OPINION OF MR ADVOCATE GENERAL JACOBS
delivered on 22 February 1990 *

My Lords,

1. This case arises from a dispute between the Commission and the Federal Republic of Germany over the treatment of certain transactions for the purposes of the Communities' own resources.

2. Provision for the Communities' own resources was introduced by Council Decision of 21 April 1970 (Decision 70/243 on the replacement of financial contributions from Member States by the Communities' own resources, Official Journal, English Special Edition 1970 (I), p. 224). That decision, to which I shall refer as the 'Own Resources Decision', provides that agricultural levies and other charges (Article 2(a)) and Common Customs Tariff and other duties (Article 2(b)) constitute own resources to be entered in the budget of the Communities. Since revenue from those sources is not sufficient to balance the budget, Article 4(1) provides that the Communities' own resources shall include also those accruing from value-added tax ('VAT') and obtained by applying a rate not exceeding a certain percentage to an assessment basis which is determined in a uniform manner for Member States according to Community rules. The maximum percentage, initially set at 1%, was increased in 1985 to 1.4% and fixed at that level by Council Decision 88/376 on the system of the Communities' own resources (Official Journal 1988, L 185, p. 24), which also introduced an additional own resource based on the sum of Member States' gross national product. The Communities' own resources are collected by the Member States and transferred to the Community.

3. The provisions for financing the Communities' budget from own resources did not come fully into force until 1980. One of the necessary steps was the introduction of a uniform basis of assessment for VAT own resources, which was effected by the Sixth Directive (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, Official Journal 1977, L 145, p. 1). Article 2 of the directive provides that any supply of goods or services effected for consideration by a taxable person acting as such shall be subject to VAT. Articles 13 to 16, however, provide for certain transactions to be exempt.

4. Under Article 28(3)(b), which occurs in Title XVI — Transitional Provisions, Member States may, during a transitional period, 'continue to exempt the activities set out in Annex F under conditions existing in the Member State concerned . . . '. The

* Original language: English.

activities listed in Annex F include, at item 5, 'telecommunications services supplied by public postal services and supplies of goods incidental thereto'.

5. Council Regulation No 2892/77 lays down detailed rules for the determination of the basis of assessment for VAT own resources (Official Journal 1977, L 336, p. 8). Article 3(1) gives Member States a choice between two methods, 'method A' and 'method B'. In fact, it appears from the case file that all Member States have opted for 'method B', according to which the own resources basis is calculated by dividing the total net VAT revenue collected by a Member State by the VAT rate, expressed as a fraction, or, where several rates are applied, by the average weighted VAT rate, again expressed as a fraction (Article 6). The result is to discount the impact of varying rates of VAT, and in effect to base VAT own resources on the turnover in all transactions treated as subject to VAT.

6. Crucial to this case are the provisions of Regulation No 2892/77 concerning the transactions to be taken into account for the purpose of determining the basis of assessment. Article 2(1) of Regulation No 2892/77 provides that the VAT own resources basis shall be determined from the taxable transactions referred to in Article 2 of the Sixth Directive, with the exception of the transactions definitively exempted under Articles 13 to 16 of that directive. Under Article 2(2), third indent, the transactions which Member States continue to exempt pursuant to Article 28(3)(b) of the Sixth Directive (i.e. those which are only transitionally exempt) 'shall be taken into account for determining VAT own resources'. Article 9(2) is concerned with the application of Article 2(2). The second indent of Article 9(2) provides that:

'With regard to the transactions listed in Annex F to Directive 77/388/EEC which Member States continue to exempt pursuant to Article 28(3)(b) of the said directive, Member States shall calculate the VAT own resources basis as if these transactions were taxed.'

7. The validity of Regulation No 2892/77, which was initially limited to five years, was extended by Council Regulation No 3550/82 (Official Journal 1982, L 373, p. 1) and by Council Regulation No 3735/85 (Official Journal 1985, L 356, p. 1). Council Regulation No 1553/89 on the definitive uniform arrangements for the collection of own resources accruing from VAT (Official Journal 1989, L 155, p. 9), which applied from 1 January 1989 and which largely superseded Regulation No 2892/77, provides for a single method of calculation of the VAT own resources basis corresponding to the old 'method B' (Article 3). The provisions which I have just cited from Articles 2(2) and 9(2) of Regulation No 2892/77 are reproduced in the 1989 Regulation (Articles 2(2) and 6(2)).

