OPINION OF ADVOCATE GENERAL JACOBS
delivered on 2 March 1989 *

My Lords,

1. This case comes before the Court by way of a request for a preliminary ruling on the interpretation of the Sixth VAT Directive (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; Official Journal 1977, L 145, p. 1). It concerns the tax treatment of a business car in so far as it was used by the owner of the business for his own private purposes. The difficulty of the case arises from the fact that the car was bought second-hand from a private person who was not a taxable person for VAT purposes.

2. Article 2 of the Sixth VAT Directive provides:

'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;

2. the importation of goods.'

Article 6 of the Directive provides *inter alia*:

'1. "Supply of services" shall mean any transaction which does not constitute a supply of goods within the meaning of Article 5.

...

2. 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;

(b) ...

Member States may derogate from the provisions of this paragraph provided that such derogation does not lead to distortion of competition.'

3. Defining the taxable amount, Article 11(A)(1)(c) of the Directive provides: 'The taxable amount shall be:

* Original language: English

... in respect of supplies referred to in Article 6(2), the full cost to the taxable person of providing the services'.

4. In the case of the Federal Republic of Germany, the Sixth Directive was to have been implemented by 1 January 1979 at the latest (Article 1, as amended by Directive 78/583; Official Journal 1978, L 194, p. 16).

5. Paragraph 1(1)(2)(b) of the German Law of 1980 on turnover tax ('Umsatzsteuergesetz') provides, under the heading 'Taxable transactions': 'The following transactions are subject to turnover tax: ... private use within the territory. Private use occurs where a trader makes other supplies of the kind defined in Paragraph 3(9) in the course of his business for purposes other than those of his business'. Paragraph 3(9) provides, under the heading 'Supply of goods and other supplies': 'Other supplies are supplies which do not constitute supplies of goods'.

6. It may be noticed that the provisions of Paragraph 1(1)(2)(b) of the German Law are in substance similar to those of Article 6(2)(a) of the Directive, with one exception: the Directive makes the charge to tax subject to the condition that the VAT on the goods in question should be deductible whereas the German Law contains no such condition.

7. Dr Heinz Kühne, the plaintiff in the main action, is a lawyer. He bought a second-hand car from a private person who was not a taxable person for VAT purposes. The car was used partly for the purposes of his business and partly by him for his own private purposes. The Finanzamt (Tax Office) München III, the defendant in the main action, included in its 1981 turnover tax assessment of Dr Kühne's legal practice his private use of the business car. Dr Kühne lodged an objection against that assessment and was successful to the extent that the Finanzamt reduced the assessment of the private use of the business car from 40 to 25% of the total expenditure on the car and reduced the turnover tax correspondingly. The objection otherwise having failed, the plaintiff lodged an appeal. He took the view that the taxation of private use should relate only to the running costs of the car and not to the depreciation, because the car had been purchased from a private individual from whom he was unable to obtain an invoice on the basis of which tax could have been deducted. If the depreciation proportionate to the private use were subjected once again to turnover tax by means of taxation of his own use then turnover tax would be levied twice, which would be contrary to the system.

8. In order to resolve the dispute before it, the Finanzgericht (Finance Court) München referred a series of questions to the Court for a preliminary ruling by a decision of 9 December 1987, lodged at the Court Registry on 16 February 1988. The questions are in the following terms:

'I — How should Article 6(2) of the Sixth Directive be interpreted?

(1) Does the conditional clause "where the value-added tax on such goods is wholly or partly deductible"

(a) exclude the taxation of private use only in cases where input tax is not deductible on account of use of the goods for exempt transactions in the business (Paragraph 15(2) of the Law on turnover tax) or on account of use of the goods for purposes other than those of the taxable transactions of the taxable person (Article 17(2) of the Sixth Directive), or

(b) does it also exclude such taxation where input tax is not deductible for other reasons, for example because of acquisition from a non-taxable person?

If Question (1)(b) is answered in the affirmative:

(2) Is VAT on goods partly deductible within the meaning of Article 6(2)(a) of the Sixth Directive when a taxable person may not deduct VAT for the supply of the goods to him but may do so for supplies of services or goods which he has made use of or received from other businesses for the maintenance (repairs, servicing, etc.) or for the use (fuels, lubricants, etc.) of the goods?

(3) If Question (2) is answered in the negative:

(a) Does the second sentence of Article 6(2) allow Member States to make derogations only in the sense of refraining wholly or partly from taxing the use of goods within the meaning of Article 6(2)(a), or

(b) are they also authorized to tax such use irrespective of whether the VAT on the goods used is wholly or partly deductible?

