

OPINION OF ADVOCATE GENERAL  
DARMON

delivered on 30 June 1993 \*

*Mr President,  
Members of the Court,*

1. May the consideration payable by a landlord to a tenant in return for the surrender of a lease be subjected to VAT by being excluded from the exemption relating to the letting of immovable property provided for by Article 13B(b) of the Sixth VAT Directive? <sup>1</sup> That, in substance, is the question raised by the London Value Added Tax Tribunal.

2. By a lease dated 14 April 1971 Esso Pension Trust Ltd granted a lease to Lubbock Fine and Company, a firm of chartered accountants, in respect of office premises situated in London for a term of 25 years and one quarter from 29 September 1970 at an initial rent of £35 300 per annum. <sup>2</sup>

3. On 14 February 1990 Guildhall Properties Ltd, which had become the owner of the premises, concluded with the tenant an 'Agreement to surrender' <sup>3</sup> under which Lubbock Fine surrendered the residue of the lease and agreed to return the premises to the

landlord ('the tenant agrees that on 1st June 1990 it will surrender all its estate interests and rights in the Premises to the Landlord') in return for a consideration of £850 000, including VAT amounting to £110 869.56.

4. The agreement was implemented and the owner paid the aforementioned sum. On 1 June 1990 it released Lubbock Fine from all commitments and claims in respect of the lease.

5. The Commissioners of Customs and Excise made an assessment to VAT upon Lubbock Fine in the aforementioned sum of £110 869.56, against which Lubbock Fine has appealed to the Value Added Tax Tribunal, relying upon Article 13 of the Sixth Directive.

6. That article, under the heading 'Exemptions within the territory of the country', provides *inter alia*:

'(...).

B. Other exemptions

Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse:

\* Original language: French.

1 — Sixth Council Directive (77/388/EEC) of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1).

2 — See the observations of the appellants in the main proceedings, Annex C.

3 — *Ibid.*

- (...)
- C. Options
- (b) the leasing or letting of immovable property excluding:
1. the provision of accommodation, as defined in the laws of the Member States, in the hotel sector or in sectors with a similar function (...);
  2. the letting of premises and sites for parking vehicles;
  3. lettings of permanently installed equipment and machinery;
  4. hire of safes.
- Member States may allow taxpayers a right of option for taxation in cases of:
- (a) letting and leasing of immovable property;
  - (b) the transactions covered in B (...) (g) (...).
- Member States may restrict the scope of this right of option and shall fix the details of its use.<sup>4</sup>
7. Before 1989 the transactions exempted from VAT were set out in item 1 of Group 1 of Schedule 6 to the Value Added Taxes Act 1983, which, subject to exceptions, exempted *inter alia* 'the grant, assignment or surrender of any interest in a right over land or of any licence to occupy land'. Until 1989, therefore, a payment made in consideration of the surrender of a lease was not subject to VAT.
- Member States may apply further exclusions to the scope of this exemption;
- (...)
- (g) the supply of buildings or parts thereof, and of the land on which they stand, other than as described in Article 4(3)(a);
8. Following the Court's judgment in Case 416/85 *Commission v United Kingdom*,<sup>4</sup> in which the Court held that the United Kingdom had failed to fulfil its obligations by continuing to zero-rate a number of supplies of goods and services, the United Kingdom legislation was amended by the Finance Act 1989.
9. The national court states that that amendment had the effect of subjecting to VAT the surrender of a lease to the landlord, that is to
- (...).

4 — [1988] ECR 3127.

say the transaction concerned in this case (a matter which is not contested by Lubbock Fine). However, the court raises the question whether the new legislation is in this respect compatible with the abovementioned Community provisions. It therefore puts three questions to the Court<sup>5</sup> which may be summarized as follows:

- (1) Do the terms 'letting' and 'leasing of immovable property' in Article 13B(b) of the Sixth Directive include the surrender of a lease for consideration paid by the landlord to the tenant?
- (2) If so, may a Member State exclude such a surrender from the exemption and hence tax it by virtue of the final words of Article 13B(b)?
- (3) In the event of a negative reply being given to the first question, does the surrender of a lease for consideration constitute a supply for the purposes of Article 13B(g)?

