OPINION OF ADVOCATE GENERAL
BOBEK
delivered on 7 September 2017(1)

Case C−305/16

Avon Cosmetics Ltd
v
The Commissioners for Her Majesty's Revenue and Customs

(Request for a preliminary ruling from the First-tier Tribunal (Tax Chamber), United Kingdom)

(VAT — Derogation — Sales through intermediaries not subject to VAT — Taking into account notional input tax)

I. Introduction

1. Avon Cosmetics Limited ('Avon') sells its beauty products in the United Kingdom to representatives, known colloquially as 'Avon Ladies', who in turn make retail sales to their customers ('direct selling model'). Many of the Avon Ladies are not registered for VAT. As a result, their profit margins would not normally be subject to VAT.

2. That problem of 'lost VAT' or 'VAT avoidance' at the last stage of the supply chain is typical of direct selling models. In order to deal with that problem, the United Kingdom sought and obtained a derogation from the standard rule that VAT is charged on the actual sales price. In Avon's case, that derogation essentially allowed the United Kingdom's tax authority, Her Majesty's Revenue and Customs ('HMRC'), to charge Avon VAT, not on the *wholesale price* paid by the unregistered Avon Ladies, but instead on the *retail price* at which the Avon Ladies would go on to sell the products to the final consumer.

3. However, the way the derogation is applied does not take into account the costs incurred by the unregistered representatives in their retail selling activities, and the input tax that they would normally have been able to deduct had they been VAT registered ('notional input tax'). In particular, where Avon Ladies buy products for demonstration purposes (not to resell but to use as a selling aid) they cannot deduct VAT on those purchases as input tax.

4. The result is that the disregarded notional input tax in relation to such costs 'sticks' in the supply chain and increases the overall VAT charged on the direct selling model over that charged on sales through ordinary retail outlets.

5. In the context of a challenge by Avon of its VAT assessment, the referring court asks a number of questions concerning the interpretation and validity of the Derogation. In particular, the referring court asks: (i) whether there is an obligation to take into account the notional input tax of direct resellers such as the Avon Ladies, (ii) whether there was an obligation for the United Kingdom to bring the issue of notional input tax to the European Commission's attention when it requested the Derogation, and (iii) what would be/what are the consequences of failing to comply with either of those obligations.

II. Legal framework

A. EU law

1. VAT Directives 77/388 and 2006/112

6. The relevant provisions of EU legislation which applied at the time of the arrangements in question are contained in VAT Directive 77/388/EEC (2) ('the Sixth VAT Directive'), for periods prior to 1 January 2007. For periods after that date they are found in VAT Directive 2006/112/EC (3) ('the Principal VAT Directive').

7. Save for some minor differences noted below, the relevant provisions of the Sixth VAT Directive and the Principal VAT Directive are identical. In this section, provisions of the Sixth VAT Directive will be cited below with the corresponding provisions of the Principal VAT Directive referred to in footnotes. For ease of presentation, only the relevant provisions of the Sixth VAT Directive will be cited in the remainder of this Opinion, with the corresponding provisions of the Principal VAT Directive applying *mutatis mutandis*.

8. Under Article 2 of the Sixth VAT Directive: (4)

'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.'

9. Article 4 of the Sixth VAT Directive provides: (5)

‘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.’

10. Article 11(A)(1)(a) of the Sixth VAT Directive provides: (6)

‘A. Within the territory of the country

1. The taxable amount shall be:

(a) in respect of supplies of goods and services other than those referred to in (b), (c) and (d) below, everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies including subsidies directly linked to the price of such supplies.’

11. According to Article 27 of the Sixth VAT Directive: (7)

‘1. The Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance. Measures intended to simplify the procedure for charging the tax, except to a negligible extent, may not affect the overall amount of the tax revenue of the Member State collected at the stage of final consumption.

2. A Member State wishing to introduce the measure referred to in paragraph 1 shall send an application to the Commission and provide it with all the necessary information. …

…

5. Those Member States which apply on 1 January 1977 special measures of the type referred to in paragraph 1 above may retain them providing they notify the Commission of them before 1 January 1978 and providing that where such derogations are designed to simplify the procedure for charging tax they conform with the requirement laid down in paragraph 1 above.’

2. Council Decision 89/534/EEC (‘the Derogation’)

12. Recitals 3 to 5 of the Derogation (8) state:

‘Whereas certain marketing structures based on sales of goods effected by taxable persons to non-taxable persons with a view to their resale at the retail stage result in avoidance of tax at the stage of final consumption;

Whereas, in order to prevent such tax avoidance, the United Kingdom applies a measure permitting the tax authorities to adopt administrative decisions the effect of which is to tax supplies made by the taxable persons operating such marketing structures on the basis of the open market value of the goods at the retail stage;

Whereas that measure constitutes a derogation from Article 11(A)(1)(a) of the Sixth Directive, which stipulates that, within the territory of the country, the taxable amount in respect of supplies of goods is everything which constitutes the consideration which has been, or is to be, obtained by the supplier from the purchaser or a third party for such supplies.’

13. Recitals 9 and 10 state that:

‘Whereas, in its judgment of 12 July 1988, the Court of Justice ruled inter alia that Article 27 of the Sixth Directive permitted the adoption of a derogating measure such as that at issue on condition that the resultant difference in treatment was justified by objective circumstances;

Whereas, in order to satisfy itself that this condition is met, the Commission must be informed of any administrative decisions adopted by the tax authorities in connection with the derogation in question.’

14. Article 1 of the Derogation provides as follows:

‘By way of derogation from Article 11(A)(1)(a) of the Sixth Directive, the United Kingdom is hereby authorised to prescribe, in cases where a marketing structure based on the supply of goods through non-taxable persons results in non-taxation at the stage of final consumption, that the taxable amount for supplies to such persons is to be the open market value of the goods as determined at that stage.’