II — If Question (3)(a) is answered in the affirmative:

(1) Did the German legislature improperly transpose the Sixth Directive into national law in so far as, by Paragraph 1(1)(2)(b) of the Umsatzsteuergesetz 1980, it levies VAT on the use of goods forming part of the assets of a business even when the VAT on such goods is not wholly or partly deductible?

If Question (1) is answered in the affirmative:

(2) May a taxable person rely on Article 6(2)(a) of the Sixth Directive as interpreted by the Court of Justice in the courts responsible for financial

matters in the Federal Republic of Germany?

III — If Question I(1)(a), (2) or (3)(b) is answered in the affirmative or Question II(1) or (2) is answered in the negative:

How should Article 11(A)(1)(c) of the Sixth Directive be interpreted? Does the cost consist of all the expenses incurred by the taxable person for the service or only of (or where appropriate a proportion of) the sums disbursed by him for supplies of goods and services to the extent that the VAT on these is deductible?'

9. Written observations have been submitted by the Commission in favour of the taxpayer and by the Portuguese Government in favour of the tax authorities. The thrust of the Commission's arguments is that the charging of tax on a supply which already contains a residual element of undeducted tax from an earlier marketing stage involves a double charge to tax which is contrary to the system of VAT. Such a double charge can occur where, as here, goods have been taken out of the commercial circuit when bought by a non-taxable person and are subsequently reintroduced into the commercial circuit when bought second-hand by a taxable person who has to pay output tax but is unable to reclaim input tax on the supply. The Commission submits that a national law which gives rise to such a double charge is contrary to the Sixth Directive.

10. The Portuguese Government, on the other hand, argues that the basic rule which the Sixth Directive establishes is that there cannot be any deduction where there is no taxable transaction, as in the case where goods are bought from a non-taxable person. The argument is in substance that the notion of deductibility does not arise in such a case, and that that interpretation properly leads to 'disguised taxation' in certain cases, notwithstanding that it results in double taxation contrary to the pure philosophy of the system of VAT. That is the system set up by the Sixth Directive, particularly Article 17(2), and the Directive was not concerned with disguised taxation. The fact that a separate directive was considered necessary to deal with the case of second-hand goods demonstrates that this was the basic rule. The German Government, which did not present any written observations to the Court but was represented at the hearing, expressly adopts the reasoning of the Portuguese Government and argues that, although taxation of the kind at issue does give rise to double taxation contrary to the VAT system, that double taxation must for the present be accepted because the VAT system in the Community is not yet fully harmonized.

11. It should first be made clear that, although it arises in connection with a car, the charge at issue in this case is not on a supply of goods but on a supply of services, in the form of the use of a business car for non-business purposes. Use of the car is a convenient way of referring to the nature of the supply: Article 6(2)(a) expressly refers to 'the use of goods'. Secondly, there is in reality no transaction for the charge to

relate to: no profit is made by the business, no money changes hands, no invoice is drawn up. Both under the Directive and under the German Law there is merely a deemed supply of services. Thus the Directive provides, by Article 6(2), that the matters defined 'shall be treated as supplies of services for consideration'. The purpose of the deeming provision in the Directive is to prevent a taxable person who has deducted input tax on goods from in effect making them available to a final consumer tax-free. According to the statement of reasons which accompanied the proposal for the Sixth Directive (*Bulletin of the European Communities*, Supplement 11/73, p. 11) under that provision 'tax is only charged if the input tax on the goods so applied is deductible; this provision is to avoid such applications escaping tax altogether'.

12. Article 6(2)(a) of the Directive applies only 'where the value-added tax on such goods is wholly or partly deductible'. Where a service, such as the use of a car, is supplied by a taxable person who has purchased the car from another taxable person in the normal way, VAT is paid on the purchase and can be deducted by the purchaser, and thus the condition in Article 6(2)(a) is fulfilled. The use of the car will then be subject to tax. However, the issue arises whether that condition is fulfilled where input tax cannot be deducted because the goods in question were bought second-hand from a non-taxable person. That is the issue raised by the first question referred for a preliminary ruling in this case.

