JUDGMENT OF THE COURT (Eighth Chamber)

18 December 2008 *

In Case C-488/07,

REFERENCE for a preliminary ruling under Article 234 EC from the Court of Session (Scotland), made by decision of 31 October 2007, received at the Court on 5 November 2007, in the proceedings

Royal Bank of Scotland Group plc

v

The Commissioners for Her Majesty's Revenue and Customs,

THE COURT (Eighth Chamber),

composed of T. von Danwitz (Rapporteur), President of the Chamber, E. Juhász and G. Arestis, Judges,

* Language of the case: English.

Advocate General: P. Mengozzi,
Registrar: M. Ferreira, Principal Administrator,

having regard to the written procedure and further to the hearing on 8 October 2008,

after considering the observations submitted on behalf of:

— Royal Bank of Scotland Group plc, by C. Tyre QC and D. Small, Advocate,

— the United Kingdom Government, by Z. Bryanston-Cross and S. Ossowski, acting as Agents, and I. Hutton, Barrister,

— the Commission of the European Communities, by R. Lyal and M. Afonso, acting as Agents,

having decided, after hearing the Advocate General, to proceed to judgment without an Opinion,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of the third subparagraph of Article 17(5) and the second subparagraph of Article 19(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 (OJ 1977 L 145, p. 1) ('the Sixth Directive').

2 The reference was made in the course of proceedings between the Royal Bank of Scotland Group plc ('Royal Bank of Scotland') and the Commissioners for Her Majesty's Revenue and Customs ('the Commissioners'), who are responsible for the collection of value added tax (VAT) in the United Kingdom, concerning the extent of the right to deduct VAT payable by that company.

Legal context

Community law

3 The 12th recital in the preamble to the Sixth Directive provides that '… the deductible proportion should be calculated in a similar manner in all the Member States'.

4 Article 17(5) of the Sixth Directive provides as follows:

'As regards goods and services to be used by a taxable person both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible, only such proportion of the value added tax shall be deductible as is attributable to the former transactions.

This proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person.

However, Member States may:

(a) authorise the taxable person to determine a proportion for each sector of his business, provided that separate accounts are kept for each sector;

(b) compel the taxable person to determine a proportion for each sector of his business and to keep separate accounts for each sector;

(c) authorise or compel the taxable person to make the deduction on the basis of the use made of all or part of the goods and services;

(d) authorise or compel the taxable person to make the deduction in accordance with the rule laid down in the first subparagraph, in respect of all goods and services used for all transactions referred to therein;

(e) provide that, where the value added tax which is not deductible by the taxable person is insignificant, it shall be treated as nil.'

5 Article 19(1) of the Sixth Directive is worded as follows:

'The proportion deductible under the first subparagraph of Article 17(5) shall be made up of a fraction having:

— as numerator, the total amount, exclusive of value added tax, of turnover per year attributable to transactions in respect of which value added tax is deductible under Article 17(2) and (3);

— as denominator, the total amount, exclusive of value added tax, of turnover per year attributable to transactions included in the numerator and to transactions in respect of which value added tax is not deductible. …

The proportion shall be determined on an annual basis, fixed as a percentage and rounded up to a figure not exceeding the next unit.'

National law

6 Regulation 101 of the Value Added Tax Regulations 1995 provides as follows:

'(1) Subject to regulation 102 … the amount of input tax which a taxable person shall be entitled to deduct … shall be the amount which is attributable to taxable supplies in accordance with this regulation.

(2) In respect of each prescribed accounting period:

…

(d) there shall be attributed to taxable supplies such proportion of the input tax on such of those goods or services as are used or to be used by him in making both taxable and exempt supplies as bears the same ratio to the total of such input tax as the value of taxable supplies made by him bears to the value of all supplies made by him in the period.

…

(4) The ratio calculated for the purpose of paragraph 2(d) above shall be expressed as a percentage and, if that percentage is not a whole number, it shall be rounded up to the next whole number.

…'

7 Regulation 102(1) provides as follows:

'Subject to paragraph 2 below and regulations 103, 103A and 103B, the Commissioners may approve or direct the use by a taxable person of a method other than that specified in regulation 101 …'

The main proceedings and the questions referred for a preliminary ruling

8 Royal Bank of Scotland is the representative member of a group of companies whose main business is banking and the provision of other financial services. In the course of

its business, the company makes both taxable and exempt supplies. The goods and services on whose acquisition Royal Bank of Scotland has paid VAT are used for both taxable and exempt transactions.

