JUDGMENT OF THE COURT
21 September 1988 *

In Case 50/87

Commission of the European Communities, represented by Johannes F. Buhl, a Legal Adviser to the Commission, acting as Agent, and Alain Van Solinge, a member of its Legal Department, acting as Joint Agent, with an address for service in Luxembourg at the office of Georgios Kremlis, a member of its Legal Department, Jean Monnet Building, Kirchberg,

applicant,

v

French Republic, represented by Régis de Gouttes and Bernard Botte of the Directorate for Legal Affairs of the Ministry of Foreign Affairs, acting as Agents, with an address for service in Luxembourg at the French Embassy, 9 boulevard Prince Henri,

defendant,

APPLICATION for a declaration that by introducing and maintaining in force fiscal rules restricting certain taxable persons' right to deduct the VAT paid on inputs at the time when the tax becomes chargeable, the French Republic has failed to fulfil its obligations under the EEC Treaty,

THE COURT

composed of: A. J. Mackenzie Stuart, President, G. Bosco, J. C. Moitinho de Almeida and G. C. Rodríguez Iglesias (Presidents of Chambers), T. Koopmans, U. Everling, Y. Galmot, C. N. Kakouris and F. A. Schockweiler, Judges,

Advocate General: Sir Gordon Slynn
Registrar: H. A. Rühl, Principal Administrator

* Language of the Case: French.

having regard to the Report for the Hearing and further to the hearing on 3 March 1988,

after hearing the Opinion of the Advocate General delivered at the sitting on 25 May 1988,

gives the following

Judgment

1 By an application lodged at the Court Registry on 18 February 1987, the Commission of the European Communities brought an action under Article 169 of the EEC Treaty for a declaration that by introducing and maintaining in force fiscal rules restricting certain persons' right to deduct the VAT paid on inputs at the time when the tax becomes chargeable and by failing to comply with 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 (Official Journal 1977, L 145, p. 1) (hereinafter referred to as 'the Sixth Directive') and in particular Articles 17 to 20 thereof, the French Republic had failed to fulfil its obligations under the Treaty.

2 By Decree No 79-310 of 9 April 1979 laying down special rules regarding the deduction of value-added tax charged on let immovable property, the French Republic introduced a tax system under which undertakings letting immovable property which they had purchased or had built could deduct only a fraction of the value-added tax ('VAT') charged on the purchase or construction of such property where the annual income from the letting thereof was less than one-fifteenth of the property's value. The provisions of that decree were incorporated in the Code général des impots (General Tax Code) as Articles 233 A to 233 E.

3 The Commission, considering the French legislation incompatible with the Sixth Directive, addressed a letter to the Government of the French Republic on 27 March 1985 calling upon it to submit its observations, in accordance with the first paragraph of Article 169 of the EEC Treaty.

4 The French Government did not respond to that letter and therefore the Commission delivered a reasoned opinion to it on 14 May 1986. The French Republic refused to comply with the opinion and the Commission then brought the present action on 18 February 1987.

5 Reference is made to the Report for the Hearing for a fuller account of the national legislation at issue, the course of the procedure, and the conclusions, submissions and arguments of the parties, which are referred to or discussed hereinafter only in so far as is necessary for the reasoning of the Court.

Admissibility

6 The French Republic pleads that the application is inadmissible on the ground that the only complaint made by the Commission in the letter calling for its observations related to the incompatibility of the decree in question with the Sixth Directive whereas, in the reasoned opinion and in the application, it is accused of infringing Articles 99 and 100 of the EEC Treaty by adopting that decree and by failing to comply with the said directive. Owing to that change in the subject-matter of the dispute the French Republic was not able properly to prepare its defence in the procedure prior to the commencement of legal proceedings.

7 The Commission maintains that the complaint made in the letter calling for observations is reiterated in its entirety in the reasoned opinion and in the application. The Sixth Directive was adopted under Articles 99 and 100 of the Treaty; in its reasoned opinion and in the application, the Commission confined itself to defining the scope of the complaint made in the letter calling for observations, criticizing the French Republic for adopting legislation incompatible with the directive and thus failing to fulfil its obligations under the abovementioned provisions of the Treaty.

8 It must be observed that it is apparent both from the letter calling for observations and from the reasoned opinion and the application that the issue in this dispute is whether the French legislation is contrary to the Sixth Directive. Since there has been no change in the subject-matter of the dispute during the various stages of the proceedings, the rights of the defence have not been disregarded.

9 The objection of inadmissibility raised by the French Republic must therefore be dismissed.

Substance

10 The Commission claims that Articles 17 to 20 of the Sixth Directive impose upon Member States that allow taxable persons, pursuant to Article 13 C (a), the right of option for taxation in the case of the letting of immovable property the obligation to grant those persons the right to a total and immediate deduction of the VAT paid on inputs and that that right may not be limited according to the amount of the rent charged.