8. Pursuant to Article 28(3)(b) and Annex F of the Sixth Directive, the Federal Republic exempts from VAT the telecommunications transactions of the Deutsche Bundespost (German Federal Post Office). The consequence of that exemption is that the Bundespost cannot take advantage of Article 17(2) of the Sixth Directive, according to which a taxable person is entitled to deduct from the tax which he is liable to pay the VAT paid or due in respect

of goods or services supplied to him, in so far as the goods or services are used for the purposes of his taxable transactions. However, when calculating the VAT own resources basis in respect of the telecommunications transactions of the Bundespost in 1980-85, the Federal Republic did deduct from the total value of the transactions the amount of VAT paid by the Bundespost in respect of goods and services supplied to it for the purposes of those transactions. In these proceedings the Commission essentially contends that the Federal Republic was not entitled to make that deduction.

9. The dispute turns on the interpretation of the requirement in Article 9(2) of Regulation No 2892/77 that with regard to exempted Annex F transactions Member States are to calculate the VAT own resources basis 'as if these transactions were taxed'. In the Commission's view, that provision means that the entire value of the relevant transactions is to be included in the basis of assessment, without any deduction of input tax ('taxe en amont') implicitly contained in their value. In the view of the German Government, it means that the transactions are to be treated in all relevant respects as if they were taxed; and if they were taxed, a deduction of input tax would be possible in accordance with Article 17(2) of the Sixth Directive. Both parties rely on the wording of Article 9(2), on the general scheme and on the objectives of the Community legislation.

10. In my view, reference to the wording alone of Article 9(2) of Regulation No 2892/77 does not conclusively support either party. On a literal reading of the text, the requirement that the basis of assessment in respect of Annex F transactions should be calculated 'as if these transactions were taxed' appears to support the view of the Federal Republic. On the other hand, those words can also be taken to mean merely that the transactions in question, although exempt, are to be included in the own resources basis; in other words, that those transactions are to be assimilated to taxable transactions solely for that purpose, but are not to be treated for all purposes as if they were taxed.

11. As regards the general scheme of the legislation, the Federal Republic argues that it is a fundamental principle of the VAT system, which finds expression in particular in Article 11 of the Sixth Directive, that VAT is charged only on the net value of goods or services at each stage of production or marketing, but not on the VAT already paid or to be paid at each stage. The Commission's method would involve the inclusion of an element of 'tax on tax' in the own resources basis contrary to the principle of net value. The Federal Republic also argues that that principle is supported by the case-law of the Court, notably the two *Schul* cases (Case 15/81 [1982] ECR 1409 and Case 47/84 [1985] ECR 1491).

12. The Commission does not dispute the fundamental nature of the principle of net value, but correctly points out that that principle is not absolute. In fact, the principle breaks down where there is an exempt transaction in a chain of taxable transactions. Where a supply of goods or services constitutes an exempt transaction,

the supplier is not permitted to deduct the tax paid to his suppliers, and the tax is therefore passed on as a hidden charge in the selling price. The purchaser of such goods or services is also unable to deduct this hidden charge from his own tax burden, and the result is an accumulation of tax (or tax on tax) contrary to the principle of net value. The total VAT revenue accruing from such a chain of transactions will include an element of tax on tax, and this element will enter the own resources basis. Thus, precisely where there are exempt transactions, a hidden element of non-deductible input tax can form part of the basis of assessment for VAT own resources.