10. Three preliminary remarks should be made.

11. By virtue of Article 2(1) of the Sixth Directive VAT is chargeable on 'the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such'.

12. By virtue of Article 4(1) of the directive a taxable person is in principle anyone who independently carries out an economic activity, whatever the purpose or results of that activity.

13. Consequently, the Sixth Directive confers a very wide scope on VAT comprising all economic activities of producers, traders and persons supplying services.<sup>6</sup> The fifth recital in the preamble to the First Council Directive of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes<sup>7</sup> stated that:

'A system of value added tax achieves the highest degree of simplicity and of neutrality when the tax is levied *in as general a manner as possible* and when its scope covers all stages of production and distribution and the provision of services ...'.<sup>8</sup>

14. VAT is therefore applicable to all supplies of goods and services effected for consideration, subject only to the exceptions provided for by the Sixth Directive itself. Those exceptions are moreover limited 'in order to enable the system to be applied in a simple and neutral manner, and to keep the standard rate of tax within reasonable limits'.<sup>9</sup>

6 — Article 4(2). See the judgment in Case 348/87 *Stichting Uitvoering Financiële Acties v Staatssecretaris van Financiën* [1989] ECR I 737, paragraph 10.

7 — Directive 67/227/EEC, OJ, English Special Edition 1967, p. 14.

8 — My emphasis.

9 — Fourth recital in the preamble to the Second Council Directive (Directive 67/228/EEC of 11 April 1967, OJ, English Special Edition 1967, p. 16).

5 — The text of the questions appears at point 4 of the Report for the Hearing.

15. The Court has interpreted the exemptions narrowly. Thus, for example, the Court has held, in relation to the public functions performed in return for remuneration by notaries and bailiffs, that:

‘The exemptions from VAT expressly laid down in Article 13 of the Sixth Directive for, *inter alia*, activities in the public interest, and the right accorded to the Member States by Article 28(3)(b), in conjunction with Annex F, (...) clearly demonstrate that all services effected for consideration by members of the liberal professions or professions considered as such are in principle subject to VAT.’<sup>10</sup>

16. The Court has therefore refused to interpret the exemptions provided for by the directive broadly where no factor relating to the interpretation of an exemption has been shown which permits it to be extended beyond the limits which follow from the actual wording of the provisions providing for the exemptions, in particular Article 13.<sup>11</sup>

17. As regards the exclusion by Article 4(5) from VAT of bodies governed by public law, the Court held that:

‘(...) the Sixth Directive is characterized by its general scope and by the fact that all exemptions must be expressly provided for and precisely defined’.<sup>12</sup>

10 — Case 235/85 *Commission v Netherlands* [1987] ECR 1471.

11 — Case 107/84 *Commission v Germany* [1985] ECR 2655, paragraph 20.

12 — *Commission v Netherlands*, cited above, paragraph 19.

18. In *Stichting Uitvoering Financiële Acties*,<sup>13</sup> the Court held that:

‘(...) the terms used to specify the exemptions envisaged by Article 13 of the Sixth Directive are to be interpreted strictly since they constitute exceptions to the general principle that turnover tax is levied on all services supplied for consideration by a taxable person’.<sup>14</sup>

19. It was therefore logical that, in the case of an *exception* to the exemption provided for by Article 13B(b) of the directive concerning the leasing or letting of immovable property — which therefore had the effect of bringing the transactions concerned within the general scheme of the directive — the Court should have held that the exception could not be construed narrowly.<sup>15</sup>

20. There is all the more reason to construe exemptions restrictively since they may disrupt the chain of deductions between taxable persons and give rise to a tax burden owing to the fact that tax paid at the preceding stage (‘input tax’) cannot be deducted.<sup>16</sup> Such remaining tax may lead to distortions in the commercial chain, unless taxable persons have the right to opt for taxation.

13 — See footnote 6 above.