9 According to the order for reference, if part of the input tax for which Royal Bank of Scotland is liable cannot be wholly attributed to either taxable or exempt supplies, that part is referred to by the parties to the main proceedings as 'residual' input tax.

10 On 31 May 2002, the parties to the main proceedings entered into a Partial Exemption Special Method and Approval Agreement relating to the residual input tax of Royal Bank of Scotland's VAT group. That agreement laid down certain parameters within which a special method could be agreed with that company for each sector of its business. In particular, the agreement provided that, where the method applicable to a particular sector or part of a sector forming part of Royal Bank of Scotland's business required recovery of input tax to be based on a calculated percentage, that percentage was to be rounded up to two decimal places and regulation 101(4) of the Value Added Tax Regulations 1995 was not to apply.

11 Subsequently, Royal Bank of Scotland took the view that that provision in the agreement of 31 May 2002 was contrary to Articles 17 and 19 of the Sixth Directive and was, therefore, of no effect. It considered that that directive requires rounding up to the next whole number and sought the agreement of the Commissioners to an apportionment calculation for the purpose of quantifying deductible residual input VAT in relation to a particular sector of its business which included rounding up to the next whole number. Since the Commissioners issued a decision refusing to accept the use of such a method, Royal Bank of Scotland appealed against that decision to the VAT and Duties Tribunal, which, in its decision of 20 January 2006, held that an agreed special method which provided for rounding up to two decimal places was compatible with both United Kingdom law and the Sixth Directive.

12 Royal Bank of Scotland appealed against that decision to the Court of Session (Scotland). Considering that the resolution of the dispute depended on the interpretation of the Sixth Directive, that court decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

'1. Does the second subparagraph of Article 19(1) of the Sixth VAT Directive … require the proportion deductible by a taxable person under Article 17(5) to be determined on an annual basis, fixed as a percentage and rounded up to a figure not exceeding the next unit where:

(a) that proportion is a proportion which has been determined for a sector of the business of the taxable person in accordance with either item (a) or (b) of the third subparagraph of Article 17(5); and/or

(b) that proportion is a proportion which has been determined on the basis of the use of all or part of goods and services by the taxable person in accordance with item (c) of the third subparagraph of Article 17(5); and/or

(c) that proportion is a proportion which has been determined in respect of all goods and services used by the taxable person for all transactions referred to in the first subparagraph of Article 17(5), in accordance with item (d) of the third subparagraph thereof?

2. Does the second subparagraph of the said Article 19(1) permit Member States to require the proportion deductible by a taxable person under Article 17(5) to be rounded up to a figure other than the next highest whole number?'

The questions

Question 1

13 By its first question, the Court of Session asks whether Member States are obliged to apply the rounding up rule in the second subparagraph of Article 19(1) of the Sixth Directive where the proportion of input tax deductible is calculated in accordance with one of the special methods in (a), (b), (c) or (d) of the third subparagraph of Article 17(5) of that directive.

14 The Court has consistently held that the right to deduct provided for in Article 17 et seq. of the Sixth Directive is an integral part of the VAT scheme and, in principle, may not be limited (Case C-243/03 *Commission* v *France* [2005] ECR I-8411, paragraph 28 and the case-law cited).

15 The deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures complete neutrality of taxation of all economic activities,

whatever their purpose or results, provided that they are themselves subject, in principle, to VAT (see Case C-408/98 *Abbey National* [2001] ECR I-1361, paragraph 24 and the case-law cited).

16 Accordingly, where goods or services acquired by a taxable person are used for purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected or input tax deducted (Case C-72/05 *Wollny* [2006] ECR I-8297, paragraph 20).

17 Article 17(5) of the Sixth Directive lays down the rules applicable to the right to deduct VAT where the VAT relates to goods or services used by the taxable person 'both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible'. In such a case, the first subparagraph of Article 17(5) of the Sixth Directive provides that only such proportion of the VAT is deductible as is attributable to the former taxable transactions (*Abbey National*, paragraph 37, and Case C-16/00 *Cibo Participations* [2001] ECR I-6663, paragraph 34).

18 Under the second subparagraph of Article 17(5) of the Sixth Directive, the deductible amount is calculated according to a proportion fixed in accordance with Article 19 of that directive.

19 The third subparagraph of Article 17(5) nevertheless allows derogation from that rule by permitting Member States to employ one of the other methods for determining the

deductible amount listed in that subparagraph, namely determination of a separate proportion for each sector of business or deduction on the basis of the use made of all or part of the goods and services for a specific activity, or they may even exclude the right of deduction in certain circumstances.