B. National law

1. Value Added Tax Act 1994

15. The Sixth VAT Directive, and now the Principal VAT Directive, is implemented into domestic law in the United Kingdom by the Value Added Tax Act 1994 (‘VATA 1994’), section 1 of which provides:

‘Value added tax shall be charged, in accordance with the provisions of this Act–

(a) on the supply of goods or services in the United Kingdom ...’

16. The value of a supply of goods on which VAT is due is determined by section 19 and Schedule 6 of VATA 1994. Section 19(2) states:

‘If the supply is for consideration in money its value shall be such amount, as with the addition of the VAT chargeable, is equal to the consideration.’

17. Pursuant to the Derogation, what is now paragraph 2 of Schedule 6 of VATA 1994 permits HMRC to direct that the value of a supply of goods by a taxable person shall be taken to be its open market value on a sale by retail (in effect, an increased valuation from that which would arise under

Article 11(A)(l)(a) of the Sixth VAT Directive) in circumstances where those goods are to be sold on by non-taxable persons, where:

'(a) the whole or part of a business carried on by a taxable person consists in supplying to a number of persons goods to be sold, whether by them or others, by retail, and

(b) those persons are not taxable persons,

the Commissioners may by notice in writing to the taxable person direct that the value of any such supply by him after the giving of the notice or after such later date as may be specified in the notice shall be taken to be its open market value on a sale by retail.' ('Notice of Direction.')

2. Notice of Direction

18. On 27 June 1985 HMRC issued a Notice of Direction to Avon, which remains in place to this day. It states:

'In pursuance of [paragraph 2 to Schedule 6 of VATA 1994] the Commissioners of Customs & Excise hereby DIRECT that after 1 July 1985 the value by reference to which Value Added Tax is charged on any taxable supply of goods:-

(a) by you to persons who are not taxable persons ...

(c) to be sold, whether by persons mentioned in (a) above or others, by retail,

shall be taken to be its open market value on a sale by retail.'

III. Facts, proceedings and questions referred

19. Avon uses a direct selling model in the United Kingdom. Under that model, Avon sells its products to its representatives, the Avon Ladies, who in turn make retail sales to their customers at a markup. For example, where Avon sells a product to the Avon Ladies for 75 pounds sterling (GBP), it might be resold by the Avon Ladies for GBP 100.

20. The threshold for *compulsory* registration for VAT in the United Kingdom is high — GBP 100 000. Some Avon Ladies have chosen to register for VAT. However, many fall below the threshold for compulsory registration and have chosen not to register.

21. As a result, the profit margins made by those unregistered Avon Ladies would not normally be subject to VAT. So, in the above example, VAT is charged on the GBP 75 'wholesale' price, but not on the GBP 25 'retail profit margin' earned by the unregistered Avon Ladies. That problem of 'lost' VAT at the last stage of the supply chain can also arise in other direct selling models (for example some instances of door-to-door sales).

22. In order to address the problem of lost VAT arising from use of the direct selling model, the United Kingdom obtained a derogation from the standard rule that VAT must be charged on the actual sales price (Article 11(A)(1)(a) of the Sixth VAT Directive).

23. The Derogation essentially allows HMRC, in cases where the direct selling model is used, to charge VAT not on the *wholesale price* (which in this case is the price paid to Avon), but rather on the *retail price* (or best guess thereof) paid by the end customer to the reseller, that is, to the Avon Ladies.

24. The Derogation was transposed into domestic law and implemented by way of 'Notices of Direction'. Notices of Direction have been sent by the United Kingdom authorities to around 40 companies, including Avon.

25. The Derogation is not applied to all Avon sales indiscriminately.

26. A small number of Avon Ladies are VAT registered. VAT is charged in the normal way on their sales. Thus, Avon must account for output VAT on the price it charges to the VAT registered Avon Ladies. Those Avon Ladies must account for output VAT on the sales price to the end customer. But they can deduct input VAT in relation to the corresponding purchases from Avon.

27. HMRC and Avon have also agreed to two adjustments to the application of the Derogation. First, some Avon Ladies keep (some of) the products they buy from Avon for personal use. They thus become the end customers in respect of those products themselves. Second, Avon Ladies on occasion offer small discounts. In both cases, application of the Derogation would end up in VAT being overcharged. Therefore, the proportion of sales made in those two categories is considered by Avon and HMRC from time to time. According to the order for reference, very accurate figures are derived to reflect both points.

28. The above are all examples of situations where there is no dispute in principle about the non-application or modified application of the Derogation to sales by Avon. The present case concerns an aspect of application of the Derogation that is disputed, namely: sales of demonstration products.

29. Avon sells some products to the Avon Ladies for demonstration purposes. These are typically sold at a greater discount than usual. Some of the demonstration products are used as intended, for example as a sales aid. Some are kept by the Avon Ladies for their personal use. Avon and HMRC agree that approximately 50% of products that are sold as demonstration products instead end up being used by the Avon Ladies themselves. That is apparently why Avon does not give away its demonstration products for free. In those cases, the Avon Ladies are the final customers and VAT is charged on the price paid to Avon in application of the standard rule under Article 11(A)(1)(a) of the Sixth VAT Directive. No dispute arises in relation to those demonstration products.

30. The dispute arises in relation to the approximately 50% of demonstration products that are actually used as intended: they are not resold but employed as a business tool designed to increase other sales. For VAT registered retailers, the VAT paid on the purchase of those products would normally have secured an input tax deduction. However, that cost is not taken into account in the application of the Derogation. As a result, the incidence of VAT in relation to sales made through unregistered Avon Ladies is greater than that which applies in the few cases where Avon Ladies are registered. It is also greater than the level of tax where sales to end customers are made by registered sellers.

31. According to the order for a reference, disregarding those costs has resulted in an increase of VAT of around GBP 16 million over the period 1997 to 2013.

