OPINION OF ADVOCATE GENERAL LENZ

delivered on 23 November 1995 *

A — Introduction

1. In this case, the Rechtbank van Eerste Aanleg (Court of First Instance), Bruges, seeks an interpretation of the expression 'economic activity' within the meaning of the Sixth Council Directive on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment ('the Sixth Directive'). [1] The main proceedings are concerned with a dispute between INZO (Intercommunale voor Zeewaterontzilting), a company incorporated under civil law having the form of a limited company in liquidation, and the Belgian State. INZO was formed in 1974 by, among others, the Provinces of West and East Flanders and several coastal municipalities in order to develop and exploit processes for the treatment of sea water and brackish water and to turn it into drinking water for purposes of marketing it. INZO set up a bureau for that purpose and concluded several loan contracts and a contract with the City of Ostend relating to land for a desalination plant. Above all, it commissioned a profitability study carried out from 1976 onwards.

2. The company was registered as a taxable person by the Belgian tax authorities and deducted input tax amounting to BFR 4 913 001 in respect of the abovementioned activities for the period 1978 to 1982. This was accepted by the tax authorities.

3. The study identified numerous profitability problems and some investors withdrew. Thereupon the General Meeting resolved on 27 May 1988 to wind up the company prematurely. Consequently, the planned trading operations were no longer possible.

4. As early as 1983, the tax authorities found in the course of a tax inspection that until then INZO had declared no taxable transactions. On that ground, it demanded repayment of the tax deducted by way of input VAT. The demand from the Ostend tax authorities, which INZO is contesting, was dated 3 February 1992 and was declared enforceable on 14 February 1992. The amount claimed is BFR 4 913 001 by way of input tax deducted, plus a fine of

* Original language: German.

1 — Directive 77/388/EEC of 17 May 1977 (OJ 1977 L 145, p. 1).

BFR 736 500 and default interest. The reason given for the demand was that there was no entitlement to the deduction of input VAT as INZO was not a taxable person within the meaning of the Law on Value Added Tax. The national court considered it necessary to request the Court for a preliminary ruling pursuant to Article 177 of the EC Treaty on the interpretation of Article 4(1) and (2) of the Sixth Directive. Those provisions read as follows:

'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.

2. The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. 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.'

5. The provision of the Sixth Directive relating to the deduction of input tax which is in point in these proceedings reads as follows:

'Article 17

Origin and scope of the right to deduct

(...)

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:

(...).'

6. Accordingly, the national court has referred the following question to the Court for a preliminary ruling:

'Is the activity of a company established with a specific object ("seeking and researching, establishing, exploiting and promoting all processes for the treatment of sea water and brackish water, and obtaining and selling water"), an activity which in this case extended only to commissioning and paying for a wide-ranging profitability study dealing with the process to be developed, which demonstrated the non-profitable nature of the project and immediately resulted in the liquidation of the company, to be regarded as an economic activity within the meaning of Article 4(1) and (2) of the Sixth Council Directive of 17 May 1977?'

B — Opinion

7. It is uncontested that INZO never commenced its intended economic activity and therefore never carried out any taxable transactions. Although the national tax authorities registered the company as a taxable person and gave it the right to deduct input tax, INZO only commissioned the profitability study and carried out further merely preparatory acts. This is the major difference between this case and the cases previously decided by the Court.

8. For example, the judgment in *Rompelman*, [2] which is cited in all the observations, was concerned with whether a preparatory act may be treated as part of an economic activity taken up at a later date — and, if so, on what conditions — with the result that the person who undertook the act may be regarded as a taxable person entitled to deduct input VAT. In other words, at the time of the Court's decision, the economic activity had already been commenced. The Court therefore decided retrospectively whether an act in the nature of a preparatory act was to be treated as part of an economic activity. In the judgment, the Court held that economic activities within the meaning of Article 4 of the Sixth Directive may consist of several consecutive transactions and that preparatory acts must themselves be treated as constituting part of the economic activity. [3] This means, however, that preparatory acts themselves do not constitute an economic activity but are to be treated as such.

