JUDGMENT OF THE COURT (Fifth Chamber)
29 May 1997 *

In Case C-63/96,

REFERENCE to the Court under Article 177 of the EC Treaty by the Bundesfinanzhof for a preliminary ruling in the proceedings pending before that court between

Finanzamt Bergisch Gladbach

and

Werner Skripalle,

in the presence of the **Bundesministerium der Finanzen,**

on the interpretation of the 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),

* Language of the case: German.

THE COURT (Fifth Chamber),

composed of: J. C. Moitinho de Almeida, President of the Chamber, L. Sevón, D. A. O. Edward, J.-P. Puissochet and P. Jann (Rapporteur), Judges,

Advocate General: N. Fennelly,
Registrar: H. A. Rühl, Principal Administrator,

after considering the written observations submitted on behalf of:

— the German Government, by Ernst Röder, Ministerialrat at the Federal Ministry of Economic Affairs, acting as Agent,

— the French Government, by Catherine de Salins, Head of Subdirectorate in the Legal Directorate of the Ministry of Foreign Affairs, and Gautier Mignot, Secretary for Foreign Affairs in the same Directorate, acting as Agents,

— the Commission of the European Communities, by Jürgen Grunwald, Legal Adviser, and Enrico Traversa, of its Legal Service, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Mr Skripalle, represented by Kurt Conscience, of the Bochum-Querenburg Bar, the German Government, represented by Ernst

Röder, the French Government, represented by Gautier Mignot, the Netherlands Government, represented by Marc Fierstra, Assistant Legal Adviser at the Ministry of Foreign Affairs, acting as Agent, and the Commission, represented by Jürgen Grunwald, at the hearing on 22 January 1997,

after hearing the Opinion of the Advocate General at the sitting on 27 February 1997,

gives the following

Judgment

1 By order of 13 December 1995, which was received at the Court on 8 March 1996, the Bundesfinanzhof (Federal Finance Court) referred to the Court for a preliminary ruling under Article 177 of the EC Treaty two questions concerning the interpretation of the 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, hereinafter 'the Sixth Directive').

2 The questions were raised in proceedings between the Finanzamt (Tax Office) Bergisch Gladbach (hereinafter 'the Finanzamt') and Werner Skripalle and concern the determination of the taxable amount for VAT purposes where there is a personal relationship between the supplier and the recipient of taxable supplies.

3 The order for reference states that Mr Skripalle owns a housing block built by himself and several flats. He let those properties to a limited company, whose shareholders were his adult son and his wife, each holding 50% of the shares. His wife was also the managing director of the company, with sole power of representation.

4 As regards the basis for assessing the VAT applicable to the income arising from the rent, the 1980 version of the Umsatzsteuergesetz (Turnover Tax Law, *Bundesgesetzblatt* I, p. 1953, hereinafter 'the UStG'), provides as follows:

Paragraph 10(1) of the UStG, which is the general rule: 'In respect of the supply of goods and services (Paragraph 1(1) No 1, first sentence), taxable turnover is determined according to consideration. Consideration is everything which the recipient of the supplies expends in order to acquire the supplies, but after deduction of turnover tax.'

Paragraph 10(4) of the UStG provides for derogations from that rule in the case of supplies for own consumption, in respect of which turnover is constituted, subject to certain conditions, by the costs of the supply.

Under Paragraph 10(5) of the UStG, Paragraph 10(4) applies by analogy to 'goods and services which corporations and associations of persons within the meaning of Paragraph 1(1) Nos 1 to 5 of the Corporation Tax Law, associations of persons without legal personality and communities supply in the context of their business to their equity holders, shareholders, members, partners or persons associated with them or which sole traders supply to associated persons ...'.

5 Pursuant to those provisions, the Finanzamt took as the basis for assessing VAT in the case at issue in the main proceedings a notional 'minimum basis of assessment', corresponding to the 'costs of the supply'. In this case that amount was higher than the rent agreed between Mr Skripalle and the tenant company, even though that rent corresponded to normal market rents for comparable properties in the area.

6 According to Article 11(A)(1) of the Sixth Directive, the taxable amount is to 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 ...'.

7 Although Article 11(A)(1)(c) allows the full cost to the taxable person of providing the services to be taken into account, that only applies to the supplies referred to in Article 6(2) of the Sixth Directive, which concerns supplies carried out for no consideration. Under the Sixth Directive there is accordingly no need to resort to notional costs incurred where it is established that the taxable person is carrying out a supply at the normal market price.

8 However, Paragraph 10(5) of the UStG was introduced in 1978 in Germany as a provision derogating from Article 11(A)(1)(a) of the Sixth Directive under Article 27 thereof, which provides:

'1. The Council, acting unanimously on a proposal from the Commission, may authorize 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 amount of tax due at the final consumption stage.

