the existence of an essential difference between capital goods and the other goods used in the management and in the day to day running of undertakings.

3. **In the case of goods purchased in 1972 and intended to be used for the purposes of the undertaking which do not belong to the category of capital goods within the meaning of Article 17 of the directive, it is the duty of the national court before which the rule as to immediate deduction set out in Article 11 of the directive is invoked to take those facts into account in so far as a national implementing measure falls outside the limits of the margin of the discretion left to the Member States.**

Kutscher Donner Pescatore Mertens de Wilmars Sørensen

Mackenzie Stuart O'Keeffe Bosco Touffait

Delivered in open court in Luxembourg on 1 February 1977.

A. Van Houtte
Registrar

H. Kutscher
President

OPINION OF MR ADVOCATE-GENERAL MAYRAS DELIVERED ON 14 DECEMBER 1976 [1]

Mr President,
Members of the Court,

Article 99 of the Treaty establishing the European Economic Community empowers the Commission to submit proposals to the Council on the measures necessary with a view to harmonizing the legislation of the various Member States concerning turnover taxes in the interest of the common market.

By an opinion of 3 June 1964, the Commission stated the general lines along which it appeared expedient to establish a common system of value-added tax. On the basis of Articles 99 and 100 of the Treaty, the Council has adopted a series of directives for that purpose.

The first of them, dated 11 April 1967, fixed the final objective as the abolition

1 — Translated from the French.

of cumulative multi-stage taxes and the adoption by all the Member States of a common system of value-added tax. However it was recognized that it would be necessary to proceed by stages, since the harmonization of turnover taxes would lead in Member States to substantial alterations in *tax structure* and would have *appreciable* consequences in the budgetary, economic and social fields.

This is why, whilst requiring the adoption of the system of common value-added tax by all the Member States, the harmonization of the rates and exemptions relating to that tax was not attempted, this being the first stage. The final date by which turnover taxes were to be replaces by the Community value-added tax was originally fixed at 1 January 1970. Prior to that date, Member States were required to have introduced, as is laid down by the first paragraph of Article 2, which on this point reiterates the terms of the Commission's opinion of 1964, the principle of 'a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged'. By the second paragraph of the same article, at every stage of the process, value-added tax, calculated on the price of the goods or services at the rate applicable to such goods or services, was to be chargeable *after deduction* of the amount of value-added tax borne directly by the various cost components.

A second Council directive of the same date dealt with the measures concerning the structure and procedures for application of the common system of value-added tax. The deduction system is set out in Article 11, and I shall come back to this because it is in particular the interpretation thereof that the Hoge Raad of the Netherlands has put to you in its reference for a preliminary ruling.

I ought to point out that it was not possible to introduce the system of value-added tax before 1 January 1970 in the Italian Republic and in the Kingdom of Belgium. For that reason, the date was changed to 1 January 1972 (Third Directive of 9 December 1969), except again for Italy which was authorized to postpone putting the common system of value-added tax into operation to a date which was finally fixed at 1 January 1973 (Fifth Directive of 4 July 1972).

With a view to complying with the first two directives the Kingdom of the Netherlands adopted, on 28 June 1968, a law for the replacing of the turnover tax then in force by a tax levied according to the system of value-added tax. Additions were made to that law on a number of occasions thereafter, and it was clarified in a whole series of 'explanatory notes'.

The Federation of Undertakings of the Netherlands (VNO) which, amongst other matters, publishes periodicals and engages in certain activities on behalf of its member undertakings acquired a printer and a number of packets of reply cards for its members. For the purposes of Article 7 of the Netherlands Law of 1968 VNO is an undertaking subject to turnover tax on the delivery of goods, or rather, in its case, on the supply of services which it carries out within the Kingdom within the meaning of Article 1 of the said law.

In its signed tax return VNO deducted in full that proportion of the value-added tax, charged to it for the purchase of this material, which was attributable to transactions giving entitlement to deduction on the ground of use of goods and services for the purposes of the undertaking. It based itself on two provisions of the aforesaid law, and I think I should quote them.

Article 2:

'Tax in respect of the delivery of goods and the supply of services to the trader and in respect of the importation of goods intended for him shall be

deducted from the tax due in respect of the supply of goods and services.'

Article 15, paragraph 1:

'The tax mentioned in Article 2 which the trader may deduct is:
(a) tax which, in the period covered by the declaration is charged by other traders in respect of goods and services supplied by them to the trader, invoiced in the prescribed manner ...'

These provisions simply put into practice the principles set out in the first two Community directives, as those principles are stated in particular in Article 2 of the First Directive and Article 11 (1) and (3) of the Second Directive (total and immediate deduction).