32. In the case before the referring court, Avon disputes the way the Derogation is being applied by HMRC. It argues that the Derogation should apply in such a manner as to ensure that Avon is not excessively taxed and that the amount collected under the Derogation is brought closer in line with the VAT 'avoided'. Avon argues that if the Derogation cannot be interpreted in such a way, it is invalid. Finally, Avon also argues in substance that, when requesting the Derogation, the United Kingdom was under an obligation to raise the issue of the impossibility of deducting input tax and the effect on the level of 'avoided' tax. The United Kingdom's failure to do so is also a ground for invalidity of the Derogation.

33. In the light of the foregoing the First-tier Tribunal (Tax Chamber) puts the following questions to this Court:

'(1) Where a direct seller sells goods ("Sales Aids") to unregistered resellers or the unregistered reseller purchases goods and services from third parties ("Third Party Goods and Services") which are in both cases used by the unregistered resellers to assist their economic activity of selling other goods which are also purchased from the direct seller and the subject of administrative arrangements issued pursuant to a derogation most recently authorised by Council Decision of 24 May 1989 (89/534/EEC) (the "Derogation"), do the relevant authorisations, implementing legislation and/or administrative arrangements offend any relevant provisions and/or principles of EU law in so far as they require the direct seller to account for output tax on the unregistered resellers' sale price of the other goods with no reduction for the VAT incurred by the unregistered reseller on such Sales Aids and /or Third Party Goods and Services?

(2) Whether the United Kingdom was under any obligation to inform the Commission when seeking authorisation from the Council for the Derogation, that unregistered resellers incurred VAT on purchases of Sales Aids and/or Third Party Goods and Services used for the purposes of their economic activities and that, accordingly, an adjustment to reflect that irrecoverable input tax, or overpaid output tax, should be accommodated in the derogation?

(3) In the event that the answer to questions 1 and/or 2 above is in the affirmative:

(a) Whether any of the relevant authorisations, implementing legislation or administrative arrangements can and should be interpreted so as to make an allowance in respect of either (i) irrecoverable VAT on Sales Aids or Third Party Goods and Services borne by unregistered resellers and used by such unregistered resellers for the purposes of their economic activities; OR (ii) VAT in excess of the tax avoided being collected by Her Majesty's Revenue & Customs OR (iii) the potential unfair competition that arises between direct sellers, their unregistered resellers and non-direct selling businesses.

(b) Whether:

(i) the authorisation of the UK's derogation from Article 11(A)(1)(a) of the Sixth Directive was unlawful;

(ii) a derogation from Article 17 of the Sixth Directive is necessary alongside the derogation from Article 11(A)(1)(a). If so, whether the UK acted unlawfully by failing to ask the Commission or the Council to authorise it to derogate from Article 17;

(iii) the UK is acting unlawfully by failing to administer VAT in such a way as to allow direct sellers to claim a credit for either Sales Aids or Third Party Goods and Services VAT incurred by unregistered resellers for the purposes of their economic activities;

(iv) all or any part of the relevant authorisations, implementing legislation or administrative arrangements are therefore invalid and/or unlawful.

(c) Whether the appropriate remedy is, from the Court of Justice of the European Union or from the national Tribunal or Court:

(i) a direction that the Member State is required to give effect to the Derogation in domestic law by providing for an appropriate adjustment for any of (a) irrecoverable VAT on Sales Aids or Third Party Goods and Services borne by unregistered resellers and used by such unregistered resellers for the purposes of their economic activities; OR (b) VAT in excess of the tax avoided being collected by Her Majesty's Revenue & Customs; OR (iii) the potential unfair competition that arises between direct sellers, their unregistered resellers and non-direct selling businesses; or

(ii) a declaration that the authorisation of the Derogation, and by extension the derogation itself, is invalid; or

(iii) a declaration that the domestic legislation is invalid; or

(iv) a declaration that the Notice of Direction is invalid; or

(v) a declaration that the UK is obliged to apply for authorisation for a further derogation so to provide for an appropriate adjustment for any of (a) irrecoverable VAT on Sales Aids or Third Party Goods and Services borne by unregistered resellers and used by such unregistered resellers for the purposes of their economic activities; OR (b) VAT in excess of the tax avoided being collected by Her Majesty's Revenue & Customs; OR (iii) the potential unfair competition that arises between direct sellers, their unregistered resellers and non-direct selling businesses.

(4) Under Article 27 of the Sixth Directive (Article 395 of the Principal VAT Directive), is the "tax eva[ded] or avoid[ed] " to be measured as the net loss of tax (taking account of both the output tax paid and input tax recoverable in the structure giving rise to the tax evaded or avoided) to the Member State or the gross loss of tax (taking account of only the output tax in the structure giving rise to the tax evaded or avoided) to the Member State?'

34. Written observations have been submitted by Avon, the United Kingdom Government, the Commission and the Council of the European Union. The interested parties that participated in the written stage presented oral argument at the hearing held on 31 May 2017.

IV. Assessment

35. This Opinion is structured as follows: I shall deal first with questions one and four as submitted by the referring court. Since my proposed answer to the Court on question one is in the negative (1), there is, therefore, no need to address the fourth question referred by the national court (2). Furthermore, my suggested answer to the national court's second question is also in the negative (3). Hence, again there is no need to address the third question (4).

1. First question

36. Does the Derogation or national measures implementing it infringe the Sixth VAT Directive and/or the general principles governing its application to the extent that they impose VAT on the open market value of products sold via resellers not registered for VAT, without taking into account notional input VAT on demonstration items or other goods and services purchased from third parties by those resellers? That is in essence the referring court's first question.

(a) General rules governing derogations granted under Article 27 of the Sixth VAT Directive

37. Article 27(1) of the Sixth VAT Directive foresees the authorisation of 'derogation[s] from the provisions of this Directive … to prevent certain types of tax evasion or avoidance'.