14 — Paragraph 13. See also paragraph 19 of the judgment in Case 51/88 *Hamam* [1989] ECR 767, paragraph 9 of the judgment in Case 203/87 *Commission v Italy* [1989] ECR 371, paragraph 19 of the judgment in Case C-185/89 *Velker International Oil Company* [1990] ECR I 2561 and paragraphs 13 and 14 of the judgment in Case C-193/91 *Mohsche* [1993] ECR I-2615.

15 — Case 173/88 *Skatteministeriet v Morten Henriksen* [1989] ECR 2763.

16 — See below, paragraphs 29 et seq.

21. A second preliminary remark. According to the 11th recital in the preamble to the Sixth Directive 'a common list of exemptions should be drawn up so that the Communities' own resources may be collected in a uniform manner in all the Member States'.<sup>17</sup> Thus, even though Article 13B of the Sixth Directive refers to conditions laid down by the Member States ('Member States shall exempt the following under conditions which they shall lay down'), the exemptions set out in that article must correspond to independent Community-law concepts<sup>18</sup> in order to allow 'the basis of assessment of value added tax [to be determined] in a uniform manner according to Community rules'.<sup>19</sup>

22. Finally, a third remark.

23. Immovable property raises a number of specific problems for VAT purposes.<sup>20</sup> It is understood at two levels in Sixth Directive:<sup>21</sup>

- (1) as a final product supplied to a final consumer at the end of an economic production cycle;
- (2) as a means of production the cost of which is reflected in the price of goods or services.

24. In the first respect the production cycle of immovable property, beginning with its purchase, progressing through the construction phase and ending with its first sale, is normally assimilated to the production cycle for goods and hence is subjected to VAT.

25. More specifically, even an isolated transaction in immovable property may be taxable. Thus, Article 4(3) of the Sixth Directive provides that 'Member States may also treat as a taxable person anyone who carries out, on an occasional basis (...)

(a) the supply before first occupation of buildings or parts of buildings and the land on which they stand (...);

(b) the supply of building land.'

26. In that case VAT is imposed on the final price of the immovable property, whatever the components of that price. It is the concept of 'first occupation' which is used to determine the moment at which the property leaves the production process and becomes the subject of consumption (that is to say, occupied by its owner or a tenant).

27. On the second point, with respect to buildings after first occupation, a distinction must be made.

28. A building is excluded from the tax since it has already been 'consumed' by virtue of

17 — My emphasis.

18 — See paragraph 11 of the judgment in *Stichting*.

19 — Case 139/84 *Van Dijk's Boekhuis* [1985] ECR 1405. See also to the same effect the Opinion of Advocate General Da Cruz Vilaça in Case 122/87 *Commission v Italy* [1988] ECR 2685.

20 — Such as, for example, double taxation.

21 — See on this point Annex I to the Commission's observations: explanatory memorandum is attached to the proposal for a Sixth Council Directive on the harmonization of the laws of the Member States.

its first occupation. Transactions concerning the building are therefore, in principle, exempt.

29. If an immovable property is sold or placed at the disposal of a taxable person carrying on an economic activity for the purposes of Article 4(2), it re-enters economic channels and should be capable of giving rise to taxable transactions. As already stated, where a taxable person carries out an exempt transaction, he is not obliged to pay tax on the transaction, but he is also unable to deduct the tax which has been invoiced to him by his suppliers or to pass on any charge whatsoever to the person following him in the chain of supply.<sup>22</sup> An exemption from VAT may therefore lead to an increase in his tax burden. A taxable person may therefore have an interest in being subject to tax.

30. What is the position with respect to a letting? Is that operation fiscally 'neutral'?

31. The taxation of a letting may have a significant impact on the situation of both the tenant and the landlord.

32. VAT paid on rent is deductible if the rented premises are used for the purposes of taxable transactions,<sup>23</sup> such as a commercial activity.