13. In my view, 'the value-added tax' referred to in the phrase 'where the value-added tax on such goods is wholly or partly deductible' means all the VAT which has accumulated over the successive stages of marketing and is incorporated in the price of the goods. The word 'deductible' in the same phrase has to be read subject to the provisions of the Sixth Directive governing deductions, contained in Title XI (Articles 17 to 20); so Article 6(2)(a) must be taken to mean: 'where the value-added tax on such goods is deductible in accordance with the provisions of Articles 17 and 18 of this Directive'. As the Court held in Case 268/83 *Rompelman* v *Minister van Financiën* [1985] ECR 655 at paragraph 19, 'the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of value-added tax therefore ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way'. The clause 'where the value-added tax on such goods is wholly or partly deductible' in Article 6(2)(a), must be given due weight and must be interpreted in the light of that objective, and I would therefore reject the German Government's assertion that taxation does not depend on the existence or absence of deduction. The Portuguese Government's argument, if I understand it correctly, is that when goods are sold on by a non-taxable person the situation is wholly outside the ambit of Article 17 because by

definition the transaction is not a taxable one and that consequently the condition of deductibility in Article 6(2)(a) is irrelevant. I would reject that argument, because such a reading would impose a substantial restriction on Article 6 for which there is no basis in the text: the phrase 'wholly or partly deductible' in Article 6(2)(a) is expressed at large and does not purport to exclude any category of transactions. In my view Articles 17 and 18, properly interpreted, do fall to be applied and the issue is whether the transaction in question (the purchase of a car second-hand from a non-taxable person) gave rise to a right to deduction under those Articles. Under Article 17(2) a taxable person is entitled to deduct *inter alia* VAT paid in respect of goods 'supplied to him by another taxable person'. However, no provision is made for deductions in respect of goods supplied by a non-taxable person, such as a car bought second-hand from a private individual. Moreover, in order to exercise such a right to deduction, the taxable person must, under Article 18(1)(a), hold an invoice drawn up in accordance with Article 22(3). The national court has found that the taxpayer in this case was not able to obtain such an invoice for the car in question. Therefore the VAT on a car such as the one in this case is not deductible.

14. It follows in my view that the deductibility condition in Article 6(2)(a) is not fulfilled, with the result that in principle private use of a car such as that in the present case does not fall within the terms of Article 6(2)(a) deeming it to be a chargeable supply of services. That result is consistent with the purpose of Article 6(2)(a) which is to prevent non-taxation, because there is no danger of non-taxation where, as here, the goods in question bear the VAT accumulated over previous marketing stages and the taxable person is unable to deduct that VAT.

15. Unlike more simple goods, a car can be used only along with fuel and lubricants; it also has to be regularly repaired and maintained. Assuming that the VAT on the fuel, lubricants, repairs, maintenance and so on for the car is deductible, the further question therefore arises whether that means that the VAT on the car itself is 'partly deductible' within the meaning of Article 6(2)(a) so as to bring the use of the car itself within the ambit of the charge to tax under that provision (Question I(2)).

16. Although not stated as a fact in the order for reference, it is implicit therein and in any event seems most likely that the various goods and services supplied in connection with the running of the car were obtained, unlike the car itself, from taxable persons who were able to supply invoices which would allow input tax to be deducted. In that case, the condition that the VAT should be 'wholly or partly deductible' would be fulfilled in respect of those transactions, with the result that, even though the use of the car itself was not chargeable to tax, the goods and services supplied in connection with running it would fall within the charge to tax under Article 6(2)(a), unless they fell within the charge to tax under Article 5(6) which

imposes an analogous charge on supplies of goods subject to an identical condition regarding deductibility.

17. In so far as those supplies of goods and services fall to be charged under Articles 5(6) or 6(2)(a), the taxable amount in respect of them is governed by the Directive, in particular Article 11. However, the fact, if it is a fact, that they are subject to a charge to tax is a separate matter from the tax treatment of the car itself, and does not suffice to bring the private use of the car within the ambit of Article 6(2)(a).

18. If the result of the foregoing approach is that the use of the car itself is not taxable under the Directive and that tax is chargeable only on the supplies of goods and services connected with the running of the car in respect of which the taxable person was entitled to deduct input tax, that would resolve the question of the taxation of private use in a way which would lead neither to the cumulative imposition of VAT nor to a final consumption which was untaxed. That result would therefore be fully in conformity with the system.

19. The question then arises as to the effect of the second sentence of Article 6(2), whereby 'Member States may derogate from the provisions of this paragraph provided that such derogation does not lead to distortion of competition' (the subject matter of Question I(3)). The referring court has expressed uncertainty as to whether that provision allows the legislature of the relevant Member State only to make derogations in favour of the taxable person by refraining wholly or partly from taxing the use of goods within the meaning of Article 6(2)(a) or whether it also allows derogations to the detriment of the taxable person in the sense that it would allow taxation of such use irrespective of whether the VAT on such goods was wholly or partly deductible.