13. The Court's case-law moreover supports the view that the principle of net value is not absolute. In its recent judgment of 5 December 1989 in Case C-165/88 *ORO Amsterdam Beheer BV and Concerto BV* v *Inspecteur der Omzetbelasting* [1989] ECR 4081, the Court pointed out that the two *Schul* judgments, relied on here by the Federal Republic, were based not on a general principle prohibiting accumulation of tax, but on Article 95 of the Treaty, which prohibits discriminatory taxation of imported goods (at paragraph 18). In the same judgment, the Court moreover acknowledged that harmonization of VAT was still only partial, and that while it is the objective of the Community legislation to exclude accumulation of tax, that objective had not yet fully been achieved (at paragraphs 22 and 23). The Court therefore ruled that, at its present stage of development, Community law does not prevent the application of national legislation which, as regards the calculation of VAT due on the sale of second-hand goods bought by undertakings from non-taxable individuals with a view to resale, does not permit the deduction of the amount of input tax incorporated in the purchase price of the goods. It thus appears that no firm conclusion can be drawn from the principle of net value.

14. As regards the objectives of the Community legislation, the Commission has sought to argue that the method of calculation applied by the Federal Republic permits the level of the rate of VAT to have direct repercussions on the basis of assessment of VAT own resources, contrary to the objective of neutrality pursued by the system of VAT own resources. The Commission points out that the German method involves the direct deduction of a part of VAT revenue from the basis of assessment and argues that since the amount of that revenue is a function of the level of the VAT rate, the deduction permits the rate to affect the basis of assessment of VAT own resources and thus the amount of those own resources.

15. However, in my view, the Federal Republic succeeds in refuting that argument. The Federal Republic accepts that the amount of the input tax, and thus the amount of the deduction made under its method of calculation, will indeed vary according to the rate of VAT charged, but points out that since the amount of the deduction always corresponds exactly to the amount of the input tax, there can be no effect on the basis for assessment of VAT own resources, which will always consist of the sum of the amount of the net purchase value and the value added at the stage of the exempt transaction. That, of course, is not surprising, since the method of calculation used by the Federal Republic simulates the ordinary case of taxation, under which, as the Commission itself

states, the rate of VAT cannot have repercussions on the basis of assessment. Indeed, it is clear that it is the Commission's method, rather than that of the Federal Republic, which is incompatible with the objective of neutrality. Since under the Commission's method the amount of input tax paid is included in the basis of assessment, and since that amount will vary according to the rate of VAT charged, that method permits an increase or decrease in the VAT rate to have a direct impact on the basis of assessment and thus on the amount of own resources.

16. That consideration, however, is not decisive. The answer is to be found, in my view, in consideration of the wider objectives of the Community legislation, and of the specific function of Article 9(2) of Regulation No 2892/77. The objective of Regulation No 2892/77, pursuant to the Own Resources Decision, is to give effect to a uniform basis of assessment for VAT own resources. Equally, one of the objectives of the Sixth Directive is to facilitate the determination of that uniform basis of assessment by the adoption of common rules for the levying of VAT. Implicit in the notion of a uniform basis of assessment is the objective of ensuring a fair and consistent apportionment of the burden of own resources between Member States or, to adopt the words used by Advocate General Darmon in his Opinion in Case 107/84 *Commission* v *Germany* [1985] ECR 2655, of ensuring 'an equal system of contribution for the Member States' (at pp. 2659 and 2662).

17. It will be recalled that Article 2(1) of Regulation No 2892/77 lays down the basic principle that the VAT own resources basis is to be determined from the taxable transactions laid down in Article 2 of the Sixth Directive, with the exception of the transactions definitively exempted under that directive. The transitional provisions of Article 28(3) of the Sixth Directive permit Member States to continue to tax transactions which are otherwise definitively exempt (Article 28(3)(a) and Annex E), to exempt transactions which are otherwise taxable (Article 28(3)(b) and Annex F), or to grant the option of taxation to suppliers of otherwise exempt transactions (Article 28(3)(c) and Annex G). Resort to those transitional provisions is clearly capable of distorting the uniform basis of assessment provided for in Article 2(1) of Regulation No 2892/77, unless a correction is made. It is, in my view, the function of Article 9(2) of Regulation No 2892/77 to make that correction.