33. The VAT may in certain cases replace irrecoverable taxes, such as registration duty.<sup>24</sup>

34. The landlord may deduct VAT paid on expenses connected with the letting, such as work in refurbishing the premises with a view to letting.<sup>25</sup> Similarly, in certain cases VAT on the acquisition costs of the let property will be deductible from the tax due on the rent.

35. In the light of those principles the Sixth Directive provided, first, that the leasing or letting of immovable property should be exempt from VAT (Article 13B(b)) and, secondly, that in respect of such transactions the Member States may allow taxable persons a right of option for taxation (Article 13C): that is why some lettings are taxable whereas others are not.

36. What is the position where the landlord and the tenant agree upon a surrender of a lease?

37. Does the surrender of a lease for consideration constitute the 'letting of immovable property' for the purposes of Article 13B(b)?

38. As already stated, the terms used in the Community directives concerning VAT must be given a Community definition.<sup>26</sup>

22 — Case 8/91 *Becker* [1982] ECR 53, paragraph 44, and Case 207/87 *Weissgerber* [1988] ECR 4433, paragraph 30.

23 — See Article 17(2)(a) of the Sixth Directive.

24 — See E. Bours 'Rapport sur l'application de la TVA aux opérations immobilières au sein de la Communauté', *Études de la Commission des Communautés Européennes*, Série Concurrence, 1971, p. 138.

25 — *Ibid.* p. 135.

26 — Above, at paragraph 21.

39. It is common ground that a letting is a contract by which the owner transfers in return for a rent certain rights in his property, such as the right of enjoyment of the property, whatever the nuances of national law on this point.<sup>27</sup>

40. It is also clear that the surrender has the effect of putting an end to the contract, of freeing each of the parties from his obligations and thus of restoring to the owner all his rights in the property.

41. The landlord does not acquire from the tenant a right to enjoyment of the property: he is simply restored to his rights. Moreover, the consideration given may in no way be equated with rent.

42. However, I do not agree with the United Kingdom's view that the effect of a surrender of a lease is that 'it does not create or grant anything'.<sup>28</sup> Would the landlord pay compensation — which may moreover be considerable — if the transaction were of no benefit to him?

43. In order to determine whether the surrender of a lease falls within the term 'letting of immovable property', it is necessary to interpret that term in the light of the 'context

in which it occurs, bearing in mind the purpose and structure of the Sixth Directive'.<sup>29</sup>

44. It is necessary here to adopt a purposive approach and to measure the effects of VAT on a surrender of a lease in the light of the common system of VAT, which seeks to introduce

*'on a basis common to all the Member States, a general tax on consumption levied on the supply of goods, the provision of services, and imports in proportion to their price, regardless of the number of transactions taking place as far as the final consumer, the tax being imposed only on the value added at each stage and being definitively borne by the final consumer.'*<sup>30</sup>

45. In relation to lettings, non-taxable natural or legal persons who have no involvement with any taxable transaction are not normally subject to VAT on rent. However, Member States may allow taxable persons to opt for taxation, failing which they may have to support an increased tax burden since the exemption prevents them from deducting input taxes.<sup>31</sup>

46. Where an immovable property is let, the rent is the consideration for the placing of the property at the disposal of the tenant enjoying the property.

27 — In my view a letting for the purposes of Community law includes a lease, a licence, un 'bail' or a 'convention d'occupation précaire'.

28 — United Kingdom Government's observations, paragraph 21.

29 — *Velker International Oil Company*, cited above, paragraph 17.

30 — Case 252/86 *Bergandi* [1988] ECR 1343, at paragraph 8, my emphasis.

31 — Above, paragraph 30 et seq.

47. Where the parties agree on the surrender of a lease, the tenant waives the right to enjoyment of the property for the remainder of the lease and allows the landlord either to occupy the property, to let it to another tenant or to dispose of it. The compensation paid on the occasion of such a surrender by the landlord is the consideration for the placing of the property at his disposal, and the amount thereof depends on the remaining term of the lease.