However an exception is made to this principle by Article 45 of the Netherlands Law, successively amended by the Law of 18 December 1969 and by the Law of 15 December 1971 with effect from 1 January 1972. By this provision (paragraph 1):

'In derogation from Articles 2 and 15, in respect of goods intended to be used by the trader as *business assets (bedrijfsmiddel)* deduction may be made only for:
(a) 30 % of the tax, in the case where delivery or importation takes place in 1969 or in 1970;
(b) 60 % of the tax, in the case where delivery or importation takes place in 1971;
(c) 67 % of the tax, in the case where delivery or importation takes place in 1972.'

The Netherlands legislature has thus intended to exercise the authority given to it by Article 17 of the Second Directive which provides in particular:

'With a view to the transition from the present systems of turnover taxes to the common system of value-added tax, Member States *may:*

...

Third indent

exclude, in whole or in part, during a certain transitional period, *capital goods* from the deduction system provided for in Article 11 ...'.

Acting on the basis of Article 45 (1) of the national law the Inspector voor Invoerrechten en Accijnsen the (Inspector of Customs and Excise), competent in matters of value-added tax, only accepted the deduction made by VNO to the extent of 67 % of the *pro rata* amount of the tax paid by the Federation on the purchase of the material in question. He therefore issued a corrective assessment for the difference, namely Fl 96.67.

VNO contested this assessment before the Tariefcommissie, acting on the basis of Article 11 of the second Community directive relating to total and immediate deduction. But that court rejected the application on the ground that the expression 'capital goods' used in Article 17 left the national legislature with a wide discretion as to its meaning and that therefore that Community provision was not 'directly applicable'.

An appeal on points of law has been made to the Hoge Raad and that supreme court has taken the view that it was required to call upon you for an interpretation.

In the first question which it has referred to you, it asks you whether the term 'capital goods' contained in the third indent of Article 17 of the Second Directive of the Council dated 11 April 1967 refers to goods the acquisition cost of which, according to the principles of accounting and business economy, is not treated as current expenditure but spread over more than one year.

In case the answer should be in the negative, a second question asks on the basis of what other criterion an object is to be considered to fall into the category of capital goods for the purposes of the provision in question.

Finally, in its third question, the Hoge Raad asks you whether the rule concerning the deduction of turnover tax invoiced to a taxable person in relation to goods supplied to him, which is the rule laid down by Article 11 of the directive, has direct effect in the sense that it confers a personal right on the taxpayer to make an unrestricted deduction which the national court must uphold, so far as the goods were acquired in 1972 and were used for the purpose of the undertaking but did not belong to the category of capital goods within the meaning of Article 17 of the directive.

Permit me to make some preliminary observations before stating my point of view on the system set up by the second Community directive.

In reality, in order to reach a decision on the dispute in the main action, it is the national court that will have to say whether the material acquired by VNO constitutes a 'business asset' for the purposes of the Netherlands Law of 1968 and whether such a 'business asset' comes within the concept of 'capital goods' used in Article 17 of the Second Directive. You do not, of course, have jurisdiction to define what is to be understood by 'business assets' for the purposes of the national law. Still less is it for you to say whether the material at issue is to be described as such as regards that law. Nor do these proceedings before you involve saying anything about the merits of the Netherlands Law of 1968. What is involved is the interpretation of the concept of 'capital goods' bearing in mind the purpose fixed by the directive. This will enable the national court to say whether the national legislature has had regard to that purpose, or how the national implementing law must be interpreted and applied in order that it shall accord with the directive.

Nevertheless the fact that VNO is only claiming a very small amount, should not create any illusion as to the real importance of the case. For it is, and the plaintiff in the main action does not pretend otherwise, a test case. If the decision comes down in its favour, the Netherlands taxation authorities will have to pay back considerable sums to quite a number of undertakings. In order to serve as a test, the objects at issue have been carefully chosen and assembled. They lie somewhere in between 'business assets' which, because of their small value, are treated for accountancy purposes as current expenditure, and more substantial office material (a typewriter for example) whose useful life is longer and the cost of which can, depending on the country and the time, be spread over several years.

In effect, the official 'explanatory notes' on the transitional rules adopted in the Netherlands concerning 'business assets' (explanatory notes published by circular at the same time as the law), it is stated that Article 45 is not applicable to such of those 'assets' whose value (excluding turnover tax) does not exceed Fl 50 per 'unit according to commercial usage'.

