OPINION OF ADVOCATE GENERAL GULMANN
delivered on 15 September 1992 *

Mr President,
Members of the Court,

1. The Commission has brought these proceedings for a declaration that by applying a system of value added tax which is incompatible with the provisions of Article 26 of the Council's Sixth VAT Directive [1] the Federal Republic of Germany has failed to fulfil its obligations under the EEC Treaty.

2. Title XIV of the Sixth VAT Directive contains a number of special schemes in connection with the directive's general rules. Article 24 lays down a special scheme for small undertakings, Article 25 lays down rules for a common flat-rate scheme for farmers and Article 26 lays down a special scheme for travel agents.

3. Under Article 26(1) Member States are to apply the scheme to operations of travel agents where the travel agents deal with customers in their own name and use the supplies and services of other taxable persons in the provision of travel facilities.

Article 26(2) provides:

'All transactions performed by the travel agent in respect of a journey shall be treated as a single service supplied by the travel agent to the traveller. It shall be taxable in the Member State in which the travel agent has established his business or has a fixed establishment from which the travel agent has provided the services. The taxable amount and the price exclusive of tax, within the meaning of Article 22(3)(b), in respect of this service shall be the travel agent's margin, that is to say, the difference between the total amount to be paid by the traveller, exclusive of value added tax, and the actual cost to the travel agent of supplies and services provided by other taxable persons where these transactions are for the direct benefit of the traveller.'

Article 26(2) which, according to the evidence, has been implemented in German law, provides, in so far as is relevant to the present case,

(a) that the taxable transactions are to be treated as a single service, and

(b) that the taxable amount is the travel agent's margin, which roughly speaking is the difference between the price payable by the traveller to the travel agent and the

* Original language: Danish.

1 — 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).

cost to the travel agent of purchasing from other taxable persons hotel, transport and other services which are for the direct benefit of the traveller.

The margin thus defined constitutes the taxable amount for the travel agents in question. It is provided in Article 26(4) that travel agencies can neither deduct nor receive a refund of the VAT paid by the taxable person from whom the travel agent purchases hotel and transport services and so forth.

4. Article 26(3) provides:

'If transactions entrusted by the travel agent to other taxable persons are performed by such persons outside the Community, the travel agent's service shall be treated as an exempted intermediary activity under Article 15(14). Where these transactions are performed both inside and outside the Community, only that part of the travel agent's service relating to transactions outside the Community may be exempted.'

It is that provision which, in the Commission's view, has not been correctly implemented in German law.

It is apparent from that provision that the travel agent's taxable amount, that is to say, its margin, is reduced if the hotel, transport and other services which are included in the travel agent's supply to the traveller, are provided outside the Community. It is also apparent from the provision that that is also the case where only part of the services are provided outside the Community. It follows from Article 26(3) that a travel agent must, for example, only pay VAT on only 50% of his margin if 50% of the services purchased from other taxable persons are supplied outside the Community.

The distinction made by Article 26(3) between services supplied inside and those supplied outside the Community does not give rise to any particular problems as far as services which, like the provision of hotel and meals, are supplied in the place or places which constitute the traveller's destination or destinations. The distinction does cause difficulty, however, as far as transport services are concerned. In their case it might be difficult to carry out the division prescribed in the second sentence of Article 26(3) between services supplied in the Community and those supplied outside the Community (international waters and non-member countries).

5. The Sixth VAT Directive was implemented in Germany by the Law of 29 November 1979 on Turnover Tax which entered into force on 1 January 1980 (referred 'the 1980 VAT Law'). The special rules for value added tax on travel services were laid down in Paragraph 25 of the Law and no amendments of any significance for this case have subsequently been made. The rules in Paragraph 25 implement the main principles of Article 26 of the Sixth VAT Directive. That is not true, however, of Paragraph 25(2) which contains rules on tax exemptions. Under Paragraph 25(2) *inter alia* supplies consisting of 'cross-frontier trans-

port by air or sea' and 'transport by air or sea taking place exclusively outside the Federal Republic of Germany' (hereinafter 'international transport by air and sea') are exempted.

6. The Commission claims that those rules mean that as far as German travel agents are concerned the scope of the tax exemption is greater than that permitted under Article 26(3) of the directive.

