OPINION OF ADVOCATE GENERAL JACOBS
delivered on 3 March 1994 *

My Lords,

1. The Finanzgericht Hamburg seeks a ruling on the interpretation of the Sixth Directive on value-added tax (VAT). [1] The questions raised by the Finanzgericht concern the basis of assessment for the imposition of VAT on the takings of gaming machines.

2. The following questions have been referred:

'1. In the case of gaming machines offering the possibility of winning, is the taxable amount for the purposes of Article 11 A(1)(a) of the Sixth Directive the total stakes inserted without deduction of the winnings automatically paid out to players?

2. If the winnings paid out must be deducted:

Does the principle of individual taxation require that winnings should be deducted only to the extent of the individual stake for a game or a series of games?

3. If Question 1 is answered in the negative:

Do the winnings automatically paid out constitute wholly or partly — to the extent of the individual stake for a game or series of games — rebates for the purposes of Article 11A(3)(b) of the Sixth Directive?'

The background to the case

3. The plaintiff in the main proceedings (hereafter 'Glawe') is a firm which installs and operates gaming machines in bars and restaurants. The machines are activated by

* Original language: English.

1 — Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value-added tax: uniform basis of assessment (OJ 1977 L 145, p. 1).

means of the insertion of one or more coins. Once they have been activated by the insertion of the appropriate stake, the machines are available to be played for a certain period of time. During that period, coins may be paid out as winnings to successful players. The amount of winnings, if any, paid out in the course of an individual game depends upon the luck (and possibly the skill) of the player concerned.

4. The machines in question are equipped with two separate compartments, which I shall refer to as the 'cash box' and the 'reserve'. The reserve holds the stock of coins from which winnings are paid out. The cash box holds coins which the operator of the machine is able to remove from the machines and retain for his own benefit. The machines are designed to ensure that, when the reserve is full, any stakes inserted by players enter the cash box. If the reserve is not full, on the other hand, the stakes enter the reserve.

5. It appears that the operation of such machines is regulated under German law by the *Spielverordnung* of 11 December 1985. [2] Machines put in operation must be of a type approved for the purposes of the *Spielverordnung* by the Federal Institute of Physical Technology *(Physikalisch-Technische Bundesanstalt)*. Machines are required to pay out as winnings on average at least 60% of the stakes inserted; however, types of machine in respect of which an application for approval was made after 25 October 1990 are required to pay out only 60% of the amounts inserted after deduction of the VAT payable on those amounts. The operator is required to fill the reserve when the machine is first put into service, and whenever opening the machine he is required to replenish the reserve so as to ensure that cash is available to be paid out as winnings.

6. In assessing Glawe's VAT liability for the year 1991, the defendant tax office took as the taxable amount, for the purposes of the German legislation implementing Article 11 of the Sixth Directive, an estimate of the gross receipts of the machines; that is to say, an estimate of the total stakes inserted into the machines, less VAT, without any deduction in respect of sums paid out as winnings. That basis of assessment is contested by Glawe, who argues that VAT should be imposed only on an operator's net receipts, that is to say on the net takings of the machines after deduction both of VAT and of the amounts paid out to successful players.

7. In what follows, I shall first set out the relevant provisions of the Sixth Directive, and discuss how those provisions extend to the taxation of gaming machines. I will then turn to consider what answers should be given to the questions referred.

2 — BGBl. 1985 I, p. 2245; last amended by the Zweite Verordnung zur Änderung der Spielverordnung, of 25 October 1990 (BGBl. 1990 I, p. 2392).

The provisions of the Sixth Directive

8. By Article 2 of the Sixth Directive:

'The following shall be subject to value-added tax:

(1) the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such;

... .'

According to Article 11A:

'Within the territory of the country

(1) The taxable amount shall be:

(a) ... everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies ...;

... .

(3) The taxable amount shall not include:

...

(b) price discounts and rebates allowed to the customer and accounted for at the time of the supply;

... .'

9. It is to be noted that Article 13B(f) of the Sixth Directive exempts from VAT:

'betting, lotteries and other forms of gambling, subject to conditions and limitations laid down by each Member State'.

At first sight, Article 13B(f) might suggest that gambling activities are in principle exempt from VAT, and that impression

might seem to be confirmed by Article 33 of the Sixth Directive, which reads as follows:

'Without prejudice to other Community provisions, the provisions of this Directive shall not prevent a Member State from maintaining or introducing taxes on insurance contracts, *taxes on betting and gambling*, excise duties, stamp duties, and, more generally, any taxes, duties or charges which cannot be characterized as turnover taxes' [my emphasis] .