20 That provision does not lay down any specific rule as to which method Member States must employ to round up the deductible amount thus determined.

21 Contrary to what Royal Bank of Scotland contends, the rounding up rule in the second subparagraph of Article 19(1) of the Sixth Directive is not applicable where a particular type of case is subject to a special set of rules laid down in the third subparagraph of Article 17(5) of that directive.

22 As is quite clear from the wording of Articles 17(5) and 19(1) of the Sixth Directive, the latter provision refers only to the proportion deductible under the first subparagraph of Article 17(5) of the directive, and therefore lays down a detailed rule for calculating the proportion referred to in that provision only.

23 That is also the conclusion to be drawn from the overall scheme of the provisions in question. While the second subparagraph of Article 17(5) provides for the application of Article 19 as the rule for calculation of the deductible amount, the third

subparagraph, which starts with the word 'however', allows Member States to provide for derogations of greater or lesser scope from that rule, extending even as far as excluding the right of deduction.

24 Finally, that conclusion is also confirmed by the purpose of (a) to (d) of the third subparagraph of Article 17(5) of the Sixth Directive, the aim of which is in particular, as the Commission contends, to permit Member States to achieve greater accuracy by taking into account the specific characteristics of the taxable person's activities. Accordingly, Member States must be in a position to apply more accurate rounding up rules than those provided for in the second subparagraph of Article 19(1) of the Sixth Directive. If Member States were obliged, for reasons of simplification, to round up in accordance with the latter method, which is less accurate, that would be contrary to the objective of those derogations.

25 It follows that, where a particular case is subject to such a special scheme allowing for derogations, the rule for calculating the deductible proportion in Article 19 of the Sixth Directive is inapplicable in that case. Thus, Member States are not obliged to apply the rounding up rule in that provision where they employ the methods of calculation set out in (a), (b), (c) or (d) of the third subparagraph of Article 17(5) of that directive but may adopt their own rounding up rules, provided that they observe the principles underpinning the common system of VAT (see Case C-484/06 *Koniklijke Ahold* [2008] ECR I-5097, paragraph 33).

26 Contrary to Royal Bank of Scotland's contention, that finding is in no way affected by the objective of the Sixth Directive stated in the 12th recital in its preamble, namely that the deductible proportion should be calculated in a similar manner in all Member States. First, there is no requirement in that recital that the deductible proportion should be calculated in an identical manner in all Member States. Second, by expressly providing that Member States are permitted to derogate from the method of calculation

in Article 19(1), by employing different methods, the Sixth Directive makes it possible for the deductible proportion to be calculated differently in the Member States.

27 Nor can it be said that the principle of fiscal neutrality, which reflects the principle of equal treatment, or the principle of proportionality require that a single method of rounding up be applied for all those methods of calculation (see, to that effect, *Koninklijke Ahold*, paragraphs 37 and 41).

28 Finally, contrary to Royal Bank of Scotland's contention, that finding is not affected by any interpretation which could be given to Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1), since that directive entered into force on 1 January 2007, after the facts giving rise to the main proceedings, and is therefore not applicable.

29 In the light of the foregoing considerations, the answer to the first question must be that Member States are not obliged to apply the rounding up rule in the second subparagraph of Article 19(1) of the Sixth Directive where the proportion of input tax deductible is calculated in accordance with one of the special methods in (a), (b), (c) or (d) of the third subparagraph of Article 17(5) of that directive.

Question 2

30 By its second question, the Court of Session asks whether the second subparagraph of Article 19(1) of the Sixth Directive permits Member States to require that the proportion deductible be rounded up to a figure other than the next highest whole number where that proportion is determined in accordance with Article 17(5) of that directive.

31 There is no need to answer that question concerning the interpretation of the second subparagraph of Article 19(1), since Member States are not obliged to apply the rounding up rule in that provision where they employ the methods of calculation provided for in the third subparagraph of Article 17(5) of that directive.

32 It follows that, having regard to the answer given to the first question and the considerations set out in the previous paragraph, it is not necessary to answer the second question referred for a preliminary ruling.

Costs

33 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs

incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Eighth Chamber) hereby rules:

Member States are not obliged to apply the rounding up rule in the second subparagraph of Article 19(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 where the proportion of input tax deductible is calculated in accordance with one of the special methods in (a), (b), (c) or (d) of the third subparagraph of Article 17(5) of that directive.

[Signatures]