9. In the instant case, the initial question is not whether an activity by way of a preparatory act may in itself be regarded as part of a later economic activity, but whether a decision by the national authorities to regard an act as a preparatory act and to register the person carrying out the act as a taxable person entitled to deduct input VAT may be revoked where it appears that the planned economic activity was never taken up and taxable transactions were never carried out.

2 — Case 268/83 *Rompelman* v *Minister van Financiën* [1985] ECR 655.

3 — *Rompelman*, cited in footnote 2, paragraph 22.

10. In the plaintiff's view, this is not possible. It argues that, according to the judgment in *Rompelman*, its activities are to be regarded as a preparatory act and hence as an economic activity. The fact that the economic activities were not taken up, for reasons for which INZO is not responsible, is irrelevant. After it carried out the preparatory act, INZO was to be regarded as a taxable person. That characteristic cannot be revoked retroactively. It refers in this connection to *Rompelman*, according to which the common system of value added tax ensures that all economic activities, whatever their purpose or results, are taxed in a wholly neutral way. [4]

11. To my mind, *Rompelman* cannot be directly transposed to cover the instant case. It was clear in *Rompelman* that the economic activity had been taken up. In the knowledge of that fact, the Court assessed the situation at the time of the preparatory acts in retrospect. It is true that it expressed the view that, on grounds of the neutrality of taxation, all economic activities should be treated equally, including preparatory acts. The Court held that it was not justified to deny the characteristic of taxable person and hence not to grant entitlement to deduct input VAT for acts preparatory for economic activity until such time as the economic activity was ultimately taken up. It was not possible, for instance, to create an arbitrary distinction between investment expenditure incurred before and during the economic activity. If the right to deduct input tax were granted only at the time when the economic activity was carried on, there would be a financial burden at odds with neutrality of taxation. [5] This means that a decision must be taken at the time of the preparatory act, that is to say, in advance, on whether it is possible to deduct input tax. The Court further held that it is for the person asserting the right to deduct VAT to show that he fulfils the necessary conditions, namely that he is a taxable person within the meaning of Article 4(1) of the Sixth Directive. The national revenue authorities may, in this connection, require objective evidence of that person's declared intention to take up an economic activity. [6]

12. However, in so holding the Court assumed that the intended economic activities were also taken up. In other words, even if the company proved, to the national authorities' satisfaction, its intention to take up economic activities, it is not yet clear what decision should be taken where the economic activity was not taken up.

13. The Court's dictum in *Rompelman* that all economic activities, *whatever their purpose or results*, should be taxed in a neutral way, means whatever the result of the

4 — *Rompelman*, cited in footnote 2, paragraph 19.

5 — *Rompelman*, cited in footnote 2, paragraph 23.

6 — *Rompelman*, cited in footnote 2, paragraph 24.

economic activity. In the instant case, however, no economic activity ensued and hence there cannot have been any result. The preparatory act (the commissioning of the profitability study) produced a result: the negative result that the economic activity should not be taken up. But the preparatory act itself does not yet constitute an economic activity. It can, at most, be treated as such. Whether it is possible to treat a preparatory act as an economic activity or to adhere to such a classification of a preparatory act where the economic activity is not taken up is the question to be decided in this case.

14. It is irrelevant for this purpose that INZO was not responsible for the complete relinquishment of economic activity; and this is questionable, since the activity was doubtless relinquished primarily because it was not profitable, and that lies within INZO's sphere of responsibility.

15. However, it is not a question of the reasons why the economic activity was not taken up. Instead the question arises as to whether a mere intention to take up an economic activity suffices in order for a person to be regarded as a taxable person, even when the preparatory act may not be imputed to any subsequent economic activity.

