

JUDGMENT OF THE COURT (First Chamber)

10 March 2005<sup>\*</sup>

In Case C-33/03,

ACTION under Article 226 EC for failure to fulfil obligations, brought before the Court on 28 January 2003,

**Commission of the European Communities**, represented by R. Lyal, acting as Agent, with an address for service in Luxembourg,

applicant,

v

**United Kingdom of Great Britain and Northern Ireland**, represented by P. Ormond and C. Jackson, acting as Agents, assisted by N. Fleming QC, with an address for service in Luxembourg,

defendant,

<sup>\*</sup> Language of the case: English.

THE COURT (First Chamber),

composed of P. Jann, President of the Chamber, K. Lenaerts (Rapporteur),  
N. Colneric, K. Schiemann and E. Juhász, Judges,

Advocate General: C. Stix-Hackl,

Registrar: M.-F. Contet, Principal Administrator,

having regard to the written procedure and further to the hearing on 11 November  
2004,

after hearing the Opinion of the Advocate General at the sitting on 14 December  
2004,

gives the following

### **Judgment**

- 1 By its application the Commission of the European Communities has brought an action for a declaration that, by granting to taxable persons the right to deduct value added tax ('VAT') in respect of certain supplies of road fuel to non-taxable persons, contrary to Articles 17 and 18 of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation 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, 'the Sixth Directive'), the United Kingdom of Great Britain and Northern Ireland has failed to fulfil its obligations under the EC Treaty.

## Legal background

### *The relevant provisions of Community law*

2 Under Article 4 of the Sixth Directive:

'1. "Taxable person" shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.

...

4. The use of the word "independently" in paragraph 1 shall exclude employed and other persons from the tax in so far as they are bound to an employer by a contract of employment or by any other legal ties creating the relationship of employer and employee as regards working conditions, remuneration and the employer's liability.

...'

- 3 Article 17 of the Sixth Directive, entitled ‘Origin and scope of the right to deduct’, provides:

‘1. The right to deduct shall arise at the time when the deductible tax becomes chargeable.

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

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

... ’

- 4 Article 18 of the Sixth Directive, entitled ‘Rules governing the exercise of the right to deduct’, provides that:

‘1. To exercise his right to deduct, the taxable person must:

- (a) in respect of deductions under Article 17(2)(a), hold an invoice, drawn up in accordance with Article 22(3);

... ’

*The relevant provisions of national law*

5 Articles 2 and 3 of the VAT (Input Tax) (Person Supplied) Order 1991 ('the U.K. Order'), which entered into force on 1 December 1991, provide:

'2. Article 3 below shall apply where road fuel is supplied to a person who is not a taxable person and a taxable person pays to him:

(a) the actual cost to him of the fuel; or

(b) an amount, the whole or part of which approximates to and is paid in order to reimburse him for the cost of the fuel, determined by reference to:

(i) the total distances travelled by the vehicle in which the fuel is used (whether or not including distances travelled otherwise than for the purposes of the business of the taxable person), and

(ii) the cylinder capacity of the vehicle, whether or not the taxable person makes any payment in order to reimburse him for any other cost.

3. Where this article applies, the fuel shall be treated for the purpose of section 14 (3) of the Value Added Tax Act 1983 as having been supplied to the taxable person for the purpose of a business carried on by him and for a consideration equal to the amount paid by him under article 2(a) or (b) above, as the case may be (excluding any reimbursement of any cost other than the cost of the fuel)'.

- 6 It is to be pointed out that section 14(3) of the Value Added Tax Act 1983 had in the meantime been replaced by section 24(1) of the Value Added Tax Act 1994 ('VATA 1994').
- 7 Although articles 2 and 3 of the U.K. Order are worded in a general fashion, it is apparent that the right to deduct VAT under those provisions concerns road fuel reimbursed by employers to their employees, as is made clear in the Explanatory Note appended to that Order, which states:

'This order, which comes into force on 1st December 1991, gives statutory effect to a long-standing administrative practice. The order provides for road fuel bought by employees to be treated as being supplied to the employer where the employee is reimbursed by means of a mileage allowance or the actual amount paid ... '.

### **The pre-litigation procedure**

- 8 The Commission initiated the infringement proceedings under Article 226 EC by a letter of formal notice sent to the United Kingdom Government on 10 May 1995 in which it at first did no more than allege infringement of Article 18(1)(a) of the Sixth

Directive. It considered that the grant of the right to deduction under articles 2 and 3 of the U.K. Order, without any obligation to produce an invoice, was not in accordance with the requirements of Article 18.