38. This case concerns a derogation from Article 11(A)(1)(a) of the Sixth VAT Directive, which defines the 'taxable amount'. No derogation is foreseen with regard to the remaining provisions of the Sixth VAT Directive or to the general principles thereof. Both of them thus remain fully applicable. (9)

39. A derogation from generally applicable rules by definition deviates from those rules. As such, it is only logical that the final result is likely to be different from the one that would have prevailed following full application of those general rules. (10)

40. However, as with any exception, derogations granted under Article 27(1) must be interpreted strictly. They are granted in relation to specific provisions of the Directive (11) and only in order either to simplify collection of VAT or to prevent tax evasion and avoidance. Moreover, 'they may not derogate from the basis for charging VAT laid down in Article 11, except within the limits strictly necessary for achieving that aim'. (12) They must also be necessary and appropriate for realising the specific objective which they pursue and have as little effect as possible on the objectives and principles of the Sixth VAT Directive. (13)

41. Article 27(1) also states that derogations 'may not affect the *overall amount* of the tax revenue of the Member State collected at the stage of final consumption' 'except to a *negligible extent*' (emphasis added). Article 27(1) explicitly provides that those limitations on 'overall amount' and 'negligible extent' apply to simplification measures. The Court's case-law has held that those limitations are 'in conformity with the fundamental principles of the Sixth Directive' and apply equally to derogations aimed at preventing tax evasion or avoidance. (14)

(b) The basic concern with failure to consider 'notional' input tax

42. In this case, the United Kingdom obtained the Derogation from Article 11(A)(1)(a) for the purposes of preventing tax evasion or avoidance. In doing so, it sought to react to a specificity of the direct selling business model used by Avon and others, namely the non-application of VAT to the final stage in the supply chain, which results in a relative reduction in output tax.

43. In its written and oral pleadings, Avon insisted on the fact that the Derogation was also sought to prevent distortion of competition. However, since Article 27(1) of the Sixth VAT Directive only foresees the grant of derogations to pursue the objectives of tax evasion and avoidance (simplification not being invoked), it must be assessed principally in the light of that objective.

44. It is not disputed that the direct selling model used by Avon and others might result in tax avoidance at the stage of final consumption. Thus, a derogation under Article 27(1) can, in principle, be justified.

45. However, Avon considers that the Derogation is not correctly applied. HMRC takes into account only the *output tax* that the Avon Ladies would normally pay on their markup *if* they were VAT registered. HMRC fails to consider the *input tax* the Avon Ladies would normally be able to deduct *if* they were VAT registered (specifically input tax on sales aids). Avon argues that failure to do so results in an 'overcorrection' of the original problem (namely, the non-application of VAT to the final stage in the supply chain). That overcorrection leads to a breach of the principle of proportionality. It also breaches the principle of fiscal neutrality, since the overcharge results in a competitive disadvantage vis-à-vis high street retailers. Finally, it goes beyond the limits imposed by Article 27(1) of the Sixth VAT Directive.

46. I disagree with Avon's assertion that HMRC's refusal to consider notional input tax is necessarily problematic for the following reasons.

47. First, the Derogation simply does not foresee or allow for the taking into account of notional input tax. So in that sense, the Derogation *cannot* be applied in a 'modified' way so as to take into account such notional input tax (Section (c)).

48. Second, the Derogation is not intended to be applied in such a way as to emulate the tax situation that would prevail if the Avon Ladies were all registered (Section (d)).

49. Third, the fact that the Derogation does not foresee or allow for the taking into account of notional input tax does not in itself breach the principles of fiscal neutrality or proportionality, or exceed the limits imposed by Article 27 of the Sixth VAT Directive. It is conceivable that *application* of the Derogation might raise issues in the light of those principles and provisions if failure to consider notional output VAT were to affect to a *non-negligible* extent the amount of VAT collected at the final stage of consumption. However, in my opinion and subject to the referring court's final assessment, that seems a rather theoretical possibility in the context of the present case (Section (e)).

(c) Scope of the Derogation

50. In accordance with the wording of Article 27(1) of the Sixth VAT Directive and the general rule that exceptions must be narrowly interpreted, (15) derogations are granted in relation to *specific* provisions of that directive.

51. The Derogation in this case was explicitly granted in relation to Article 11(A)(1)(a), authorising a deviation from the normal rules applicable to calculate the 'taxable amount', that is the amount on which *output* VAT is imposed. Thus, the text of Article 1 of the Derogation states that 'the

taxable amount for supplies to [non-taxable resellers] is to be the open market value of the goods as determined at that stage'.

52. As explained above in point 27, through two adjustments, HMRC seeks to ensure that the taxable amount calculated in application of the Derogation best reflects the purchase price actually paid by the final consumer. That is in line with the Court's finding in *Direct Cosmetics II* in relation to the predecessor of the Derogation, (16) that 'the open market value for the purposes of the system established by the derogating measure in question must be understood as meaning the value that is closest to the … actual price paid by the final consumer'. (17)

53. By contrast, no derogation was requested in relation to the normal rules applicable to input tax deduction in particular under Article 17(1) of the Sixth VAT Directive. (18) There is no mention in the Derogation of the taking into account of the costs incurred by non-taxable resellers when calculating the open market value of the products sold. To the extent the Avon Ladies are not taxable persons, there is no right of deduction. Under application of the normal rules, input tax in relation to costs incurred by them, such as the cost of sales aids, is unrecoverable. Moreover, with reference to the preceding paragraph, it is clear that the existence and extent of any notional input tax incurred by resellers is incapable of affecting the actual price paid by the final consumer.

54. As a result, in the light of the explicit scope of the Derogation, I consider that any adjustment for notional input tax is not foreseen or allowed by it. That conclusion follows from the very nature of a narrow exception. Beyond such a textual and systemic argument, expanding exceptions in the way suggested could raise issues of legal certainty if a derogation requested and granted solely in relation to either input or output tax would, nonetheless, leave it open to Member States to determine whether to take the other into consideration.

55. In the light of the foregoing, I consider that application of the Derogation *cannot* be modified to take into account notional input tax incurred by resellers who are non-taxable persons.

