OPINION OF ADVOCATE GENERAL SIR GORDON SLYNN
delivered on 25 May 1988

My Lords,

By Articles 233 A to 233 E of the French General Tax Code which incorporated French Decree No 79-310 of 9 April 1979 (JORF, 19.4.1979, p. 902) undertakings which lease buildings for an annual return of less than one-fifteenth of the value of the property, in respect of which value-added tax is chargeable, may only deduct a fraction of the value-added tax charged on the purchase or construction of the property by those undertakings. The value of the property is defined as the taxable amount of the property for the purposes of value-added tax less the value of the land and financing costs. The legislative provisions lay down a formula for the calculation of the fraction, and for adjustments which have to be made in certain eventualities, which are summarized in the report for the hearing and which I do not repeat here.

The Commission considered that these provisions were incompatible with Council Directive 77/388/EEC of 17 May 1977 (Official Journal 1977, L 145, p. 1) governing the uniform basis of assessment for value-added tax ('the Sixth Directive'). After its initiating letter of 27 March 1985 pursuant to Article 169 of the EEC Treaty and after issuing a reasoned opinion dated 14 May 1986, the Commission made the present application to the Court on 18 February 1987 for a declaration that France had failed to fulfil its obligations under Articles 99 and 100 of the EEC Treaty by adopting and maintaining in force fiscal rules restricting certain taxable persons' right to deduct VAT paid ('input tax') at the time when the deductible tax becomes chargeable and failing to comply with the Sixth Directive, in particular Articles 17 to 20 thereof.

France objects first that these proceedings are inadmissible. It contends that the initiating letter alleged incompatibility with the Sixth Directive, whereas the reasoned opinion and this application allege a breach of Articles 99 and 100 of the Treaty by the adoption of the decree and a failure to comply with the Sixth Directive.

In my view, France is right to stress the importance of the initiating letter which is intended to give the Member State to which it is addressed adequate notice of the substance of the claim against it. It is for the Commission to formulate clearly and precisely at the first stage the legal basis for its contention that a Member State has failed to fulfil its Treaty obligations (Opinions in Case 254/83 *Commission* v

Italy [1984] ECR 3395, at pp. 3401 and 3402 and Case 193/80 *Commission* v *Italy* [1981] ECR 3019, at pp. 3039 and 3040).

In this case, however, it is plain that in the letter as well as in the reasoned opinion and in this application, the essential claim made is that the French legislation contravenes the Sixth Directive. France had ample opportunity at all stages to answer that contention and I do not consider that it has been deprived of its rights under the procedure laid down by Article 169 (see Case 211/81 *Denmark* v *Commission* [1982] ECR 4547). The reference in the reasoned opinion and the application to Articles 99 and 100 of the EEC Treaty, on which the Sixth Directive was based, seem to me to be a formality, perhaps misconceived, and in any event not pursued in oral argument. For my part I accept that these proceedings are admissible.

Both in writing and orally, France has put forward arguments to explain the basis of the limitation on the deduction of VAT and to justify on an accountancy basis the formula adopted which it has variously said is to prevent fraud, or more fundamentally, to prevent deduction of the VAT where premises are let at unrealistically low rents by certain undertakings to associated undertakings and by local authorities for what are really social ends. It is said that if a full deduction of input tax paid on the construction or purchase of a building is allowed in respect of a letting at a very low rent the undertaking can deduct far more than it is liable to pay and thereby gains an advantage at the expense of public funds.

If the right to adopt this sort of provision exists, as France contends, then prima facie the actual figures put forward are persuasive. The question, however, is whether under the Sixth Directive this kind of provision may be adopted.

The Commission's case is that there is no provision in the Sixth Directive which permits this kind of arrangement.

As I see it the starting point is Article 4 (1) of the Sixth Directive which defines a 'taxable' person as 'any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity'. Those activities 'comprise all activities of producers, traders and persons supplying services'. 'The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity.' In addition, by paragraph 3 of Article 4 'Member States may also treat as a taxable person anyone who carries out, on an occasional basis, a transaction relating to the activities referred to in paragraph 2'. It seems to follow that if the undertaking in question only carries out the lettings occasionally, France could have

opted not to treat them as taxable persons. If the activities are carried out regularly and other than occasionally then the undertaking is a taxable person.