The 'explanatory notes' in question explain that many goods can in principle be purchased 'in single units' (ballpoint pens, files, punches . . .). For these goods, a single unit can be considered as the 'unit according to commercial usage'. Such, it is argued, is the case of the printer acquired by VNO. On the other hand, many other articles can only be acquired in given standard quantities (paper-clips, etc.). For these articles the 'unit according to commercial usage' must be understood as meaning the standard minimum quantity normally sold. Finally, where articles are not normally sold in single units and it is not possible to speak of a standard minimum

quantity according to usage, the 'unit according to commercial usage' is to be understood as meaning the minimum quantity which traders are willing to supply without charging less for supplying a smaller quantity. If the price of this minimum quantity does not exceed Fl 50, Article 45 is not applicable, whatever the quantity actually acquired, and the price paid by the purchaser (for example by way of a wholesale order) does not affect the matter. But if, for example, an undertaking purchases 10 000 copies of some printed matter (invoiced) at the price of Fl 45 per thousand, whereas the price of the minimum quantity which the seller is willing to deliver (without charging less for a smaller amount) is Fl 55, the tax invoiced on this occassion *cannot be deducted in its entirety.* As I see it, this is how the printed material purchased by VNO has been treated.

Let me now come to an analysis of the provisions with which the request for a preliminary ruling is concerned.

Article 11 (1) of the Second Directive is, in a sense, the key to the system of value-added tax since it lays down the principle that the taxable person may deduct the tax already borne by him. The general effect of this principle is to prevent any aggregation of taxes and to achieve one of the purposes of the system, namely fiscal neutrality as regards competition.

This is why the scope of the system of deductions is as wide as possible.

According to Article 11 (1) deduction is, in principle, authorized for:

(a) the value-added tax invoiced to the taxable person in respect of goods supplied to him or in respect of services rendered to him,
(b) the value-added tax paid in respect of goods imported by the taxable person,
(c) finally the value-added tax paid for the use, by the taxable person, for the needs of his undertaking, of goods produced or extracted by him or by another person on his behalf.

The only proviso to the right to make deduction is that the goods and services must actually be intended to be used for the purposes of the undertaking, the Member States being authorized under Article 11 (4) to exclude from the deduction system goods and services which, whilst acquired or provided for the purposes of the undertaking, are of their nature 'capable of being exclusively or partially used for the private needs of the taxable person or of his staff'.

In the second place Article 11 (3) clearly lays down the principle of *immediate deduction.* The taxable person is authorized to deduct from the value-added tax due for a given period the tax which he has himself paid during that same period on the value of goods acquired by him or of services which have been rendered to him.

Theoretically this method of procedure is equally applicable to capital goods in the finalized common system of value-added tax. However, as regards this category of goods, a first exception is made to this method by point 23 of Annex A to the directive which authorizes Member States, in so far as 'conjunctural grounds' so justify:

— either partially or wholly to exclude capital goods from the deduction system,
— or to apply in respect of such goods deductions *pro rata temporis,* that is to say annual instalments.

But the problem raised by capital goods also came up during the period of transition as regards the changeover from the old systems of turnover tax to the common system of value-added tax, and one can well understand that in respect of this matter the Second Directive authorized Member States to make exceptions to the principle of deduction for goods of this nature. By Article 17, these exceptions consisted:

— either of applying, during a certain transitional period, the method of deduction by annual instalments, that is to say deductions *pro rata temporis* (second indent),
— or of excluding, in whole or in part, the said capital goods from the normal deduction system (third indent).

The Netherlands legislature has allegedly used this second authorization in respect of goods intended to be used by taxable persons as business assets.

Thus, although the Second Directive uses the expression 'capital goods' in several places, it does not give any precise definition of it.

Must we therefore conclude, as the Tariefcommissie has done, that the concept is vague, and that it has so little defined a meaning that it was for the Member States, whose duty it was to implement the directive in terms of national law, to define its content themselves? According to this reasoning the Member States had a discretionary power to determine the scope of the said concept.

I do not think so. Although the autonomy enjoyed by Member States in matters of value-added tax remains complete, for example as regards fixing the rates of the tax, nevertheless in areas where they may make exceptions or may apply certain transitional provisions, such as those provided for in the second and third indents of Article 17, they may only act with due regard to and in accordance with the provisions of the directive.

Therefore I think that what is necessary is to look at all the provisions dealing with capital goods and to attempt to extract from them the elements, if not of a precise definition which is wanting, at least of the general criteria applicable to that expression.

A first point strikes me as valid on this subject.

It is that, unlike goods which enter directly into the production cycle, such as raw materials or semi-finished products incorporated in products sold, capital goods, which are certainly used for the purposes of the undertaking, are not directly integrated in the cycle of production and of trade. They involve goods the use of which extends over a long period and is repetitive.