(d) The accommodation of alternative business models and absence of perfect solutions

56. Avon's position is, in substance, that adjustments currently made to the 'taxable amount' in application of the Derogation could be further refined. That refinement would be to take into account the notional input tax incurred by the Avon Ladies who are not registered for tax and not taxable persons (specifically in relation to the sales aids). In Avon's words, this would 'bring it as closely as possible into line with a fully taxable supply chain'. Since such adjustments are possible they must be made in order to respect the principles of proportionality and fiscal neutrality and the limits imposed by Article 27(1) of the Sixth VAT Directive.

57. It is indeed correct that the taking into account the cost of the sales aids would bring the result closer to the notional 'net' tax avoided if one were to imagine that the Avon Ladies were in reality tax registered. However, for the reasons set out above under Section (c), in my opinion the text of the Derogation simply does not allow for such modifications.

58. Moreover, it is also not the *purpose* of the Derogation to try to reconstruct a kind of virtual, parallel reality, which is as close as possible to the one that would prevail if the unregistered Avon Ladies were in fact registered, and then to work out what the VAT position would have been. The purpose of the Derogation is to prevent tax avoidance, in full recognition that the VAT rules are being applied in a non-standard way to a specific situation.

59. Avon observes that in seeking to solve one problem (non-taxation at the final stage of the supply chain and breach of the principle of fiscal neutrality to the detriment of Avon's competitors), the Derogation (19) creates another (breach of the principle of fiscal neutrality to the detriment of Avon, which suffers an 'overcorrection' of its VAT bill).

60. It is true that the Derogation comes with issues of its own. However, it does seek to address those issues raised by the direct selling model, in particular that VAT is a tax on consumption but sales to final consumers by persons who are not taxable escape the VAT net. Moreover, the Derogation has the merit of allowing the direct selling model to be catered for within the VAT system and to continue in use. As Avon has amply demonstrated the result is not 'perfect' in the sense of precisely reflecting the situation as it would be *but for* the lack of registration of the Avon Ladies. However, such differences are inherent in the coexistence of two alternative and rather different business models. Whilst it is possible to cater for different models within the VAT system, that cannot extend to effectively creating detailed parallel regimes.

61. That leads me to my next point, which I consider to be critical in this case: the choice of business model. The Avon Ladies can choose whether to register. Although the threshold for *compulsory* VAT registration in the United Kingdom is high, the Avon Ladies may register below that threshold. Avon can also choose whether to use registered or unregistered resellers. Avon and the Avon Ladies will have their reasons for going one way or the other, for example, to follow the most competitive business model or avoid the cumbersome administrative burden associated with being registered for VAT.

62. However, the fact of being a non-taxable person also has other consequences, including the impossibility of deducting input tax. As confirmed on several occasions by the Court, as regards VAT, economic operators have the right to organise their activities in a way that limits their exposure to tax. (20) Nonetheless, that freedom of choice does not include opting for a particular business model and then having à la carte access to the VAT rules normally applicable to other models.

63. At the hearing, Avon recalled that, if the rules were applied in the standard way to its sales, there would be no adjustment for output tax at all. The Derogation in fact serves to increase the tax burden on Avon. In other words, Avon is not asking for à la carte application of the VAT rules. As maintained at the hearing, Avon is not asking to 'have its cake and eat it'. Rather it is HMRC that is seeking selective application of the VAT rules through a specific derogation. HMRC is the one looking to order free cake.

64. The dispute as to who exactly is requesting free cake in the present case hints at a deeper disagreement: in response to whose action did the normal VAT system start needing readjustment? Avon is suggesting that the problems are attributable to the Derogation and/or its incorrect application. If the United Kingdom did not request it, the normal VAT rules would be applicable. No problem would arise. By contrast, the United Kingdom's position is that the Derogation was requested only in response to the direct selling model, that is, in order to remedy a problem which was already there, inherent in the operation of that model. Thus, the underlying logic was that that model could be kept, but subject to the readjustments enabled by the Derogation.

65. That discussion takes one straight back to the point raised above, namely that some differences in VAT treatment are inevitable given the coexistence of two alternative and rather different business models. There is no perfect solution. The fact that the Derogation does not seek one and is applied with 'imperfect' results is not in itself problematic. (21)

66. Bearing those general observations in mind, I now turn to the specific issues raised by Avon: proportionality, Article 27(1) of the Sixth VAT Directive, and fiscal neutrality.

(e) No violation of the principle of proportionality, Article 27 of the Sixth VAT Directive or the principle of fiscal neutrality

(1) Proportionality and Article 27(1)

67. In order to respect the principle of proportionality, measures must be necessary and appropriate to achieve the specific objective which they pursue and have as little effect as possible on the objectives and principles of the Sixth VAT Directive. (22)

68. It was already noted (23) that the Derogation pursues the legitimate objective of preventing tax avoidance. (24) It also makes it possible to limit any distortions of competition that might exist to the detriment of undertakings adopting a different distribution model. (25)

69. Moreover, adjustments are made to the taxable amount to take into account situations where the price paid by the final consumer is less than full 'catalogue price'. (26) To that extent the *output tax* imposed is proportionate. It is no more and no less than what is normally required by the nature of VAT as a tax on consumption.

70. I also explained above why, in my opinion, it cannot be expected that the Derogation be applied in such a way as to emulate as closely as possible the tax position that would exist in the case of a fully taxable supply chain. Thus, the mere fact that notional input tax is 'disregarded', leading to a tax position different from that which would apply in the case of a fully taxable supply chain does not in itself conflict with the principle of proportionality. (27)

71. Is it nonetheless possible that the amount of notional input tax disregarded is so significant that application of the Derogation would result in a breach of the principle of proportionality?

72. That is, in my view, theoretically possible, and if such a breach were to be found, the solution would be that the Derogation could not be applied to Avon. However, subject to final assessment by the referring court, it seems highly unlikely in the present case. In that regard I observe the following points relating to (i) risk and proof, (ii) complexity and administrative burden, and (iii) materiality.