The directive, however, gives a Member State the right to exempt the leasing or letting of immovable property (subject to certain exceptions) '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' (Article 13 (B) (b)). A Member State may also grant taxpayers the right of option for taxation in cases of letting and leasing of immovable property (Article 13 (C) (a)).

Once VAT is chargeable the basic rule is to be found in Article 17: '(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;'. Rules for the application of this basic provision are set out in Articles 17 to 20 of the Sixth Directive.

The directive allows two modifications to this basic provision. In the first place Article 20 provides detailed mechanisms for the adjustment, in certain circumstances, of deductions allowed earlier. In particular, Article 20 (1) (a) permits an adjustment to be made where the deduction was in reality higher or lower than that to which the taxable person was entitled. In the second place, Article 27 enables the Council to authorize a Member State to derogate from the provisions of the directive 'in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance'.

Subject to these possible modifications it seems to me that Article 17 is to be read, and indeed can only be read, as meaning that the right to deduct arises in full at the time when the deductible tax becomes chargeable. It seems to me impossible to construe that article, or any other provision of the directive, in the absence of the special authorization under Article 27, as enabling a Member State to permit the deduction of a fraction only of input tax over a prescribed number of years.

This is not undermined by the provision in Article 13 (B) that Member States shall exempt the leasing or letting of immovable property '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'. It seems to me that that provision goes to the conditions which must be present before the right to deduct arises and cannot operate to limit the right to deduct once it has arisen.

I find nothing in the wording or purpose of the system for the deduction of tax found in Articles 17 to 20 to provide for the deduction of a fraction only of input VAT

by taxable persons. An interpretation to the latter effect would it seems to me, in any event, run counter to the judgments of the Court in Case 15/81 *(Gaston Schul Douane Expediteur BV* v *Inspecteur der Invoerrechten en Accijnzen* [1982] ECR 1409, at p. 1426, paragraph 10) and Case 268/83 *(Rompelman* v *Minister van Financiën* [1985] ECR 655, at pp. 663 and 664, paragraph 16). In the latter case the Court said that 'a basic element of the VAT system is that VAT is chargeable on each transaction only after deduction of the amount of the VAT borne directly by the cost of the various components of the price of the goods and services and that the deduction procedure is so designed that only taxable persons may deduct the VAT already charged on the goods and services from the VAT for which they are liable'. The deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of his economic activities, so that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way (*Rompelman*, paragraph 19 of the judgment). That does not accord with the concept — central to the position adopted by the French Republic — that part of the right to deduct input VAT may, in appropriate circumstances, be deferred.

The French Republic contends that in so far as Article 2 (2) of Directive 67/227/EEC (Official Journal, English Special Edition 1967, p. 14) ('the First Directive') states that: 'On each transaction, value-added tax, calculated on the price of the goods or services at the rate applicable to such goods and services, shall be chargeable after deduction of the amount of value-added tax borne directly by the various cost components', the Member State is entitled to limit the right to deduct if it can prove that the deduction relates to goods and services the cost of which will not be passed on in the price of the taxed transaction.

I do not accept that argument. That article of the First Directive must be read in the light of the greater elaboration of the harmonized system of VAT contained in the Sixth Directive. In my view, the passages in the judgments of the Court in *Gaston Schul* and *Rompelman*, cited earlier, make it clear that VAT only becomes chargeable on a transaction after deduction of input VAT and that the trader is to be relieved entirely of the burden of the VAT payable or paid in the course of all his economic activities. It follows that the Member State is not entitled to limit the right to deduct if it can prove that the deduction relates to goods and services the cost of which will not be passed on in the price of the taxed transaction. If it were permitted to do so, the burden of the input VAT paid would still fall on the taxable person and that is plainly contrary to the interpretation already given by the Court as to the purpose and operation of the deduction system.

Thus, the directive provides certain options to deal with particular economic circumstances — in Article 4, in Article 13 (A), (B) and (C), in Article 20 and in Article 27. There is no power to create a further option however convenient or defensible econ-

omically that may appear. Member States must choose between the options laid down in the directive to achieve so far as possible the result they desire.

It follows that the provisions contained in Decree No 79-310 are not compatible with the uniform basis of assessment established by the Sixth Directive.

Accordingly, in my opinion, the Commission is entitled to a declaration to that effect and the French Government should pay the costs of this application.