16. The judgment in *Lennartz*, [7] in which the Court referred to *Rompelman*, was also concerned with determining retroactively whether an investment which was used only subsequently for an economic activity was to be regarded as an economic activity already at the time when the investment was made. In that case, too, the Court assumed that the intended economic activity was also taken up. It even went as far as to mention as a criterion for assessing this question the period which elapsed between the investment and the subsequent economic activity. [8]

17. In my view, it follows that *Rompelman* cannot be applied directly to the instant case, in which the company never took up any economic activity.

18. The Commission, too, refers in its observations to the distinction between the situation in *Rompelman* and the case now before the Court. However, it takes the view that *Rompelman* should be applied in this case. It considers that from the time when a person declares himself to be a taxable person in accordance with Article 22(1) of the Sixth Directive without any intent to deceive and to the satisfaction of the national tax authorities on the basis of objective evidence, it is irrelevant whether or not taxable transactions are made. If no taxable transactions are

7 — Case C-97/90 *Lennartz* v *Finanzamt München II* [1991] ECR I-3795.

8 — *Lennartz*, cited in footnote 7, paragraph 20.

made, this does not preclude the investment from being regarded as an economic activity within the meaning of Article 4(1) and (2) of the Sixth Directive and the grant of the right to deduct input VAT under Article 17 of that directive. If the tax authorities consider, on the basis of the documentation submitted to it, that there is an intention to carry on an economic activity and consequently register someone as a taxable person and grant him the right to deduct input VAT, they are not entitled to retract this in the light of subsequent unforeseen circumstances. This would be possible only if the person concerned gave false particulars with an intent to deceive.

19. The Commission bases this view on the principle of the protection of legitimate expectations. That principle means that once a right to deduct input VAT has been granted it cannot retroactively be revoked. However, the Commission itself considers that there is one limitation: the national tax authorities are bound by their decision so long as no change occurs in the taxable person's activity.

20. In my view, the situation in the instant case could also be regarded as being a change in economic activity, indeed the most radical conceivable change: no economic activity was taken up. Perhaps nothing is changed as regards the intention and the preparatory act itself, but the intended economic activity, to which the preparatory act would be imputed, is not taken up. In other words, there is a change which — also in the Commission's view — means that the national administration is no longer bound by its original decision.

21. A major argument, to my mind, in favour of the possibility of reclaiming input tax deducted is that Article 20 of the Sixth Directive itself provides for the adjustment of deductions. Such an adjustment may be effected if the amount of the deduction changes, for instance, where a purchase is cancelled or a price reduction is obtained. The first consequence of this is that a deduction of input tax granted may certainly be rectified.

22. In addition, the question arises as to why, if a deduction of input tax may be adjusted where the amount changes, the deduction should not, *a fortiori*, be adjusted when in fact there is no economic activity and hence no right to deduct input VAT. Why should someone who is not engaged in an economic activity and therefore is not entitled to deduct input tax not be subject to adjustment, whilst a taxable person has to repay the difference in the event of a change in the amount of the input tax deducted? There is no perceivable justification for such a differentiation. It must therefore be possible to claim back the deduction of input VAT granted.

23. Problems may arise in the sphere of the protection of legitimate expectations as a result. However, this will depend above all on how matters are designed nationally. Germany stated, for example, that in the event of preparatory acts the decision on whether the person is to be regarded as a trader and on the right to deduct input tax is initially only provisional, that is to say, it is subject to the suspensive condition that transactions for consideration must indeed have been performed. Only if transactions are actually carried out for consideration does the decision become definitive.

24. There is nothing to suggest that the Sixth Directive prescribes such a procedure. However, it can readily be seen that where such a national rule exists, problems relating to protection of legitimate expectations will scarcely arise where a tax deduction granted is claimed back — unless there are exceptional circumstances, such as, for example, a disproportionate time lapse between the provisional decision and its revocation.