The German rules implement Article 26(3) of the Sixth VAT Directive as regards hotel supplies and supplies relating to transport which take place over land, for example by coach or train. However another rule applies with regard to transport by air or sea. The German rules exempt any form of air and sea transport provided it is 'international', that is to say not limited to German territory. Article 26 of the Sixth VAT Directive allows only for exemption in so far as such transport services take place outside the Community. The Commission points out that that incorrect implementation of the directive creates distortion of competition in relation to travel agents in other countries and, moreover, has a negative effect on the Community's own resources arising from VAT.

7. The German Government does not dispute that the said provision in the 1980 VAT Law constitutes a defective implementation of Article 26(3) of the Sixth VAT Directive. It contends, however, that that defective implementation is justified on the following two grounds:

The Government contends, principally, that Article 26 cannot in practice be implemented — at least as far as international flights are concerned — and must therefore be deemed non-existent.

The German Government contends in the alternative that the German system is lawful because it is covered by the transitional provisions in Article 28(3)(b) of the directive in conjunction with Point 27 of Annex F thereto.

Should Article 26(3) be deemed non-existent because it cannot in practice be implemented?

8. The Commission asks that the German Government's submissions concerning the invalidity of the provision be rejected. It argues that according to the case-law of the Court the question of the validity of a provision in a measure adopted by the Council, including provisions in directives, cannot be examined in an infringement action.

The Commission has referred *inter alia* to the Court's judgment in Case 226/87 *Commission* v *Hellenic Republic*, [2] in which, con-

2 — [1988] ECR 3611. Amongst other cases mention should also be made of Case 156/77 *Commission* v *Belgium* [1978] ECR 1881.

sistently with earlier judgments, the Court held:

'The system of remedies set up by the Treaty distinguishes between the remedies provided for in Articles 169 and 170, which permit a declaration that a Member State has failed to fulfil its obligations, and those contained in Article 173 and 175, which permit judicial review of the lawfulness of measures adopted by the Community institutions, or the failure to adopt such measures. Those remedies have different objectives and are subject to different rules. In the absence of a provision of the Treaty expressly permitting it to do so, a Member State cannot therefore plead the unlawfulness of a decision addressed to it as a defence in an action for a declaration that it has failed to fulfil its obligations arising out of its failure to implement that decision.' (paragraph 14)

As the citation shows, in that judgment the Court set out the position in a case where the infringement action related to a decision addressed to the Member State. The Court has not as yet stated whether the same result ensues where an objection of illegality is made in an infringement action concerning the incorrect implementation of a provision in a directive.

At first glance there would not appear to be any reason why directives should be treated any differently from decisions in that connection. Directives are, like the decisions with which the Court's case-law hitherto has been concerned, addressed to the Member States which will be able to contest their validity under Article 173 of the Treaty.

In my view, however, it cannot be completely ruled out that closer analysis covering *inter alia* the substantive reasons underlying the availability of review of the applicability or validity of a general legal measure under Articles 184 and 177 of the Treaty might show that there are grounds for treating directives differently from decisions in that connection. [3]

There is, however, no need to adopt a position on the question in this case. That is because the German Government contends that Article 26(3) of the directive should be deemed non-existent and that it follows from the case-law of the Court that the Member States may also raise an objection of illegality in infringement proceedings if the contested provision 'contained such particularly serious and manifest defects that it could be deemed non-existent'. [4]

9. The German Government claims that Article 26(3) should be deemed non-existent because in practice it is not possible to apply the provision to services consisting of international air transport. It mentions in particular that it follows from the Court's case-law that it should be possible for taxable persons to calculate their tax liability in advance, [5] and that such advance calculation is impossible in the case of international air transport. It refers, in particular, to the fact that not

3 — The question is not discussed by the parties to the case. To my knowledge there is no examination of this particular issue in legal writing on the subject. For a more genereal review of theory and practice in relating to objections of illegality see Kovar, 'Contentieux de la légalité — L'exception d'illégalité', *Jurisclasseur de droit international*, 1981, vol. 161-C, part three, sections 19 to 25.

4 — See paragraph 16 in the judgment cited in footnote 2.