73. First, as regards risk and proof, it is important to recall that the purpose of the Derogation is to prevent tax evasion and avoidance. The Avon Ladies are not taxable persons and simply do not bear the obligations of documentation and justification that taxable persons do, which would allow them to demonstrate that they *would have* hada right of deduction (and the extent of that right) *if* they had been registered. Any potential consideration of notional input tax would be subject to acceptable documentary evidence (28) being provided by Avon demonstrating that such costs had been incurred.

74. Second, in the *Sudholz* case, the Court held that overly complicating the process of applying a derogation can have the effect of neutralising its benefits. (29) Attempting to account for notional input tax undeniably increases the degree of complexity involved in applying the derogation, especially given the absence of complete records in relation to relevant costs. Admittedly, the *Sudholz* case concerned a derogation aimed at simplification. However, the concern in *Sudholz* about added complexity is, in my view, equally valid as regards the Derogation in the present case. One of the attractions of the direct selling model is specifically the reduced complexity in terms of administration. Bringing that complexity in 'through the back door' in practice by (partially) delegating to the public administration an administrative burden that the Avon Ladies have *chosen* not to assume (30) is, to my mind, just as problematic as in the *Sudholz* case.

75. Third, in the light of the previous two points, *clear and unequivocal* evidence of costs giving rise to notional input tax exceeding a *material threshold* is necessary before it could be held that an absolute refusal to consider those costs is disproportionate.

76. What is that threshold of materiality?

77. The starting point in answering that question is Article 27(1) of the Sixth VAT Directive, which captures the principle of proportionality in the context of that specific provision, (31) providing that derogations 'except to a negligible extent, may not affect the overall amount of the tax revenue of the Member State collected at the stage of final consumption'.

78. In my view, any threshold of materiality must be *objective*. In order to respect equal tax treatment and reflecting the above wording of Article 27(1), it cannot differ depending on the specific circumstances of a given taxpayer, but must be assessed with reference to the VAT revenues of the Member State.

79. However, the point of comparison for determining what is or is not 'negligible' is not clear. Thus, a range of meanings *of quite different orders of magnitude* could potentially be attributed to the words 'overall amount of tax revenue of the Member State collected at the stage of final consumption'.

80. There are at least three conceivable options, depending on whether the comparison of what is not negligible would be carried out with regard to:

– *the total of the EU's own resources provided from VAT*. That reading finds support in the recitals of Directive 2004/7/EC, (32) which added the word 'overall' to Article 27(1) and which stated explicitly that assessment ought to be 'made in a global manner by reference to macroeconomic forecasts relating to the likely impact of the measure on the *Community's own resources* provided from VAT'; (33)

– *the total of Member State resources provided from VAT*. That reading is closer to the more natural meaning of 'tax revenue of the Member State collected at the stage of final consumption', since it is clearly stated that what is aimed at is the tax revenue *of the Member State*, and not the tax revenue *of the Community*;

– *VAT revenues from a specific supply chain or from individual products or transactions*. That reading arguably finds some support, for example, in the Court's judgment in *Vandoorne*. (34) In that case, the Court effectively held that reimbursement of VAT would not be negligible because it would represent 100% of the VAT paid *on supplies to a single customer*. (35)

81. I am of the opinion that both the wording and the logic of Article 27(1) of the Sixth VAT Directive and Directive 2004/7 tend to point more towards one of the macroeconomic points of comparison, namely at the level of the Union or at the level of the individual Member State. In my view the 'Vandoorne' approach goes too far in the opposite direction. It comes close to requiring a detailed approach of the type rejected above in points 60 to 62. It could in fact seriously compromise the application of any derogation. It is also important to underline that the circumstances in *Vandoorne* were rather specific, in particular the fact that VAT was paid up front by the supplier.

82. However, I consider that there is in fact no need for the Court to address this issue in detail in the context of the present case, as (subject to factual verifications by the referring court) none of the above thresholds appear to be met. Thus, on a macroeconomic scale the figures involved are tiny. On a more microeconomic, transaction by transaction level, according to the figures provided, the amounts involved still appear to be very marginal.

83. In the light of the foregoing, it is in my view not possible to argue that the refusal to take into account notional input tax associated with sales aids would have a non-negligible impact on the '[overall] amount of tax revenue of the Member State collected at the stage of final consumption'. As a result, and subject to the final assessment by the referring court, I consider there to be no breach of the principle of proportionality or the limits imposed by Article 27(1) of the Sixth VAT Directive.

(2) Fiscal neutrality

84. As regards fiscal neutrality, that principle precludes treating similar goods and supplies of services differently for VAT purposes. (36)

85. Let us assume for these purposes that products sold through direct selling structures such as Avon's and more traditional retail outlets can indeed be considered to be 'similar' within the meaning of the Court's case-law, which, in my view, is not so obvious.

86. However, even if that were the case, then both with and without the Derogation there is a potential issue of fiscal neutrality, in the former case to the detriment of Avon and in the latter to the detriment of its competitors. (37) To use Avon's words, in solving one problem, another has been created.

87. In that regard, I refer to the comments above in point 60 to the effect that, in cases such as the present involving very different business models, perfectly equal treatment is simply not achievable.

88. It might be argued, nonetheless, that 'more equal' treatment is possible in this case. That in my view is, however, simply a restatement of the proportionality argument, which has already been rejected above.

89. In the light of the foregoing, the Derogation and its application by the United Kingdom authorities do not conflict with the principle of proportionality and fiscal neutrality or Article 27(1) of the Sixth VAT Directive to the extent that 'notional input tax' generally, and specifically in relation to sales aids, is not taken into account.

(f) Conclusion on the first question

90. In view of the above, I suggest that the Court reply to the first question of the referring court as follows:

Neither the Derogation nor, subject to the referring court's final assessment, national measures implementing that decision — to the extent that that decision and those national measures result in the imposition of VAT on the open market value of products sold via non-VAT registered resellers without taking into account irrecoverable input VAT on demonstration items or other goods and services purchased from third parties by those resellers — infringe the principles of proportionality and fiscal neutrality or Article 27(1) of the Sixth VAT Directive or Article 395 of Directive 2006/112.