20. In my view, because it is a derogation, the second sentence of Article 6(2) falls to be construed narrowly, and the harmonizing purpose of the Directive requires powers of derogation granted to Member States to be read restrictively (see Case 249/84 *Profant* [1985] ECR 3237 at pp. 3257 and 3258, especially paragraph 25). Therefore the narrower of the two possible constructions suggested by the national court should be adopted, to the effect that Member States may derogate only by refraining from taxing the use of goods under Article 6(2)(a).

21. Even if the second sentence of Article 6(2) were read as authorizing Member States to impose tax under Article 6(2)(a) irrespective of whether the VAT on the goods concerned was wholly or partly deductible, that authorization would remain subject to the proviso that such imposition must not 'lead to distortion of competition'. In that connection the Court

has held (in Case 16/84 *Commission* v *Netherlands* [1985] ECR 2355 at p. 2371, paragraph 18, and in Case 17/84 *Commission* v *Ireland* [1985] ECR 2375 at p. 2380, paragraph 14): 'Second-hand goods which are reintroduced into commercial circulation are . . . taxed once again, whereas second-hand goods which pass directly from one consumer to another remain burdened solely by the tax imposed on the occasion of the first sale to a non-taxable consumer. Especially where the rate of VAT is high, that difference in treatment distorts competition between direct sales from one consumer to another and transactions passing through ordinary commercial channels, and thus places at a disadvantage branches of trade in which a large number of transactions involve second-hand goods, such as the motor-car trade in particular'. On that conception of distortion of competition, it seems that a Member State would distort competition if it derogated from the deductibility condition in Article 6(2)(a) by imposing a tax charge in respect of second-hand goods on which the VAT was not deductible. Accordingly I consider that the proviso in the second sentence of Article 6(2) would prevent Member States from imposing VAT on the use of goods within the meaning of Article 6(2)(a) where those goods were second-hand goods bought from a non-taxable person.

22. In the context of second-hand goods, it is appropriate also to consider the effect of Article 32, although the national court has not enquired about it. It appears that the Council was unable, at the time that it adopted the Sixth Directive, to agree on a tax regime for second-hand goods, the Commission's proposals on that regime being set out and explained in the *Bulletin of the European Communities*, Supplement 11/73, pp. 23, 24 and 50. As to second-hand goods, Article 32 of the Directive provides:

'The Council, acting unanimously on a proposal from the Commission, shall adopt before 31 December 1977 a Community taxation system to be applied to used goods, works of art, antiques and collectors' items.

Until this Community system becomes applicable, Member States applying a special system to these items at the time this Directive comes into force may retain that system.'

23. Nevertheless the Council has failed to adopt a Directive regarding second-hand goods, although the Commission put forward a proposal in January 1978 (Official Journal 1978, C 26, p. 2) which was amended in 1979 (Official Journal 1979, C 136, p. 8) and apparently withdrawn in November 1987. It appears that the Commission has recently prepared a fresh proposal for a directive on the subject (Official Journal 1989, C 76, p. 10). Thus at the present time the Community rules on the VAT treatment of second-hand goods remain incomplete.

24. Three points arise as to the possible effect of Article 32. First, it may be argued that second-hand goods are a reserved area,

excluded from the ambit of the Sixth Directive altogether. The express wording of Article 32 does not, however, contain any such exclusion. It merely enjoins the Community legislator to adopt a Community system for those goods. To infer that this excludes second-hand goods from the Directive until such time as that system is adopted would risk leaving the Directive in part a dead letter, particularly where, as here, the Community legislator remains inactive long after the deadline set. The better view, and the view more in accordance with the effectiveness of the Directive, is that, subject only to the second paragraph of Article 32, to which I turn below, the Directive applies to second-hand goods, in so far as its provisions are capable of doing so, until the Community legislator adopts a Community taxation system for second-hand goods. On that view, the first paragraph of Article 32 is wholly irrelevant to any case concerning second-hand goods.

25. Secondly, it may be thought that Article 32 might apply to cases involving the supply of second-hand goods but is inapplicable to any case involving the supply of services, and for that reason is inapplicable to the present case. Both the Commission and the German Government take that view. It is consistent with the fact that the 1978 proposal and its 1979 amendment as well as the Commission's latest proposal for a directive on the taxation of second-hand goods concern only supplies of goods and not services. I do not, however, find it necessary to express a concluded view on that argument.