2. A Member State wishing to introduce the measures referred to in paragraph 1 shall inform the Commission of them and shall provide the Commission with all relevant information.

3. The Commission shall inform the other Member States of the proposed measures within one month.

4. The Council's decision shall be deemed to have been adopted if, within two months of the other Member States being informed as laid down in the previous paragraph, neither the Commission nor any Member State has requested that the matter be raised by the Council.

...'

9 It appears that that procedure was duly followed in this case and that there was no request that the matter be raised by the Council. However, the authorization procedure, as provided for in Article 27(2) to (4) of the Sixth Directive, was not publicised in the official publications of the Member State concerned after the derogation was implemented.

10 Mr Skripalle considered that the 'costs of the supply' should not be taken into account and accordingly lodged an objection to the Finanzamt's assessment on 8 August 1984. The objection was dismissed and he brought an action before the Finanzgericht (Finance Court), Cologne, which upheld his appeal on the basis that Paragraph 10(5)(1) of the UStG was inapplicable where the tenant company was not a person associated with the applicant in the main proceedings within the meaning of Paragraph 10(5)(1) of the UStG. Furthermore, according to the Finanzgericht, that provision was to be interpreted restrictively, so that it did not apply where normal remuneration had been agreed for the supplies provided.

11 On 3 April 1986 the Finanzamt lodged an appeal on a point of law before the Bundesfinanzhof (Federal Finance Court).

12 In contrast to the Finanzgericht, the Bundesfinanzhof considered that the tenant company was a person associated with Mr Skripalle within the meaning of Paragraph 10(5) of the UStG because of the close personal links between its shareholders and Mr Skripalle. The national court nevertheless expresses doubt as regards the applicability of the minimum basis of assessment in the case at issue in the main proceedings, because it considers it disproportionate and not covered by the derogation rules under Article 27 of the Sixth Directive, which only permit derogations 'in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance'. The national court does not regard that condition as satisfied where, as in this case, the agreed remuneration, although less than the minimum basis of assessment, corresponds to normal market rents, so that no tax evasion is involved. The Bundesfinanzhof states that such cases do not arise very frequently and their financial consequences are not so serious that they lead to distortion of competition; they are not wholly exceptional, however.

13 In those circumstances, the Bundesfinanzhof referred the following questions to the Court of Justice:

'1. Does Article 27 of Directive 77/388/EEC cover an authorization by the Council to introduce special measures for derogation from Directive 77/388/EEC in order to prevent tax avoidance which, in the case of supplies for consideration made between associated persons, apply the cost to the taxable person within the meaning of Article 11(A)(1)(c) of Directive 77/388/EEC as the minimum basis of assessment also where the agreed consideration represents the market rate but is less than the minimum basis of assessment and there is therefore no tax avoidance?

2. Can a Member State invoke special measures under Article 27 of Directive 77/388/EEC as taxation rules applying to a taxable person, if the Council's decision authorizing the measures was not published in the Official Journal of the European Communities and the authorization procedure under Article 27(2) to (4) of Directive 77/388/EEC was not notified — after its completion — in official publications of the Member State?'

14 As a preliminary point, the Netherlands Government expressed doubts at the hearing as regards the jurisdiction of the Court to review the legality of a national measure derogating from Article 27 of the Sixth Directive, in so far as it had been authorized by the Council. It maintained that the question of the compliance with Community law of a decision allowing a derogation could only be raised in a case where the validity of that decision was expressly challenged. The national court had not referred a question to the Court concerning its validity.

15 However, as Advocate General Fennelly rightly stated in paragraph 26 of his Opinion, in fact the Court is being asked to provide criteria for a decision as to whether the derogation relied upon by the German Government in support of the applicability of special measures to the circumstances of the case is authorized by virtue of the derogation granted under Article 27 of the Sixth Directive.

16 In those circumstances the Court has jurisdiction to reply to the questions raised by the national court.

First question

17 Mr Skripalle and the Commission consider that Article 27(1) of the Sixth Directive must be interpreted strictly. Although that provision authorizes derogations in order principally to prevent tax evasion or avoidance, measures adopted pursuant to that derogation should nevertheless not derogate from the basis for charging VAT laid down in Article 11 of the Sixth Directive, except within the limits strictly necessary for achieving that aim.

18 They submit that that is not the case here, since the agreed rent, although less than the costs of the supply, corresponds to normal market rents. In such a case tax evasion or avoidance are automatically excluded, so that the measure in question is not necessary to achieve the objective, which is to prevent such tax evasion or avoidance.

19 According to Mr Skripalle, the German rules also bring about the absurd result that a family link is a criterion for additional taxation because it gives rise to a

suspicion of tax evasion, even where there is manifestly no abuse. That is all the more serious because the VAT, inasmuch as it is calculated on a notional basis, cannot be passed on to the final consumer, who is the tenant. Thus the fundamental principle governing VAT is disregarded.