Article 33 appears designed to allow for taxes other than turnover taxes to be imposed on activities such as betting and gambling — and also insurance — for which, as will be seen below, turnover taxes were structurally unsuited. However, it appears that the words 'subject to conditions and limitations laid down by each Member State' were included in Article 13B(f) so as to enable certain Member States to retain turnover taxes on certain forms of gambling; and it appears that the provision has accordingly been interpreted by the Member States and by the Commission as permitting, in particular, the imposition of VAT on the use of gaming machines. According to the Commission, the operation of gaming machines is subject to VAT in Denmark, Germany, the Netherlands, Spain and the United Kingdom, but is exempt in Belgium. The operation of such machines is prohibited in France, Greece, Italy and Portugal. The Commission does not provide any information about the position in Ireland or Luxembourg.

10. It seems to me that it is defensible to interpret the Sixth Directive as permitting the imposition of VAT on the operation of gaming machines. It is clear that the provision allows a Member State to exclude at least some gambling activities from the scope of the exemption, since Member States are expressly permitted to subject the exemption to 'limitations'. Moreover, no bounds are expressly set to the range of gambling activities which may be excluded. It might however be doubted whether a Member State would be entitled to impose VAT on *all* forms of gambling.

11. Notwithstanding the discretion conferred by Article 13B(f), if a Member State has decided to exercise its option of imposing VAT on the use of gaming machines, the tax thereby imposed must, as the Commission points out, conform to the Community rules applicable to VAT. In particular, the tax must conform to the rules governing the basis of assessment laid down by Article 11 of the Sixth Directive. Indeed, as its title suggests, one of the principal objects of the Directive is precisely to lay down such a uniform basis of assessment. Thus the power to impose 'conditions and limitations' given by Article 13B(f) allows a Member State to decide which gambling activities are to be exempted pursuant to that provision, but does not permit it to choose a basis of assessment different from that laid down by Article 11.

12. As far as gaming machines offering the player an opportunity of winning are concerned, it is I think clear that Member States

have a discretion rather than an obligation to impose VAT. The German Government attempts to argue that, since skill is involved in playing the machines, their use cannot be regarded as gambling, and that the use of gaming machines is accordingly not an activity falling within Article 13B(f). In my view such a conclusion is plainly wrong, since it depends upon the fallacious assumption that skill cannot be involved in gambling. The fact that the machines offer players the opportunity of winning back a sum greater than the stakes inserted, and that, even in the case of a skilled player, the outcome depends at least in part upon chance is sufficient to characterize the use of such machines as gambling.

13. I conclude, therefore, that under Article 13B(f) of the Sixth Directive Member States have the power, but not the obligation, to impose VAT on the use of gaming machines offering the possibility of winning. In what follows, I shall refer to such a gaming machine simply as a 'machine'. It is clear that, when a player makes use of such a machine, there is a supply of services made by the operator to the player.

Question 1

14. By its first question the national court asks whether the taxable amount for the purposes of Article 11A(1)(a) of the directive constitutes the total stakes inserted into the gaming machine by players.

15. The German Government proposes an affirmative reply to that question, whereas Glawe and the United Kingdom consider that the taxable amount should be limited to the total stakes less the winnings paid out, i.e. the amounts actually emptied from the machine by the operator. The Commission, although agreeing with the German Government that the taxable amount comprises the total stakes inserted, suggests that the winnings should be treated as expenditure on which tax is deductible under Article 17(2) of the directive, applied by analogy. Article 17(2) provides that:

' In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:

(a) value-added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person ... .'

The Commission's view would lead to the same result as that proposed by Glawe and the United Kingdom, albeit by a different legal analysis.

16. As already stated, the underlying problem in this case is that gaming transactions are ill-suited to value added taxation. This was recognized by the Commission in its Proposal for the Sixth Directive, which provided for unqualified exemption of 'gaming and lotteries' (Article 14(B)(k) of the Proposal); the Explanatory Memorandum to the Proposal stated: 'The exemption under paragraph (k) of gaming and lotteries is based on purely practical considerations. Such activities are in effect ill-suited to taxation on a value-added basis and are better dealt with by means of special taxes.' [3] In the absence of complete exemption under the adopted text of the directive, the Court must seek an interpretation which is consistent with the aims and principles of the common VAT system.

17. The simplicity of the German Government's analysis is attractive at first sight. The amount 'obtained' by the supplier from the player is the stake inserted into the machine. When the player inserts the stake he parts with his money and it becomes the property of the machine operator, even if the latter is obliged to leave part of the monies inserted in the reserve while the machine continues in operation.