25. Precisely this gives rise to difficulties in this case. The tax deduction was granted for the first time in 1978. Five years went by before the national authorities conducted their first tax inspection and a further nine before the demand for payment was served. This may give rise to difficulties in connection with the protection of legitimate expectations. However, this is a matter for the national court to resolve in the particular case in the light of the national rules.

26. In contrast, it falls to the Court of Justice to resolve the basic question as to whether it is indeed possible to claim back the deduction of input tax. Since, as has already been seen, the aspects relating to the protection of legitimate expectations may be taken into account sufficiently also where a tax deduction is claimed back, such a claim is possible, especially since the Sixth Directive itself provides for the adjustment of deductions. In other words, reasons relating to the protection of legitimate expectations do not defeat the possibility of claiming back the tax deduction granted.

27. The Commission provides a further argument against the possibility of claiming back the deduction of input tax: namely, the principle of neutrality of taxation stressed by the Court in *Rompelman*. Under that principle, all traders should be treated neutrally as regards their tax burden, regardless whether they are engaged in only preparatory acts or whether they are already carrying out taxable transactions.

28. In this context, too, it must be pointed out once again that no economic activity was taken up in this case. I consider that for that reason the principle of neutrality of taxation

would, in contrast, be contravened if the tax deduction granted were not repaid. No deduction of input tax is granted in respect of an activity which is not an economic activity. In that respect, preparatory acts are given special treatment because and if they may be imputed to a subsequent economic activity. If they cannot be so imputed, however, because there is no subsequent economic activity, it will be impossible to deduct input VAT. What is important, in fact, is not the preparatory act, but the economic activity. It is the starting point of the analysis. It must be dealt with neutrally in the case of individual traders. The defendant refers to this in its observations. Consequently, why should someone who is not engaged in an economic activity be treated in the same way as someone who is engaged in such an activity?

29. In this connection, both the defendant and Germany rightly refer to Article 17(2) of the Sixth Directive. According to that provision, the deduction of input tax is possible only where the taxable person incurs expenditure 'for the purposes of his taxable transactions'.

30. In this respect too, it could be argued again that only the intention is important. On that view, it is immaterial whether subsequently transactions are actually carried out. However, according to Article 17(2) of the Sixth Directive only a *taxable person* is entitled to deduct input tax. According to Article 4(1) of the directive, a taxable person is someone who *carries out* an economic activity — not someone who merely *intends* to do so.

31. As Germany rightly states, *Rompelman* was concerned only with *when* the economic activity carried out begins. In the interests of the neutrality of taxation, the commencement of economic activity was shifted back to preparatory acts and thereby the emphasis was placed on the connection between the preparatory act and subsequent economic activity. However, if the person concerned does not subsequently take up an economic activity, those considerations no longer hold good. There is no reason to grant a right to deduct input tax if there is no economic activity at all.

32. A further principle of the value added tax system, to which the defendant and the Germany have also referred, is at least equally as important as the principle of neutrality of taxation. This is the principle that value added tax always falls due from the private ultimate consumer. In other words, a chain of transactions is assumed. A taxable person who carries out transactions and provides goods or services for others is not at the end of the chain and is therefore entitled to deduct input VAT. The tax is not due until the stage of the ultimate consumer to whom he has provided goods or services. If, however, the 'taxable person' carries out no transactions and hence provides no goods or services, he is in practice the ultimate

consumer. In other words, the VAT is due from him. If he were granted a right to deduct input tax, his activities would be untaxed. As the defendant rightly argues, this would conflict with a fundamental principle of the value added tax system. On that ground, INZO can no longer be granted any right to deduct input VAT. It is established that INZO never engaged in any economic activity and hence never carried out any transactions. This means that the company should be treated as an ultimate consumer and liable to pay value added tax. For that reason, INZO must repay the deduction of input tax granted to it.

33. Contrary to the Commission's view, this does not upset the value added tax system. The Commission argues that if no right to deduct were granted, a taxable person would have to pay value added tax even if subsequently a transaction was carried out. Then value added tax would be imposed twice and might be passed on by the taxable person in the price of the product.