48. There is no doubt that the tenant supplies a service — measurable in economic terms — to the landlord and that what he returns to the landlord is of exactly the same nature as that which he could give to a third party under a sub-lease: enjoyment of the premises for the remaining term of the lease, even if the landlord also has the power — which he never lost — to dispose of the property.

49. May therefore a surrender be subject to tax rules which are different from those applicable to the letting itself?

50. Let us take two examples.

51. Suppose that an owner who is a taxable person grants a commercial lease to a trader. By virtue of Article 13C(a) the letting may be subject to tax, in which case the rent payments will be taxable.

52. May the surrender be exempt where (1) it has effects symmetrical to those of the initial letting, namely placing the let property at the disposal of one of the parties, and (2) that exemption would disrupt the chain of deductions and introduce distortions into the economic cycle?

53. Indeed, how would the tenant be able to recover the VAT which has been invoiced to him in respect of substantial repairs or improvements which he has undertaken during the letting if the consideration for the surrender was not subject to tax? Moreover, how could such an exemption be reconciled with the fact that if, in the absence of a surrender, the tenant granted a sub-lease to the owner, that transaction would be subject to VAT?<sup>32</sup>

54. Conversely, suppose that a taxable owner lets an immovable property to a tenant who is also a taxable person but does not have the right of deduction: Article 13B(b) exempts the letting from VAT. If the surrender of the lease before the end of the tenancy — which will allow the owner to dispose freely of the property for the remainder of the term — is subject to VAT, that VAT will not always be recoverable by the landlord. In addition, it should be noted that a sub-letting by the tenant to the owner — which would have the same effect — would not be taxable.

55. In my view, therefore, the tax rules applicable to surrenders should be aligned on those applicable to lettings. The coherent application of the Sixth Directive and respect for the principle of the neutrality of VAT demand that that should be so.

56. It is for that reason that I consider that the surrender of a lease falls under Article 13B(b) or, where appropriate, Article 13C(a).

32 — There is no doubt that a sub-letting must be subject to the same tax rules as a letting.



57. I should add that, contrary to the Commission's view, I do not consider that the judgment in *Henriksen*<sup>33</sup> can be usefully relied upon here.

58. In response to a request to interpret the exception to the exemption provided for by Article 13B(b)(2), the Court took account of the subject of the lease and concluded that, with respect to the applicable tax rules, the letting of a garage adjoining a house was not separable from the lease of the house itself, since the two lettings constituted a 'single economic transaction'.<sup>34</sup>

59. The letting of an immovable property and the surrender by a tenant of his rights are *two transactions that are economically and legally distinct*. I do not see how the principle of *accessorium sequitur principale* applied by the Court in *Henriksen* to the subject-matter of the lease can be extended to successive transactions arising from the lease.

60. The solution which I propose is supported by two considerations.

61. First, it is worth noting that the law of several Member States establishes a link between the taxation of the letting and taxation of the compensation paid by the landlord. That is so in the case of Italian law, which expressly subjects the termination of a lease to the same tax treatment as the lease itself, and in French law, which provides that compensation is taxed where it is received by a taxable person, is linked to the activity

carried on and, above all, is received in the context of the normal risks and hazards of the profession.

62. Secondly, in my view the inclusion of the surrender of a lease within the concept of the letting of immovable property is in keeping with the objective of the Sixth Directive, namely to lay down *simple* rules.<sup>35</sup>

63. Let us therefore examine the second question.

64. As already stated, Article 13B(b) exempts from VAT the leasing or letting of immovable property subject to four exceptions and states, in the final sentence, that 'Member States may apply further exclusions to the *scope* of this exemption'.<sup>36</sup>

65. Is a Member State entitled to exclude from the exemption in Article 13B(b), and hence subject to VAT, the surrender of a lease for consideration?

66. The exceptions to the exemption laid down by Article 13B(b) are extremely restricted. The first exception may be explained by the fact that the provision of accommodation in a hotel is not considered a letting by the legislation of several Member States but is akin to a simple authorization. The second concerns the letting of immovable property for a specific use (parking of

33 — Cited above at footnote 15.

34 — Paragraph 15, my emphasis.