The consequence of these characteristics of capital goods is that as a general rule they are written off over a period.

Now it is this concept of writing off that is found linked to the concept of capital goods in several provisions of the Second Directive of 11 April 1967.

Article 11 (2) provides that value-added tax on goods and services used in non-taxable or exempt transactions shall not be deductible. Now, the same taxable person may have entered into transactions some of which do and some of which do not give entitlement to deduction. In such a case, the directive applies the so-called *pro rata* rule and deduction is only allowed for that part of the value-added tax which is proportional to the amount relating to the transactions giving entitlement to deduction as compared to the whole of the taxable transactions.

Article 11 (3) provides that in the case of such a partial deduction, the amount of the deduction shall be provisionally determined in accordance with criteria established by each Member State, and finally adjusted at the end of the year when all the facts necessary for calculating the *pro rata* figure are known.

In respect of the same situation, the third paragraph of Article 11 (3) contains particular rules for capital goods.

It provides that the adjustment shall be effected on the basis of the variations of

the *pro rata* figure which have occurred during a period of five years starting with the year during which the goods were acquired. Thus, each year, the adjustment only applies to one fifth of the tax borne by capital goods.

This spread over five years can only be explained by the fact that the use of capital goods extends over a long period.

The same interpretation should be put upon the authority given to Member States to apply the method of deduction by annual instalments for capital goods, whether on a transitional basis (second indent of Article 17), or permanently (point 23 of Annex A to the Second Directive).

The fact that it is thus possible to proceed by way of deduction *pro rata temporis* is another reason for thinking that capital goods are goods which are written off over several years..

Finally, as part of the transitional measures intended to prevent possible instances of aggregation of taxation resulting from the transition from the old system of turnover taxes to the system of value-added tax, the fourth indent of Article 17 authorizes, on an exceptional basis, standard deductions for *inter alia,* capital goods *not yet written off* from turnover tax paid prior to the entry into force of the new system.

I think that the concept of capital goods constitutes in a certain sense the transposition into the realm of value-added tax of the concept of 'goods eligible for writing off' found in the field of direct taxation on the profits of an undertaking.

But it is indeed the criterion of writing off which enables one to say whether an object counts as capital goods for the purposes of Article 17.

It is otherwise with goods the acquisition cost of which is treated as general costs. The normal practice of business management is not to enter these costs as assets in the balance sheet and not, therefore, to write them off over several years.

In these circumstances I do not think that any useful purpose is to be served by answering the second question referred to you by the Hoge Raad of the Netherlands.

The third question, to my mind, should be answered in the affirmative.

The national court has made this question very specific. It asks you whether the rule as to unrestricted reduction laid down by Article 11 of the directive is directly applicable 'in respect of goods purchased in 1972 and intended to be used for the purpose of the undertaking which do not belong to the category of capital goods within the meaning of the said Article 17, whatever use the Netherlands legislature may have made of the powers mentioned in Article 11 and 17 of the said directive'.

As I have said, the principle of deduction of the whole of the tax already borne on goods intended to be used for the purposes of the undertaking is the key to the system of common value-added tax.

Not only is this rule binding on the Member States, and since 1 January 1972 as regards the Netherlands; it is clearly expressed in terms which do not lead themselves to any ambiguity.

It is not subject to any condition other than that the goods acquired must be used for the purposes of the undertaking.

The only exceptions to it, which are made by Article 11 (2) and (4) are clearly circumscribed and cannot affect its direct effect.

Those exceptions are concerned either with the case where goods are used in non-taxable or exempt transactions

(Article 11 (2)), which necessarily means that there is no deduction, or with the case where the condition requiring that the goods be used for the purposes of the undertaking is not fulfilled (Article 11 (4)); this is the provision which covers the use of certain goods for the private needs of the taxable person or of his staff.

Such provisions do not take away the right available to taxable persons to use the principle laid down by Article 11 (1), which does not confer any discretion upon the national authorities. On the contrary, it imposes upon them an obligation as to the result, which consists in bringing into force a non-cumulative system of turnover taxes.

I am of the opinion that you should rule:

1. In the third indent of Article 17 of the Second Council Directive No 228 of 11 April 1967, on the harmonization of legislation of Member States concerning turnover taxes, the expression 'capital goods' means goods with a long serviceable life, the acquisition cost of which is spread over several years.

2. In so far as goods, other than capital goods, are used for the purposes of an undertaking, Article 11 (1) (a) of the said directive is a provision which creates in favour of taxable persons rights of which the latter may avail themselves at law in a Member State and which the national courts must uphold.