34. That is not, however, the situation in the present case. Here deduction of input tax was granted and is now being claimed back, since it has become clear that INZO will never carry out any transactions. It is therefore clear that INZO is the ultimate consumer. This means that there is no danger of double taxation, but there is the fear that a transaction will never be taxed at all. This would upset the value added tax system.

35. At the hearing, Germany also rightly pointed to the danger of abuse. The intention of a person or a company to carry out economic activities is difficult to determine in advance. Deception would be very easy and accordingly the danger of abuse is commensurately high. As a result, the right to deduct input tax could be granted in many cases even though in fact there were no plans to carry out an economic activity. For this reason, it must be possible to carry out checks and possible adjustments retrospectively. As has been explained above, it is possible to take sufficient account of the protection of legitimate expectations in so doing. If it is possible to claim back input tax deducted, this does not mean that it is not possible to refrain from claiming back such tax in individual cases on grounds relating to the protection of legitimate expectations.

36. Germany also refers in its observations to the judgment in *Staatssecretaris van Financiën* v *Hong Kong Trade Development Council*, [9] where it was held that services provided free of charge cannot give rise to tax liability. Germany infers from this that, *a fortiori*, there can be no liability to tax where no goods or services are provided. This argument does not seem entirely in point, since the instant case does not turn on the demarcation between services provided for consideration and services provided free of charge, but on whether the intention to carry out an

9 — Case 89/81 *Staatssecretaris van Financiën* v *Hong Kong Trade Development Council* [1982] ECR 1277, paragraph 10, at 1286.

economic activity is sufficient in itself or whether it must be put into effect. INZO had the intention to carry out an economic activity for consideration. The question is only whether that intention alone was sufficient in order for INZO to be regarded as a taxable person. As I have already stated, such intention is not, in my view, enough.

37. All the parties taking part in the proceedings also discuss whether, at the time when the profitability study was commissioned, there genuinely was an intention to carry out economic activities. The defendant maintains, for example, that INZO did not intend to decide until the findings of the study were ready whether or not it would actually take up the economic activity and that, until that time, all its activities were subject to that reservation. There is no need to consider this further, since it contests the original decision of the national tax authorities that INZO was a taxable person and had the right to deduct input VAT. In other words, reliance is not placed on the fact that INZO did not take up economic activities subsequently, but it is argued that the INZO should not have been classed as a taxable person already at that time. It is not the task of the Court to consider this matter.

38. Whether the national authorities can go back on the assessment that they made at that time is a question of national administrative law to be decided by the national court having regard to the principle of the protection of legitimate expectations.

39. I would merely observe as follows in that regard. It cannot be assumed that INZO did not have any intention at all to engage in economic activities. On the contrary, it is undisputed that INZO had a definite intention to take up economic activities if the findings of the profitability study were to prove favourable. If, in such a case, the deduction of input tax were to be refused from the outset, it would have to be considered whether that very fact would not contravene the principle of neutrality of taxation, for if the findings of the study were favourable, economic activities would be taken up. If the right to deduct input tax were refused, the economic activity would then be afforded tax treatment differing from that given to an economic activity and preparations for such activity where they are commenced without a prior investigation into profitability. There is no legal basis for such a distinction.

40. This does not, however, constitute the real question in this case, which is that of establishing what should be done where the economic activity is not taken up. In such a case, the preparatory act alone cannot be regarded as an economic activity. The previously granted tax deduction may — as has already been shown — be claimed back (provided that the national court has regard to the principle of the protection of legitimate expectations).

C — Conclusion

41. I therefore propose that the Court should answer the national court's question as follows:

The activity of a company with a view to a future economic activity of the company may not be regarded as an economic activity within the meaning of Article 4(1) and (2) of the Sixth Directive of 17 May 1977 once it becomes clear that the company has been wound up without having embarked on any economic activity.