5 — See the Court's judgment in Case 15/81 *Gaston Schul* [1982] ECR 1409, especially paragraph 14.

only in many cases is it extremely laborious for travel agents to split up the cost of air transport taking place partly over Community territory and partly over international waters and the territory of non-member countries, but that it can even be impossible to calculate in advance the various parts of a given air journey. Travel agents do not always know beforehand the routes which air companies will use. There may be alternative routes and there may be routes on which it is impossible to know in advance whether the flight will pass over the territory of a Member State or over international waters, and not infrequently it might happen that, for example, because of meteorological conditions it becomes necessary to alter the planned route.

10. The Commission disputes the fact that the problems raised by the German Government make it impossible to apply Article 26(3) in practice. In this connection the Commission has pointed out *inter alia* that according to its information the other Member States which have not availed themselves of the directive's exemption provisions have been able to apply the provision in practice.

11. It is clear that the German Government has succeeded in showing that Article 26(3) must be difficult for the travel agents concerned to apply. That is presumably also the reason why the Commission, according to the evidence, is in the course of preparing a draft amendment of the provision.

It is, however, in my view, also clear that those difficulties do not mean that the provision should be deemed non-existent.

The serious and manifest character of the defect alleged is required to be extremely marked before a measure adopted by the Council may be deemed non-existent.

It is very significant as far as my assessment of the actual situation is concerned that according to the information supplied by the Commission the system is applied in practice in the Member States which have implemented the provision and that the German Government has not established the contrary. [6]

Weight should also be attached to the fact that, according to the evidence, it was only in 1989, after the Commission had commenced infringement proceedings, that the German Government first submitted the problem to the VAT Advisory Committee set up pursuant to Article 29 of the directive. [7]

6 — The Member States concerned are Spain, France, Italy, Luxembourg and Great Britain. The evidence indicates that the other Member States have used the directive's exemption provisions either wholly to exempt the relevant services from VAT whether transport takes place inside or outside the Community (Denmark, Ireland and the Netherlands) or to impose tax on all supplies, whether made inside or outside the Community. That information is contained in a survey submitted as an annex to the working document prepared by the Commission, see annex 18 to the application (sub-annex II).

7 — At the Committee's Twenty-fifth Meeting held on 10 and 11 April 1989 the problem was discussed and a majority of the delegations were in favour of allowing the place of destination to determine whether a journey takes place inside or outside the Community. The Committee's recommendations are not binding.

It is also significant that by proceeding to implement Article 26(3) in a way that was clearly contrary to the Treaty, the German authorities ruled out in advance any possibility that the practical difficulties which the Government is now pleading could be resolved by a practical application of the law, for example by way of an interpretation of the directive whereby in calculating the taxable amount the planned route would be taken as a basis, not the route actually flown.

12. In addition the German Government's contention that the implementation effected represents the implementation closest to the legal reasoning behind Article 26(3) would not appear justified. The German rules exempt from tax every form of international air (and sea) transport and can certainly not be regarded as a genuine attempt to implement Article 26(3) of the directive, even if account was taken in that implementation of the abovementioned practical difficulties. [8]

13. The German Government has argued that international sea transport must be exempted from tax because it is almost exhaustively carried out outside the Community. That fact, which may perhaps be used as an argument for amending Article 26(3) of the directive, cannot of course be used as a ground for not implementing the rule in force.

14. The German Government has also claimed that the provision of the directive at issue is in breach of the principle of legal certainty, including the requirement that Community provisions which can have financial consequences should be clear and foreseeable. [9] That submission can be dismissed by the Court straight away, in my view. It is hard to see that it has any significance of its own alongside the Government's submission concerning the difficulties of applying the provision in practice.

15. There is no need either to examine further the German argument concerning the distortive effects on competition of a correct implementation of Article 26(3). It is true that if the provision was implemented correctly German travel agents would be placed in a worse position from the competition point of view than travel agents in the Netherlands and Denmark, where Article 26(3) has not been implemented. The reason for that difference, however, is that those two countries have made use of the transitional provision in the directive. That circumstance cannot therefore be put forward as a reason for non-implementation of a provision of the directive in Member States which have not made use of the transitional provision.

16. The Court should, on those grounds, dismiss the German submission that Article 26(3) should be deemed non-existent. Germany was and is under an obligation to

8 — It appears from the preparatory documents of the 1980 VAT Law that the reasons for the rules at issue here were the risk of distortion of competition and the need for a simplied tax charge, see *Schriftlicher Bericht des Finanzausschusses des Deutschen Bundestages* of 8 May 1979 on Article 25 (Annex 16 to the Commission's answers to the Court's questions).