35 — See Article 13A(1).

36 — My emphasis.

vehicles). The last two relate to the leasing of goods attached to immovable property.

no circumstances be able to recover it and, secondly, a sub-letting by the tenant would in principle be exempt?

67. I do not agree with the Commission's view that the *ejusdem generis* principle of interpretation limits the power of Member States to lay down further exclusions from the exemption provided for by Article 13B(b) to certain cases which are akin or similar to the four exceptions listed in that article.<sup>37</sup> As was asked at the hearing, what is the *genus*?

71. The distinction which exists in relation to lettings (exemption/right of option) should also apply to surrenders.

68. In the context of Article 13 a large degree of latitude is accorded to the Member States, who are to lay down the conditions of exemption, may grant taxable persons the right to opt for taxation of the leasing or letting of immovable property and may restrict the scope of the right of option (Article 13C).

72. For that reason I propose that the Court should give a negative reply to the second question.

69. However, I do not think that, taken in isolation, the surrender of a lease should be capable of being excluded from exemption.

73. In view of the replies given to the first two questions, the third is redundant. I therefore only examine it *ex abundanti cautela*.

70. As I have stated, that transaction and the letting itself produce symmetrical effects. Lettings of immovable property are in principle, and unless a right of option is exercised, *exempt*. Is it therefore conceivable that Member States should be able to tax a surrender when, first, if he is not a taxable person the landlord who pays the tax will under

74. Is a surrender of a lease covered by the concept of 'the supply of buildings or parts thereof, and of the land on which they stand, other than as described in Article 4(3)(a)'?

75. It is common ground that the latter provision — which concerns the supply of a building before first occupation — has no bearing on this dispute.

76. Article 13B(g) lays down an exception to the general principle laid down by Arti-

37 — See observations of the Commission, point 6.6.

cle 2 of the Sixth Directive, according to which supplies of goods are subject to VAT.

disposal which the former never had and the latter never lost.<sup>40</sup>

77. Consequently, a transaction can fall under the exemption in Article 13B(g) only if it constitutes a supply of goods in the generic sense of Article 2.

81. Consequently, the surrender of a lease cannot be regarded as a 'supply of goods' for the purposes of Article 2. Nor, therefore, can it fall within the definition in Article 13B(g).

78. Article 5 of the directive provides that the "supply of goods" shall mean the transfer of the right to dispose of tangible property as owner'.

82. The Community definition of the 'supply of goods' cannot vary according to the articles of the Sixth Directive.

79. In its judgment in *Staatssecretaris van Financiën v SAFE*<sup>38</sup> the Court held that that term was to be given a Community definition, stating that:

83. I scarcely need to point out that a surrender of a lease cannot be assimilated to 'the supply of buildings or parts thereof, and of the land on which they stand'.

'It is clear from the wording of this provision that "supply of goods" does not refer to the transfer of ownership in accordance with the procedures prescribed by the applicable national law but covers any transfer of tangible property by one party which empowers the other party actually to dispose of it *as if he were the owner of the property*.'<sup>39</sup>

84. As the United Kingdom Government correctly states, the terms 'land' or 'land which has not been built on' refer to the 'physical' concepts and not the *rights* in the land or the land which has not been built on.<sup>41</sup>

80. Even by the surrender of a lease a tenant cannot transfer to the owner the power of

85. I therefore conclude that the surrender of a lease does not fall within the scope of Article 13B(g).

38 — Case C-320/88 [1990] ECR I-285.

39 — Paragraph 7, my emphasis.

40 — An owner may sell a property even when it is let.

41 — United Kingdom Government's observations, paragraph 38.

86. Consequently, I propose that the Court rule as follows:

- (1) The surrender of a lease in return for compensation paid to the tenant falls within the term 'letting of immovable property' in Article 13B(b) of the Sixth Directive.
- (2) The last subparagraph of that provision does not confer on Member States the right to exclude such a transaction from the exemption provided for by the first subparagraph of that provision, subject however to the right of option provided for by Article 13C(a) of the directive.