2. Fourth question

91. In essence, the referring court's fourth question is whether under Article 27 of the Sixth VAT Directive, the tax 'evaded or avoided' means (i) the net tax, taking into account the output and input tax in the structure giving rise to the evasion or avoidance, or (ii) the gross tax, taking into account only the output tax?

92. In the light of the negative answer given to the first question, there is no need to consider the fourth question.

3. Second question

93. Article 27(2) of the Sixth VAT Directive provides that Member States seeking a derogation 'shall provide the Commission with all relevant information'. The second question of the national court asks essentially whether that provision required the United Kingdom to raise the issue of irrecoverable input VAT in this case, so that it could be factored into the Derogation.

(a) Admissibility

94. The United Kingdom Government argues that the second question is inadmissible. In that regard, it considers that it is unclear why the question is being asked, that the Court does not have the factual and legal background necessary to be able to answer it, and moreover that the question is hypothetical.

95. I disagree.

96. In that regard, I recall first that questions put to this Court by national courts enjoy, in general, a presumption of relevance. (38) In the present case, and contrary to the arguments put forward by the United Kingdom Government, it appears to me rather clear why the referring court asks its second question and why the answer could have an impact on the outcome of the case.

97. If Article 27 of the Sixth VAT Directive were to impose a legal obligation on a Member State to provide specific information to the Commission in the context of a request for a derogation, I can see why a failure to do so might well have consequences for the validity of the derogation ultimately granted.

98. As regards the absence of sufficient elements to enable the Court to give a useful answer, the United Kingdom Government refers in particular to a letter sent by Avon to HMRC raising the issue of 'lost input tax' and asserts that the Court is not in a position to assess the weight that should have been attached to that letter. In my view, however, the referring court's second question is rather at the level of principle, asking whether there was an obligation to raise certain issues with the Commission rather than what specific pieces of factual information had to be communicated in the present case.

99. Finally, the United Kingdom Government asserts that the second question is hypothetical because information on costs incurred by direct sellers would only be relevant in relation to a derogation from the rules normally applying to input tax deduction under Article 17 of the Sixth VAT Directive. However, no such derogation was requested in this case.

100. In that regard, suffice it to say that that argument rather puts the cart before the horse. In order to determine whether there is a legal obligation to provide certain information under Article 27, the central question is precisely whether it is actually relevant.

101. In the light of the above, I propose that the Court reject the arguments of inadmissibility put forward by the United Kingdom Government and declare the second question admissible.

(b) Substance

102. As a preliminary remark, it is true that in the *Direct Cosmetics II* case, the Court confirmed the validity of Council Decision 85/369 — the temporary predecessor to the Derogation applicable from 1985 to 1987 — and in doing so held that '[the] notification made by the United Kingdom to the Commission referred in sufficient detail to the needs which the measure in question was intended to meet and it contained all the essential elements to enable the aim pursued to be identified'. (39)

103. However, that ruling does not definitively settle the issue raised in the national court's second question, since technically speaking it related to a previous — albeit very similar and related — derogation requested by the United Kingdom. Also, as noted by Avon, the Court did not specifically consider the sufficiency of the information from the fiscal neutrality angle.

104. In any event, Article 27(2) does not in my opinion impose a requirement to provide information of the type envisaged in the referring court's second question.

105. Article 27(2) of the Sixth VAT Directive does not lay down such specific requirements expressly. I also agree with the Commission that a request for a derogation by its very nature needs to be couched, to some degree at least, in abstract terms.

106. Admittedly, those elements in themselves do not preclude an implied requirement to provide specific information that would, for example, have a significant impact on the magnitude of costs involved in the derogation. However, ultimately I do not consider it necessary to discuss in detail the precise contours of the information requirement under Article 27(2).

107. Avon argues specifically that the United Kingdom was under an obligation to inform the Commission either that: (i) the unregistered resellers incurred VAT on purchases of sales aids and/or other relevant inputs used for the purposes of their economic activities; or (ii) the United Kingdom's interpretation of the Derogation was such that it was not possible to allow a direct seller a reduction for VAT incurred by the unregistered reseller on sales aids and/or other relevant inputs when calculating the output tax payable by the direct seller based on the unregistered reseller's sale price.

108. In my opinion, it was not necessary for the United Kingdom to raise either of those two points explicitly in order to comply with the requirements of Article 27(2) of the Sixth VAT Directive for a rather simple reason: both points are obvious, either inherent in the VAT system (the first point) or entirely logical and predictable in view of the scope of the requested derogation (the second point).

109. In relation to the first point, it is difficult to imagine an economic operator, regardless of how marginal its activity, that does not incur any input costs related to its business. Moreover, the offsetting of input tax against output tax is such a fundamental element of the VAT system that it is certainly not an aspect that needs to be explicitly raised with the Commission.

110. On the second point, the Derogation was requested and granted in relation to Article 11(A)(1)(a) of the Sixth VAT Directive. As such, and for the reasons set out above in points 50 to 54, it should have been clear to the Commission that any consideration of notional input tax under the Derogation was excluded.

111. In the light of the above, I propose that the Court reply to the second question as follows:

When seeking authorisation for the derogation granted by virtue of Council Decision 89/534, the United Kingdom was not under an obligation to inform the Commission that unregistered resellers incurred VAT on purchases of goods used for the purposes of their economic activities.

4. Third question

112. The referring court asks its third question only in the event that the answer to its first and/or second question is in the affirmative.

113. Since my proposed replies to the first and second questions are in the negative, there is no need to address the third question.

V. Conclusion

114. In the light of the above, I propose that the Court respond to the questions posed by the First-tier Tribunal (Tax Chamber), United Kingdom as follows:

First question

Neither the derogation authorised by Council Decision 89/534/EEC of 24 May 1989 authorising the United Kingdom to apply, in respect of certain supplies to unregistered resellers, a measure derogating from Article 11(A)(1)(a) of the Sixth Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes nor, subject to the referring court's final assessment, national measures implementing that decision — to the extent that that decision and those national measures result in the imposition of VAT on the open market value of products sold via non-VAT

registered resellers without taking into account irrecoverable input VAT on demonstration items or other goods and services purchased from third parties by those resellers — infringe the principles of proportionality and fiscal neutrality or Article 27(1) 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 or Article 395 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

Second question

When seeking authorisation for the derogation granted by virtue of Council Decision 89/534, the United Kingdom was not under an obligation to inform the Commission that unregistered resellers incurred VAT on purchases of goods used for the purposes of their economic activities.