26. Thirdly, as has been noted, the Council has not yet fulfilled the requirement in the first paragraph of Article 32 to adopt a Community taxation system for second-hand goods. Therefore, under the second paragraph of the Article, it continues to be the case that 'Member States applying a special system to these items at the time this Directive comes into force may retain that system'; and it may be asked whether rules such as the German rules in question are authorized as a 'special system' under that provision. Nothing in the terms of Paragraph 1(1)(2)(b) or Paragraph 3(9) of the German Law on turnover tax appears to refer specifically to second-hand goods. They are expressed in entirely general terms. It seems impossible, even by the most strained interpretation, to treat any provision of national law expressed in entirely general terms without making a specific reference to second-hand goods as laying down a 'special system' applying to second-hand goods. Therefore, in my view, such provisions are not authorized as a 'special system' under Article 32. On that view, the further question does not arise as to whether the German rules were applied at the time the Sixth Directive 'came into force'.

27. Each of the three arguments considered thus leads to the conclusion that Article 32 has no effect on the outcome of this case.

28. In the light of the answers I have proposed to Question I, it becomes necessary to address Question II. Question II(1) on the compatibility of German legislation with Community law cannot be answered in the terms in which it is put by way of a preliminary ruling. Such questions may form the subject-matter of infringement proceedings under Article 169 of the EEC Treaty, but under Article 177 the Court is confined to ruling on the interpretation or validity of the Community measure in question.

29. If the national court applying the preliminary ruling finds that the national provision in question is irreconcilable with the Community provision as interpreted in the preliminary ruling, it must decline to apply the national provision in favour of the Community provision if the latter has direct effect: Case 106/77 *Amministrazione delle finanze dello Stato* v *Simmenthal* [1978] ECR 629. In that connection it is necessary to consider whether Article 6(2)(a) of the Directive may have direct effect, which is the object of Question II(2).

30. The Portuguese Government has made no submissions on this point. The German Government considers that the provision does not have direct effect, and the Commission that it does, both of them relying on the Court's case-law on the subject.

31. The criteria for the direct effect of such a provision are that it be sufficiently precise and that it be unconditional: see in particular Case 8/81 *Becker* v *Finanzamt Münster-Innenstadt* [1982] ECR 53 at p. 70 *et seq.* It seems to me that the deductibility condition in Article 6(2)(a) is clear and simple enough to satisfy the first criterion: the national court will have no difficulty in applying that condition. As to the second criterion, two matters fall to be considered. First, it might be asked whether Article 32 suspends the application of Article 6(2)(a) to second-hand goods. It contains no general words to that effect but only a specific derogation, and for the reasons already given I consider that derogation inapplicable in the present case. In my view, therefore, Article 32 does not render Article 6(2)(a) 'conditional' so as to prevent it having direct effect. Secondly, the second sentence of Article 6(2) enables Member States, at their discretion, to derogate from the provisions of the first sentence of Article 6(2), and it might be asked whether that renders Article 6(2)(a) 'conditional' so as to exclude its direct effect. For the reasons already given, I consider that the derogation in the second sentence of Article 6(2) does not apply to the deductibility condition in Article 6(2)(a) but only allows the Member States to refrain from taxing the use of goods under Article 6(2)(a). On that view, the second sentence of Article 6(2) does not require any condition to be fulfilled before the deductibility requirement comes into play. Accordingly, I take the view that

Article 6(2)(a) of the Directive is capable of having direct effect.

32. On the foregoing basis Question III does not call for an answer. Lest a different view be taken, I would add that I consider for the reasons given above that the use of the car, on the one hand, and the supply of the goods and services necessary to run the car such as fuel, lubricants, repairs and maintenance, on the other, fall to be treated separately for tax purposes and cannot be amalgamated under Article 11 of the Directive.

33. Accordingly, the questions referred for a preliminary ruling should in my opinion be answered as follows:

'(1) Article 6(2)(a) of the Sixth Directive excludes the taxation of the private use of goods forming part of the assets of a business where input tax on the goods is not deductible because they were acquired from a non-taxable person.

(2) Where a taxable person may not deduct VAT for the supply of the goods to him but may do so for supplies of other goods or services which he has made use of or received from other taxable persons for the maintenance or for the use of the goods, that does not have the effect that VAT is partly deductible on the first-mentioned goods for the purposes of Article 6(2)(a) of the Sixth Directive.

(3) The second sentence of Article 6(2) of the Sixth Directive allows Member States to derogate from the provisions of Article 6(2)(a) of the Directive, only in the sense of refraining wholly or partly from taxing the use of goods under Article 6(2)(a).

(4) Article 6(2)(a) of the Sixth Directive may be relied on by a taxable person before the courts of a Member State.'