20 The German Government, however, considers that the rules in question are covered by Article 27 of the Sixth Directive inasmuch as they are necessary and generally appropriate for the prevention of tax evasion or avoidance. Cases such as the present, where the remuneration is normal for the market but less than the costs incurred, are very rare. A legal rule must, however, by its nature, be formulated to a certain degree in abstract terms and cannot be directly limited to specific cases of tax evasion or avoidance. The rule in question is consequently not disproportionate even if, in a given case, the result is not appropriate.

21 Furthermore, Paragraph 10(5) of the UStG is not solely intended to prevent tax evasion and avoidance but is also aimed at simplifying the procedure for charging the tax, since assessment of the actual costs also has the advantage that the latter, unlike the normal market value, can be objectively and easily determined.

22 The Court notes that it is not disputed that Paragraph 10(4) and (5) of the UStG derogates from the system of the taxable amount provided for in Article 11 of the Sixth Directive.

23 According to Article 27(1) of the Sixth Directive, derogations are allowed 'in order to simplify the procedure for charging the tax or to prevent certain types of tax

evasion or avoidance'. The file on the main proceedings shows that the Federal Republic of Germany requested and received authorization for the derogating measure in respect of the second alternative.

24 As the Court has already held, national derogating measures designed to prevent the evasion or avoidance of tax must be strictly interpreted and may not derogate from the basis for charging VAT laid down in Article 11 of the Sixth Directive, except within the limits strictly necessary for achieving that aim (Case 324/82 *Commission* v *Belgium* [1984] ECR 1861, paragraph 29). The question to be examined is whether those conditions are satisfied in this case.

25 It is not disputed that, as between family members or associated persons, there may be a certain risk of tax evasion or avoidance justifying measures of the type which Article 27 of the Sixth Directive permits.

26 However, there is no such risk where the objective facts show that the taxable person has acted properly. In retaining as the taxable amount the costs incurred where there is a relationship between associated persons, including cases where it is clear that the agreed income, which corresponds to normal market rent, is lower than those costs, the German rules are not confined to introducing the derogations strictly necessary to deal with the risk of tax evasion or avoidance. They are not, therefore, covered by Article 27 of the Sixth Directive.

27 That finding is not affected by the fact that a legal rule must be formulated to a certain degree in abstract terms, which necessarily implies that the result will not always be appropriate in a specific case.

28 First, as pointed out by the national court and confirmed by the parties at the hearing, cases in which the notional taxable amount is higher than normal market income, albeit rare, are not exceptional, in particular as far as rents are concerned. For political reasons rents are often set at a level aimed at facilitating access to housing, whereas costs in the building sector are extremely high.

29 Secondly, there is nothing to prevent a provision formulated in fairly general or abstract terms from excluding cases in which the agreed rent is lower than the amount normally necessary to amortize building costs but is in accordance with normal market rent.

30 As regards the argument put forward by the German Government that the measure in question is legitimate because it is also aimed at simplifying the procedure for charging tax, corresponding to the first alternative provided for in Article 27(1) of the Sixth Directive, it must be noted that authorization for the derogating measure was requested in respect of the second alternative, namely in order to prevent tax evasion or avoidance. The authorization cannot therefore extend beyond that purpose.

31 Consequently, the reply must be that an authorization by the Council to introduce a special measure for derogation from the Sixth Directive whereby, in order to prevent tax avoidance, in the case of supplies for consideration made between associated persons the cost to the taxable person within the meaning of Article 11(A)(1)(c) of the Sixth Directive is to be used as the minimum basis of assessment is not covered by Article 27 of the directive where the agreed consideration represents the market rate but is less than the minimum basis of assessment.

Second question

32 In view of the reply to the first question, there is no need to reply to the second.

Costs

33 The costs incurred by the German, French and Netherlands Governments and by the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main action, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT (Fifth Chamber),

in answer to the questions referred to it by the Bundesfinanzhof by order of 13 December 1995, hereby rules:

An authorization by the Council to introduce a special measure for derogation from the Sixth Council Directive (No 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) whereby, in order to prevent tax avoidance, in the case of supplies for consideration made between associated persons the cost to the taxable person within the meaning of Article 11(A)(1)(c) of the Sixth Directive is to be used as the minimum basis of assessment is not covered by Article 27 of the directive where the agreed consideration represents the market rate but is less than the minimum basis of assessment.

Moitinho de Almeida Sevón Edward

Puissochet Jann

Delivered in open court in Luxembourg on 29 May 1997.

R. Grass J. C. Moitinho de Almeida

Registrar President of the Fifth Chamber