Third and fourth questions

In the light of the answers given to the first and second questions, there is no need to reply to the third and fourth questions.

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1 Original language: English.

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2 Sixth Council Directive 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).

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3 Council Directive of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1).

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4 Article 2 of the Principal VAT Directive.

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5 Article 9 of the Principal VAT Directive.

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6 Article 73 of the Principal VAT Directive.

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7 Article 395 of the Principal VAT Directive. The wording of Article 395(1) of the Principal VAT Directive differs slightly and in a non-material way from that employed in Article 27(1) of the Sixth Directive.

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8 Council Decision of 24 May 1989 authorising the United Kingdom to apply, in respect of certain supplies to unregistered resellers, a measure derogating from Article 11(A)(1)(a) of the Sixth Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes (OJ 1989 L 280, p. 54).

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9 See, in that sense, judgments of 19 September 2000, Ampafrance and Sanofi(C−177/99 and C−181/99, EU:C:2000:470, paragraph 68), and of 27 January 2011, Vandoorne (C−489/09, EU:C:2011:33, paragraph 33).

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10 That is the case for simplification measures, as has been already explicitly confirmed by the Court. See, for example, judgments of 29 April 2004, Sudholz(C−17/01, EU:C:2004:242, paragraph 62), and of 27 January 2011, Vandoorne(C−489/09, EU:C:2011:33, paragraph 31). However, it holds true in relation to any derogation.

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11 For an overview of extant derogations and the provisions they relate to as compiled by the Commission see https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/key_documents/table_derogations/vat_index_derogations_en.pdf.

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12 Judgment of 10 April 1984, Commission v BelgiumCommission v BelgiumCommission v Belgium(324/82, EU:C:1984:152, paragraph 29). See also judgment of 29 May 1997, Skripalle(C−63/96, EU:C:1997:263, paragraph 24).

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13 Judgments of 19 September 2000, Ampafrance and Sanofi (C−177/99 and C−181/99, EU:C:2000:470, paragraph 60), and of 29 April 2004, Sudholz(C−17/01, EU:C:2004:242, paragraph 46).

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14 Judgment of 12 July 1988, Direct Cosmetics and Laughtons Photographs(138/86 and 139/86, EU:C:1988:383, paragraph 52).

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15 Above, points 40 to 41 of this Opinion.

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16 85/369/EEC: Application of Article 27 of the Sixth Council Directive of 17 May 1977 on value added tax (Authorisation of a derogation requested by the United Kingdom to enable certain types of tax evasion to be prevented) (OJ 1985 L 199, p. 60).

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17 Judgment of 12 July 1988, Direct Cosmetics and Laughtons Photographs(138/86 and 139/86, EU:C:1988:383, paragraph 53).

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18 Article 167 of the Principal VAT Directive.

19 Or at least the United Kingdom's application of it.

20 Judgment of 21 February 2006, Halifax and Others(C−255/02, EU:C:2006:121, paragraph 73).

21 See also above the case-law cited in footnote 10.

22 Judgments of 19 September 2000, *Ampafrance and Sanofi* (C−177/99 and C−181/99, EU:C:2000:470, paragraph 60), and of 29 April 2004, Sudholz(C−17/01, EU:C:2004:242, paragraph 46).

23 Above, point 44 of this Opinion.

24 See also in that sense judgment of 12 July 1988, Direct Cosmetics and Laughtons Photographs (138/86 and 139/86, EU:C:1988:383, paragraph 48) in relation to the predecessor of the Derogation (Council Decision 85/369).

25 See judgment of 12 July 1988, Direct Cosmetics and Laughtons Photographs (138/86 and 139/86, EU:C:1988:383, paragraph 39).

26 See above point 27.

27 See above footnote 10.

28 See, in that sense, the reference to 'objective facts' in the judgment of 29 May 1997, Skripalle(C−63/96, EU:C:1997:263, paragraph 26).

29 See, in that sense, judgment of 29 April 2004, Sudholz(C−17/01, EU:C:2004:242, paragraph 63).

30 See above, point 60 of this Opinion.

31 See, in that sense, judgment of 12 July 1988, *Direct Cosmetics and Laughtons Photographs* (138/86 and 139/86, EU:C:1988:383, paragraph 52).

32 Council Directive of 20 January 2004 amending Directive 77/388 concerning the common system of value added tax, as regards conferment of implementing powers and the procedure for adopting derogations (OJ 2004 L 27, p. 44).

33 Emphasis added.

34 Judgment of 27 January 2011, Vandoorne(C−489/09, EU:C:2011:33).

35 The case concerned a derogation under which VAT on cigarettes was paid up front by the manufacturer, on the basis of the expected final sales price (tax stamp). Following insolvency and failure to pay by one of its customers, Vandoorne sought reimbursement of the money paid to its supplier representing the/that VAT (technically it was not the VAT, since that had already been paid by the manufacturer but that cost had been passed down the supply chain to Vandoorne).

36 Judgment of 10 November 2011, Rank Group(C−259/10 and C−260/10, EU:C:2011:719, paragraphs 41 and 42).

37 See, in that sense, judgment of 12 July 1988, Direct Cosmetics and Laughtons Photographs(138/86 and 139/86, EU:C:1988:383, paragraph 49).

38 For example, see judgment of 11 November 2015, *Pujante Rivera* (C-422/14, EU:C:2015:743, paragraph 20).

39 Judgment of 12 July 1988, Direct Cosmetics and Laughtons Photographs(138/86 and 139/86, EU:C:1988:383, paragraph 36).