VAT payable on the purchase of motor cars used by a taxable person for the purposes of his taxable transactions, even though

— those cars were essential tools in the business of the taxable person concerned, or

— those cars could not, in a specific case, be used for private purposes by the taxable person concerned.

The third question

27 In light of the reply to the first two questions, the third question no longer serves any purpose and accordingly does not require an answer.

The fourth question

28 Royscot, Harrison and Domecq submit that the standstill clause in the second subparagraph of Article 17(6) of the Sixth Directive is linked to the first sentence of the first subparagraph and that this link is also temporal. Once the rules envisaged can no longer enter into force, the four-year period referred to in the first subparagraph having expired, the temporary discretion of the Member States to maintain national exclusions no longer exists.

29 However, as all the governments which submitted observations point out, it should be noted that the wording of Article 17(6) of the Sixth Directive makes it clear that the authorisation granted to Member States to retain their existing legislation in regard to exclusion from the right of deduction remains in force until such time as the Council has adopted the provisions envisaged by that article.

30 This interpretation is consistent with that given by the Court in Case C-165/88 *ORO Amsterdam Beheer and Concerto* v *Inspecteur der Omzetbelasting* [1989] ECR 4081 to the former Article 32 of the Sixth Directive, which contained, for second-hand goods, a transitional provision similar to that of Article 17(6). In paragraph 24 of that judgment, the Court held that until the Community legislature, which had failed to comply with the time-limit imposed for that purpose, had taken action, it was necessary to continue to apply Article 32 of the Sixth Directive, which merely authorised Member States which applied a special system of VAT to second-hand goods to retain that system. Article 32 of the Sixth Directive was repealed by Council Directive 94/5/EC of 14 February 1994

supplementing the common system of value added tax and amending Directive 77/388/EEC — Special arrangements applicable to second-hand goods, works of art, collectors' items and antiques (OJ 1994 L 60, p. 16).

31 So far as Article 17(6) of the Sixth Directive is concerned, it is also for the Community legislature to establish a Community system of exclusions from the right to deduct VAT and thereby to bring about the progressive harmonisation of national VAT legislation.

32 The answer to the fourth question must therefore be that, on a proper construction of Article 17(6) of the Sixth Directive, Member States may retain the exclusions from the right to deduct VAT referred to in its second subparagraph, even though the Council did not decide, before the expiry of the period laid down in the first subparagraph, which expenditure should not be eligible for deduction of VAT.

Costs

33 The costs incurred by the United Kingdom, Danish, Greek, French, Irish, Finnish and Swedish Governments and by the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT (Sixth Chamber),

in answer to the questions referred to it by the Court of Appeal (England and Wales) by order of 29 July 1997, hereby rules:

1. **Article 11(4) of Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes — Structure and procedures for application of the common system of value added tax, authorised Member States to introduce or retain, and Article 17(6) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment, authorises them to retain, general exclusions from the right to deduct the value added tax payable on the purchase of motor cars used by a taxable person for the purposes of his taxable transactions, even though**

   — **those cars were essential tools in the business of the taxable person concerned, or**

   — **those cars could not, in a specific case, be used for private purposes by the taxable person concerned.**

2. **On a proper construction of Article 17(6) of Sixth Directive 77/388, Member States may retain the exclusions from the right to deduct value added tax referred to in its second subparagraph, even though the Council did not decide, before the expiry of the period laid down in the first subparagraph, which expenditure should not be eligible for deduction of value added tax.**

Hirsch Murray Schintgen

Delivered in open court in Luxembourg on 5 October 1999.

R. Grass P.J.G. Kapteyn

Registrar President of the Sixth Chamber