18. However, that view is inconsistent with the commercial reality of the transaction and with the aims and basic principles of the directive. VAT is intended to be charged in proportion to the actual turnover which a trader earns from his supplies of goods and services after deduction of tax on the cost components thereof: see Article 2 of the First Directive. [4] As Glawe and the United Kingdom observe, for all practical purposes the operator's turnover consists in the amounts he is able to remove from the machine, and not in the total amounts inserted by players. Otherwise one would arrive at the surprising result that the machine operator refunds the larger part of his turnover to his customers. Such an analysis would be possible, although implausible, if the refunds could be regarded as 'discounts' or 'rebates' for the purposes of Article 11A(3)(b) so that the taxable amount were reduced accordingly. However, for the reasons given below (at paragraph 31 et seq.) they cannot be so regarded. Such a view might also be possible if the winnings paid out could, as the Commission suggests, be

3 — *Bulletin of the European Communities*, Supplement 11/73, p. 16.

4 — First Council Directive 67/227/EEC of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes (OJ, English Special Edition 1967, p. 14).

treated as expenditure on goods or services on which VAT was deductible under Article 17(2) of the directive. The tax would then operate normally and in accordance with Article 2 of the First Directive, since it would be charged on the total stakes inserted after deduction of input tax on the cost components of the operator's services, i. e. after deduction of the input tax deemed to have been incurred by the operator on the winnings paid out. However, Article 17(2) is clearly inapplicable on its wording since, as the Commission concedes, the sums paid out to winning players do not constitute the consideration for 'goods or services supplied or to be supplied to [the operator] by another taxable person' for the purposes of that provision. Nor do I think it possible or necessary to arrive at that result by applying Article 17(2), as the Commission seeks to do, by analogy.

19. In my view the consideration which the operator obtains for his services for the purposes of Article 11A(1)(a) is limited to the amounts which he empties from the machine. That is apparent from an analysis of the transactions in issue and of other forms of gambling.

20. Whilst gambling for money entails expenditure by gamblers, it does not in its simplest form give rise to consumption of goods or services. Suppose, for example, that A enters into a private bet with B, both placing their respective bets on the table. A wins the bet and collects the money on the table. In such a case it would be absurd to suggest that A and B provide services to each other for a consideration equal to the amount of their respective bets. The placing of the bets and collection of the winnings is simply part of the gambling transaction. The placing of the bets, although it involves the outlay of money, does not constitute the consumption of goods or services which is the taxable event under the VAT system.

21. Commercial gambling is different in so far as the person organizing the gambling arranges matters in such a way that on average his winnings are sufficient to meet his costs in organizing the gambling and to provide him with a reasonable profit. For example, a bookmaker will set the odds for bets on horse races at a level intended to ensure that he makes an overall profit on bets placed. To that extent the person organizing the gambling may perhaps be regarded as not only taking part in the gambling himself but also providing a service to the other gamblers consisting in organizing the gambling. On that view his reward for that service would not, however, be the total amount of the bets placed by gamblers. As already stated, the placing of bets and payment of winnings form the nucleus of the gambling activity. The service provided by the organizer consists in providing the framework within which that activity can take place, his reward for that service being the surplus of winnings which he arranges for himself, together with any specific commission which he may charge.

22. It is true that there may be some theoretical difficulty in viewing, for example, a bookmaker's net winnings as the consideration for services. Whilst it seems possible to regard him as providing a service, the 'price' which he receives for that service varies and depends partly on chance and partly on his skill in setting the odds. However, that difficulty provides no support for the proposition that the total bets placed should be regarded as the consideration for his service. Instead it explains why the Commission took the view, in its Proposal for the Sixth Directive, that betting and gaming are ill-suited to taxation on a value added basis and lend themselves better to specific taxes.

23. It seems to me that the difficulties inherent in applying VAT to betting and gaming transactions apply with less force to transactions involving gaming machines. That is perhaps why most Member States permitting the operation of such machines choose not to exempt the proceeds from VAT. Gaming machines such as those concerned here are specifically designed to provide the operator with a predictable return. From the way in which the machine is set, he knows within a few percentage points the return which he can expect. The certainty for the operator is such that his takings may be regarded less as winnings than as a fee for his service consisting in the provision of the machine. Moreover, the amount of that fee is easily determined since it corresponds to the money emptied from the cash box.