9 — See, for example, the judgments in Joined Cases 92/87 and 93/87 *Commission* v *France and the United Kingdom* [1989] ECR 405 and Case C-30/89 *Commission* v *France* [1990] ECR I-681.

implement Article 26(3) properly unless incomplete implementation is based on one of the transitional provisions of the directive.

The transitional provision in Article 28(3)(b) of the directive

17. As stated, the German Government has contended that, in so far as Article 26(3) should be regarded as valid, the basis for the German rules at issue lies in the special transitional provision in Article 28(3)(b) of the directive, in conjunction with Annex F, point 27. [10]

The provision in question is worded as follows:

'3. During the transitional period referred to in paragraph 4, Member States may:

(b) continue to exempt the activities set out in Annex F under conditions existing in the Member State concerned;' [11]

Annex F, point 27, is worded as follows:

'The services of travel agents referred to in Article 26, and those of travel agents acting in the name and on account of the traveller, for journeys within the Community.'

That transitional provision, which is still in force, [12] has, as already stated, been applied by three Member States as the basis for the maintenance in force of earlier tax exemption systems for travel agents.

18. The transitional provision is, in the Commission's view, not applicable in the present case. The Commission claims that the transitional provision does not provide a basis for only partly derogating from the directive's provisions when derogations can be made under the transitional provisions. A Member State may not, therefore, choose, as the Federal Republic has done, to implement the main principles of Article 26 of the directive yet not to implement the provision as far as part of the content of Article 26(3) is concerned.

The Commission also claims that the transitional provision cannot be applied because the special rules in the 1980 VAT Law on tax

10 — In the course of the administrative procedure the Government also referred to point 17 of Annex F, but that was not cited before the Court.

11 — The wording of the provision in German and French is as follows:
'b) die in Anhang F aufgeführten Umsätze unter den in den Mitgliedstaaten bestehenden Bedingungen weiterhin befreien;'
'b) continuer à exonérer les opérations énumérées à l'annexe F dans les conditions existantes dans l'Etat membre;'

12 — The Commission suggested that the provision should be repealed in its proposal for the Eighteenth VAT Directive on the abolition of certain derogations provided for in Article 28(3) of the Sixth Directive. That part of the Commission's proposal was not, however, adopted by the Member States: see Eighteenth Council Directive, OJ 1989 L 226, p. 21.

exemption for international air and sea transport do not represent a continuation of a tax exemption 'under conditions existing in the Member State concerned'.

19. In their reply to the questions posed by the Court the parties submitted detailed information regarding the legal situation in the Federal Republic before the adoption of the 1980 VAT Law. It appears from that information that the adoption of the new VAT Law led to fundamental changes in the calculation of tax for travel agents' services. Under the VAT law in force previously there was no special treatment of travel agents, and their transactions were therefore mainly dealt with under the law's general rules, that is to say the travel agents paid VAT on each single supply, with the right to deduct the VAT paid to other taxable persons. It further appears that the rules on the tax treatment of international air and sea transport at issue in this case were different both in their formulation and legal bases from the rules in the 1980 VAT law. [13] Finally, it appears from the information provided that the conclusion may be drawn that despite those differences the rules in force previously did in fact lead to the same tax result as the rules in the 1980 VAT law.

20. On that basis it cannot be disputed in that respect that the 'activities' consisting of international air and sea transport 'continue' to be exempted. [14] The question remains therefore, first, whether the Commission is right in its view that a Member State wishing to apply the transitional provision may do so only in relation to Article 26 as a whole, and secondly whether the exemption continues to apply 'under conditions existing in the Member State concerned'.

21. As a preliminary point it is worth emphasizing that the transitional provisions which enable exemptions to be made from the rules of the directive and thus delay implementation of the harmonization of the rules of the Member States,

which is the aim of the directive, must be construed strictly.

It would, nevertheless, I believe be wrong for the Court to interpret Article 28(3) in a way that completely ruled out for the possibility that exemptions might be applied in part.