18. Thus, under the first and third indents of Article 9(2), the transactions referred to in Article 28(3)(a) and Annex E of the Sixth Directive and in Article 28(3)(c) and paragraph (1)(a) of Annex G respectively, are to be treated for the purposes of the calculation of the own resources basis as if they were exempted: this is consistent with the definitive exemption of those transactions under the Sixth Directive and ensures that the own resources basis in respect of such transactions is calculated in the same way irrespective of whether Member States have made use of the transitional provisions. Conversely, the second indent of Article 9(2), which is at issue in this case, provides that the transactions referred to in Article 28(3)(b) and Annex F

of the Sixth Directive are to be treated as if they were taxed: this is consistent with the taxable status of those transactions under the Sixth Directive and again restores equality of treatment between the Member States as regards the calculation of the own resources basis.

19. The function of Article 9(2), second indent, is thus to cancel out the effect of the transitional exemption of Annex F transactions by restoring to the basis of assessment for VAT own resources the resources which would otherwise be lost as a result of the exemption and to achieve a result which is neutral as between Member States which opt for transitional exemption and those which do not. To that end it is only necessary to restore the amount which would accrue to the basis of assessment if the transactions in question were taxed.

20. However, if that principle is correct, the question remains how it is to be implemented. The difficulty is that since Article 9(2) refers to a hypothetical situation (i.e. the situation which would obtain if the transactions were taxed), no obviously correct method exists of calculating the amount which should be restored to the basis of assessment. Indeed, the difficulty in devising a method which will give rise to approximately the correct result is illustrated by the fact that the Federal Republic has at different times used three different methods of calculation. From the case file it appears that from 1980 to 1982 its practice was to deduct from the value of the Bundespost's telecommunications transactions a flat-rate 13% which was deemed to represent the amount of input tax paid. In 1983 it changed to the method at issue in this case, at the same time revising its calculations for the previous years. Finally, in 1987 it adopted yet another method of calculation designed to eliminate the element of 'tax on tax' contained in the value of the transactions.

21. But, even if the principle is difficult to achieve, this does not mean that it is incorrect. In any event, it is in my view clear that the method advocated by the Commission cannot be accepted. That method does not permit any account to be taken of the amount of tax paid by the Bundespost as part of the cost of acquisition of goods and services. Since that amount, in the absence of the right of deduction, is in the normal course of events passed on to the Bundespost's customers, the Commission's method must result in a substantially higher valuation of the relevant transactions than would occur if the transactions were taxable and the right of deduction did exist. The Commission's method thus goes further than is required for the purposes of restoring the uniform basis of assessment and, in so far as it in effect penalizes Member States which exercise the option of exemption under Article 28(3)(b) of the Sixth Directive, it is incompatible with the objective of equality of treatment underlying the own resources legislation.

22. The method advocated by the Federal Republic, is, it is true, open to the objection that it assumes that if the telecommunications transactions of the Bundespost were taxed, so that the Bundespost could exercise the right to deduct input tax, the turnover for the transactions in question would be

reduced by exactly the amount of the input tax paid. As the Commission points out, in practice it is not possible to predict the behaviour of the Bundespost if the transactions were taxed: it might choose not to pass on to its customers all or part of the benefit of the deduction.

23. In spite of this element of uncertainty in the method of calculation used by the Federal Republic, that method is in my view likely to come closer to the correct result than that proposed by the Commission, which makes no allowance at all for the input tax reflected in the transactions of the Bundespost. In any event, it is not necessary for the purpose of these proceedings to endorse any particular method. It is sufficient to find that the general approach of the Federal Republic is correct and that the Commission has failed to establish the correctness of its own approach.

24. The Commission advances certain other arguments in favour of its own method of calculation and against that used by the Federal Republic. Thus it argues that its own method is simpler and more easily verifiable, and results in a larger basis of assessment (and thus higher own resources) than the opposing method. The Commission also points out that if the Federal Republic's method were to prevail, then because of the three-year time-limit on correction of VAT own resources accounts contained in Article 10b of Regulation No 2892/77 (inserted by Article 9 of Council Regulation No 3625/83, Official Journal 1983, L 360, p. 1), other Member States which have duly applied the Commission's method of calculation in relation to Annex F transactions will, as against the Federal Republic, suffer a lasting disadvantage. These arguments are undoubtedly well founded from the practical point of view, but cannot prevail against the clear purpose of the own resources legislation.

25. Accordingly, I am of the opinion that the Court should dismiss the action and order the Commission to pay the costs.