- 9 After further examination of the matter, the Commission concluded that the grant of a right to deduction in the circumstances envisaged by articles 2 and 3 of the U.K. Order was contrary to Article 17(2)(a) of the Sixth Directive also. It sent the United Kingdom an additional letter of formal notice on 17 October 1996. In order to dispel any doubt about the fact that it considered the employer's right to deduct VAT at the time of reimbursement to the employee of the cost of fuel under articles 2(a) and (b) of the U.K. Order to be contrary to Article 17(2)(a) of the Sixth Directive, the Commission sent the United Kingdom a second additional letter of formal notice on 3 December 1997.
- 10 The United Kingdom submitted its observations in letters of 13 July 1995, 16 December 1996 and 28 January 1998.
- 11 Those answers not having satisfied the Commission, the latter sent a reasoned opinion to the United Kingdom on 14 October 1998, calling upon it to take the measures necessary to comply with that opinion within two months of its notification.
- 12 In its reply of 15 December 1998 to the reasoned opinion, the United Kingdom repeated its disagreement with the Commission's position.

## The action

### *Concerning the allegation of infringement of Article 17 of the Sixth Directive*

- 13 The Commission maintains that articles 2 and 3 of the U.K. Order are contrary to Article 17(2)(a) of the Sixth Directive because they give taxable persons the right to deduct VAT in respect of fuel supplied to non-taxable persons. Furthermore, those provisions of national law do not make the deduction of VAT by the taxable person conditional upon the fuel's being used by the non-taxable person for the purposes of the taxable person's taxable transactions.
- 14 The United Kingdom Government argues that the system of deductions provided by the Sixth Directive is intended to relieve taxable persons entirely of the burden of the VAT payable or paid in the course of their economic activities (Case 268/83 *Rompelman* [1985] ECR 655, paragraph 19). If someone pursues an economic activity, all the goods and services supplied to him for the purposes of that activity are components of the cost of his own transactions and all the VAT that has been borne by them ought therefore to be deductible.
- 15 It is, according to that government, current commercial practice for an employer — a taxable person — to entrust to employees — non-taxable persons — the purchasing of goods for use in the employer's business. In order to ensure that an employer should be able to exercise the right to deduct VAT on all goods used for the purposes of his taxable transactions, it must be held that where an employee acts on behalf of his employer and purchases goods to be used by the employer for the requirements of his business, the supply is in fact made to the employer.



- 16 It must first be recalled in this connection that the provisions of Article 17 specify the conditions giving rise to the right to deduct and the extent of the right to deduct. They do not leave the Member States any discretion as regards their implementation (Case C-62/93 *BP Soupergaz* [1995] ECR I-1883, paragraph 35, and Case C-388/98 *Commission v Netherlands* [2001] ECR I-8265, paragraph 43).
- 17 Finally, Article 17(2)(a) of the Sixth Directive makes it clear that a taxable person is authorised to deduct VAT due or payable in respect of goods and services supplied to him by another taxable person in so far as those goods and services are used for the purposes of his taxable transactions.
- 18 Now, in the instant case, articles 2 and 3 of the U.K. Order enable a taxable person, viz., the employer, to deduct VAT on the fuel supplied to non-taxable persons, viz., employees, when the employer reimburses them the cost of the fuel.
- 19 It is true that, as the United Kingdom Government stresses, in carrying out their work employees generally act on behalf of their employer. In its view, therefore, there must exist a right for the employer to deduct VAT in respect of the fuel bought by the employee for the purposes of the employer's taxable transactions.
- 20 Nevertheless, it must be held that the U.K. Order does not make the right to deduction which it confers subject to the condition that the fuel bought by the non-

taxable person should be used for the purposes of the taxable person's taxable transactions. Indeed, neither the U.K. Order nor the explanatory note imposes as a condition for eligibility for deduction of VAT that the fuel bought by the employee should be used for the purposes of the employer's taxable transactions. On the contrary, articles 2(b)(i) and 3 of that order, read in conjunction, allow the employer to deduct VAT on the amount of fuel reimbursed to the employee computed by reference to the total distance travelled by the employee's vehicle 'whether or not including distances travelled otherwise than for the purposes of the business of the taxable person'.

21 In answer to a written question asked by the Court, the United Kingdom Government expressly acknowledged that '[t]he Order itself does not lay down an obligatory link between the employer's right to deduct VAT in respect of fuel bought by the employee and the use of the fuel by the employee for the requirements of taxed operations of the employer'.