I find it difficult to see that there can be substantive grounds for an absolute requirement that the transitional system should only be used if a Member State completely omits to implement the system in Article 26. It is hard to see that the uniform application of Community law in the Member States will be

13 — Thus international sea transport was not covered at all by the tax system previously in force and there was therefore no question of any actual exemption. On the other hand international air transport was in principle subject to VAT, but exempted by a dispensation pursuant to a ministerial decree.

14 — Thus it was not the case here that the German Government after first implementing the directive correctly then reintroduced an earlier exemption system. The judgments in Case C-35/90 *Commission* v *Spain* [1991] I-5073 and Case 73/85 *Kerrutt* [1986] ECR 2219, which the Commission cited, are not therefore directly relevant, because they concerned cases where a Member State had reintroduced exemptions that had applied previously.

adversely affected if a Member State chooses to implement the main principles in Article 26 and omits solely to implement the special rules in Article 26(3) as far as clearly delimited and easily identifiable activities are concerned. The exemption does not alter the principle in Article 26(2) according to which transactions performed by a travel agent are to be treated as a single service supplied by the travel agent to the traveller. Under German law, in conformity with Article 26(2), it is the travel agent's margin which is taxed. The special exemption simply entails a reduction on the content of that margin in relation to what ensues from the rules laid down in Article 26(3). It is not easy to see why legal certainty is improved if the transitional provision may only be used by the German Government for the purpose of maintaining in their entirety the earlier rules applying to travel agents.

It might even be maintained that a narrow interpretation of the transitional provision could have adverse effects for the uniform application of the directive in the Member States. A restrictive interpretation imposes an 'all-or-nothing' choice on the Member States. That choice would compel a Member State which finds it necessary to maintain an existing exemption to maintain the existing legal position in its entirety, even if it were considered possible, appropriate and desirable otherwise to implement the system laid down in the directive on the subject.

There is no doubt that from the point of view of uniform application of law in the Community it is unfortunate that it continues to be possible for the Member States to maintain their own special rules on the basis of the transitional provision. It does not, however, seem reasonable to me in that context to interpret the transitional provision to the effect that as long as the Member States wish to make use of it they should be prevented from undertaking a partial implementation of the special system in Article 26 — implementation which, when all is said and done would be beneficial for the uniform legal application of Article 26 in the Member States and after all would be a first step towards complete implementation of that provision.

22. Whilst application of the transitional provision in Article 28(3)(b) therefore should not, in my view be rejected on the first of the grounds put forward by the Commission, I believe that the Commission is right in its argument that continued exemption of international air and sea transport did not, as required by the transitional provision take place 'under conditions existing in the Member State concerned'.

That condition, which amplifies the statement that the Member States may 'continue' to exempt must in my opinion be interpreted as meaning that — even if a complete maintenance in force of the rules applicable can hardly be required — an identical legal position is nevertheless required. It must be possible to determine without difficulty that the Member State does 'continue' to apply the exemption for the purpose of ensuring thereby that the transitional provision is not being used to create fresh exemptions.

In the present case it cannot reasonably be asserted that the relevant rules in the 1980 VAT Law fulfil that condition. The evidence supplied by the parties and referred to above shows that the process of framing the relevant rules under the earlier legislation was considerably more complicated and less transparent than the framing of the rules in Paragraph 25(2) of the 1980 VAT Law. In addition the legal position prevailing earlier was to a certain extent laid down at the administrative level by way of a dispensation system and thus had a completely different legal status from that of the present tax exemptions laid down clearly in the provisions of a law.

23. Accordingly the conclusion may be drawn that the transitional provision in Article 28(3)(b) may not be relied upon as the basis for defective implementation of Article 26 of the directive.

24. Moreover, I find some support for the correctness of that result in the fact that in the preparatory work for Paragraph 25(2) of the 1980 VAT Law reference was made to the fact that the special rules for international air and sea transport implied maintenance of the rules hitherto applicable contrary to the Sixth VAT Directive, and that their legal basis was constituted by the transitional provisions of the directive. Furthermore, the Germany Government first made that submission at a late point in the infringement procedure, that is to say in a supplementary reply of 30 April 1990 to the Commission's reasoned opinion of 29 December 1989.

Conclusion

25. I accordingly suggest that the Court should declare that the Federal Republic of Germany has failed to fulfil its obligations under the Treaty as requested by the Commission and order the Federal Republic to pay the costs.