24. From the foregoing analysis it follows that, in so far as it is appropriate to charge VAT on gaming machine transactions, the taxable amount should be limited to the operator's actual takings, i.e. his net receipts after payment of winnings to the players. The correctness of that view is confirmed by looking at the transaction from the players' viewpoint. What players as a group pay for the operator's services is the amount retained by the machine and collected by the operator. For the rest the machine acts as a means of collecting players' bets and paying them out to winners.

25. The German Government's point that the property in the stakes inserted passes to the operator is not conclusive. That is simply a reflection of the way in which the game is arranged. Coins inserted into the machine enter either the cash box or the reserve. Coins entering the cash box become the property of the operator because they form part of his takings. Coins entering the reserve become the property of the operator because it is he who initially fills the reserve. By doing so he places at the players' disposal the money in the reserve needed for the operation of the machine and, when coins enter the reserve, is merely being reimbursed in respect of winnings paid out. The money which enters the reserve cannot therefore be regarded as payment for goods or services or

as part of the operator's turnover for VAT purposes.

26. I conclude therefore that the first question referred by the national court should be answered in the negative. The taxable amount in the case of gaming machines such as those concerned in the main proceedings does not include the proportion of the stakes inserted which is paid out as winnings to successful players.

Question 2

27. By its second question the national court asks whether, if the winnings must be deducted in calculating the taxable amount, the principle of individual taxation permits their deduction only to the extent of the individual stake for each game.

28. The premise underlying this question seems to be that, notwithstanding the negative reply to Question 1, it is the total stakes inserted into the machine which in principle constitute the operator's turnover but that some or all of the winnings may be deducted in determining the taxable amount. The national court therefore raises the question whether the principle of individual taxation, i.e. the principle that each supply should give rise to a separate VAT charge which is proportional to the price paid, precludes deduction of all the winnings since this would involve setting the losses of some players against the winnings of others.

29. In view of the reasoning underlying my proposed reply to Question 1, this question does not strictly speaking arise. There is no question of deducting winnings or of setting off losses and winnings. The stakes inserted form part of the operator's turnover for VAT purposes only to the extent to which they are included in the takings which he empties from the cash box. The remaining proportion of the stakes, and the winnings paid out, are simply part of the gambling process as in the case of a private bet. As the United Kingdom points out, each stake must be regarded as consisting of two components. One component is the price paid for the services provided by the operator (including the VAT payable on that amount). The remainder of the stake may be regarded as an amount contributed to the common pool available to be paid out as winnings. Over a given period, those components will correspond to the amounts collected respectively by the cash box and the reserve of the machine.

30. VAT is therefore charged at a uniform rate on each individual transaction. It is true that the proportion of each stake representing the price of the operator's services can only be determined by applying a percentage based on the average winnings paid out by a machine over a given period. In practice, however, such a calculation is unnecessary. What is surely more important is that the taxable amount for a given period can be determined precisely on the basis of the sums removed by the operator from the cash box after replenishing the reserve. The view that the taxable amount consists of the total stakes inserted is open to the much more serious objection that in the case of many machines the taxable amount itself would have to be estimated on the basis of average pay-outs.

Question 3

31. By its third question the national court asks whether winnings paid out constitute 'rebates' for the purposes of Article 11A(3)(b) of the Sixth Directive. In view of my proposed reply to Question 1, this question does not arise since the amounts paid out as winnings do not form part of the consideration obtained by the operator. I shall however consider it briefly.

32. On the assumption that the taxable amount is the full stake inserted, it seems clear that, to the extent to which the winnings paid out to a player exceed his stake, they cannot be regarded as a discount or a rebate granted to that player. Nor can the payment of winnings to one player be regarded as a discount or rebate granted in respect of the price paid by other players.

33. Although it might be possible, at least in principle, to treat that part of the winnings which represents the return of the player's stake as a discount or rebate, such a view would in my view be highly artificial. It may also be difficult to apply in practice, since it would be necessary to determine the number of occasions upon which winnings are paid out to successful players.

34. The impossibility of applying any sensible notion of 'rebate' to the refunds made to players, which account for approximately 60% of the stakes inserted, demonstrates the artificiality of treating the entire stakes as the operator's turnover. It thus provides further support for the view which I have taken on Question 1.

Conclusion

35. I am accordingly of the opinion that the questions referred by the Finanzgericht Hamburg should be answered as follows:

Article 11A(1)(a) of the Sixth VAT Directive must be interpreted as meaning that, where a Member State subjects to VAT supplies of services consisting in the making available of gaming machines offering the possibility of winning money, the taxable amount in respect of such supplies over a given period does not include that proportion of the total stakes inserted which corresponds to the winnings paid out to successful players during that period.