22 It follows, therefore, that articles 2 and 3 of the U.K. Order are not compatible with Article 17(2)(a) of the Sixth Directive, inasmuch as they enable a taxable person, namely, the employer, to deduct VAT in respect of fuel supplied to non-taxable persons, namely, employees, in conditions that do not guarantee that the VAT deducted relates solely to fuel used for the requirements of the taxable person's taxed transactions.

23 The United Kingdom Government observes, however, that the necessary link between the right to deduct VAT and the use of fuel for the requirements of the taxable person's taxed operations is provided by the VATA 1994, as applied by the British tax authorities. It explains in this respect that the system of reimbursement

conferring entitlement to deduction of VAT, which is recognised by the tax authorities, operates as follows. First, the employee provides the employer with detailed mileage records showing which trips were used for business purposes and the corresponding mileage, together with the cylinder capacity of the vehicle used. The employee also provides the employer with the invoices relating to the purchase of fuel. Next, the employer uses a list drawn up by the Royal Automobile Club, the Automobile Association or the U.K. Customs and based on rates approved by the Inland Revenue, relying on detailed information supplied by the vehicle manufacturers in order to determine the cost of fuel per mile for the kind of vehicle concerned. That system offers sufficient guarantees, according to that government, to ensure that the amount reimbursed to the employee corresponds to the cost of the fuel actually used by the latter for the employer's business requirements.

- 24 In this regard it is to be noted that the VATA 1994 is a general law relating to VAT which, in sections 24 to 26, lays down the principles of the deductibility of this tax. Even though, under that law, the right to deduct VAT relates generally to the goods and services used by the taxable person for the purposes of his taxable transactions, that act is not capable of rendering articles 2 and 3 of the U.K. Order compatible with Article 17(2)(a) of the Sixth Directive. Since, in accordance with article 3 of that order, fuel the cost of which is reimbursed by an employer to his employees is automatically treated, for the purposes of the VATA 1994, as having been supplied for the purpose of his business, the national legislation at issue does not ensure that the right to deduct VAT which it confers attaches solely to fuel actually used by employees for the purposes of the employer's taxable transactions.

- 25 As regards the United Kingdom Government's argument that the practice adopted by the tax authorities guarantees the existence of an obligatory link between the

employer's right to deduct VAT and the use of the fuel by the employees for the employer's taxed operations, it must be borne in mind that it is settled case-law that the incompatibility of national legislation with Community provisions can be finally remedied only by means of national provisions of a binding nature which have the same legal force as those which must be amended. Mere administrative practices cannot be regarded as constituting the proper fulfilment of obligations under Community law (Case C-197/96 *Commission v France* [1997] ECR I-1489, paragraph 14; Case C-358/98 *Commission v Italy* [2000] ECR I-1255, paragraph 17, and Case C-145/99 *Commission v Italy* [2002] ECR I-2235, paragraph 30).

- <sup>26</sup> It follows from the foregoing that, by granting taxable persons the right to deduct VAT on certain supplies of fuel to non-taxable persons in conditions that do not ensure that the VAT deducted attaches solely to fuel used for the purposes of the taxable person's taxable transactions, articles 2 and 3 of the VAT Order are incompatible with Article 17(2)(a) of the Sixth Directive.

- <sup>27</sup> It is apparent from all the foregoing that the Commission's first claim is well founded.

*Concerning the allegation of infringement of Article 18 of the Sixth Directive*

- 28 The Commission maintains that the deduction provided for by articles 2 and 3 of the VAT Order is allowed without its being required that an invoice should be produced, contrary to Article 18(1)(a) of the Sixth Directive.
- 29 The United Kingdom Government challenges this claim only if the first claim should be held to be unfounded.
- 30 In those circumstances, it has to be considered that the allegation of infringement of Article 18(1)(a) of the Sixth Directive is also well founded.
- 31 It must therefore be declared that, by granting taxable persons the right to deduct VAT on certain supplies of fuel to non-taxable persons, contrary to the provisions of Articles 17(2)(a) and 18(1)(a) of the Sixth Directive, the United Kingdom has failed to fulfil its obligations under that directive.

## Costs

- 32 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for. The Commission having applied for costs and the United Kingdom having been unsuccessful, the latter must be ordered to pay the costs.

On those grounds, the Court (First Chamber) hereby:

1. **Declares that, by granting taxable persons the right to deduct value added tax on certain supplies of fuel to non-taxable persons, contrary to the provisions of Articles 17(2)(a) and 18(1)(a) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment, the United Kingdom of Great Britain and Northern Ireland has failed to fulfil its obligations under that directive;**
2. **Orders the United Kingdom of Great Britain and Northern Ireland to pay the costs.**

[Signatures]