11 The French Republic contends that the legislation in question relates to leases at rents lower than those usually charged on the market, which are granted either by certain undertakings to their subsidiaries or by certain local authorities, for social reasons, to sports or cultural associations or to undertakings in order to help the latter to establish themselves. Such activities essentially appear to involve the grant of a benefit, but to allow the landlord no right of deduction in such cases would be excessively severe. The legislation in question is, it claims, in conformity with Article 2 of Directive 67/227 of the Council of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes (Official Journal, English Special Edition 1967, p. 14, hereinafter referred to as 'the First Directive'); that article lays down the principle that the price of property purchased must be passed on in the cost price of the property let by the taxable person.

12 The relevant aspects and features of the VAT system should first be described.

13 Article 4 (1) of the Sixth Directive 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'. Paragraph (2) of that article adds that 'the economic activities referred to in paragraph (1) shall comprise all activities of producers, traders and persons supplying services'. Also considered to be an economic activity is 'the exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis'.

14 Article 17 (1) of the same directive provides that 'the right to deduct shall arise at the time when the deductible tax becomes chargeable' and Article 17 (2) authorizes the taxable person, to the extent to which the goods and services are used for the purposes of his taxable transactions, 'to deduct from the tax which he is liable to pay ... value-added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person'.

15 From the features of VAT described above it may be inferred, as the Court pointed out in its judgment of 14 February 1985 in Case 268/83 *(Rompelman* [1985] ECR 655), that the deduction system is meant to relieve the trader entirely of the burden of VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way.

16 The combined effect of the rules referred to above is that, in the absence of any provision empowering the Member States to limit the right of deduction granted to taxable persons, that right must be exercised immediately in respect of all the taxes charged on transactions relating to inputs.

17 Such limitations on the right of deduction have an impact on the level of the tax burden and must be applied in a similar manner in all the Member States. Consequently, derogations are permitted only in the cases expressly provided for in the directive.

18 With regard more particularly to the taxation of lettings of immovable property, it should be noted that the Sixth Directive allows the Member States either to exempt them (Article 13 B (b)) or to grant taxable persons the right to opt for taxation (Article 13 C (a)). In the latter case, which is the relevant case here, where the right to opt for taxation is exercised, undertakings which let immovable property and which are taxable persons within the meaning of Article 4 of the Sixth Directive are covered by the deduction system mentioned above.

19 The French legislation on the deduction of VAT charged on let immovable property does not allow total and immediate deduction where the aggregate amount of the proceeds from the letting of the property is less than one-fifteenth of the property's value. Such legislation is therefore incompatible with the abovementioned provisions of the Sixth Directive.

20 It is true that, as pointed out by the French Republic, such legislation is necessary particularly in order to deal with lettings at low rents granted by local authorities to associations with social objects or to undertakings which have come to their areas in order to establish themselves. The result of such practices would be to allow local authorities to make subsidies which would in part be borne by the State if the principle of total and immediate deduction were upheld in such cases.

21 In that connection, however, it must be stated that in order to deal with situations such as those referred to by the French Republic, Article 20 of the Sixth Directive provides for a system of adjustment. Where, because of the amount of the rent, the lease must necessarily be regarded as involving a concession and not as constituting an economic activity within the meaning of the directive, the deduction initially made is adjusted and the time-limit for that adjustment may be extended up to 10 years.

22 As regards the need to prevent tax evasion, mentioned by the French Republic, that need cannot justify measures derogating from the directive otherwise than under the procedure which is provided for in Article 27 thereof and to which the French Republic has not had recourse.

23 Finally, it must be observed that Article 2 of the First Directive, according to which 'on each transaction, value-added tax, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the value-added tax borne directly by the various cost components', cannot serve as a basis for the French legislation at issue. That provision merely lays down the principle of the right to deduction, and the conditions applicable thereto are laid down in the abovementioned provisions of the Sixth Directive.

24 It follows from the foregoing that by introducing and maintaining in force, in breach of the Sixth Council Directive of 17 May 1977, fiscal rules which, for undertakings that let immovable property which they have acquired or had built, limit the right to deduct value-added tax paid on inputs where the amount of the proceeds of the letting of such immovable property is less than one-fifteenth of its value, the French Republic has failed to fulfil its obligations under the Treaty.

Costs

25 Pursuant to Article 69 (2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs. Since the French Republic has failed in its submissions, it must be ordered to pay the costs.

On those grounds,

THE COURT

hereby:

(1) Declares that by introducing and maintaining in force, in breach of the Sixth Council Directive of 17 May 1977, fiscal rules which, for undertakings that let immovable property which they have acquired or had built, limit the right to

deduct value-added tax paid on inputs where the amount of the proceeds of the letting of such immovable property is less than one-fifteenth of its value, the French Republic has failed to fulfil its obligations under the Treaty;

(2) Orders the French Republic to pay the costs.

Mackenzie Stuart Bosco Moitinho de Almeida Rodríguez Iglesias

Koopmans Everling Galmot Kakouris Schockweiler

Delivered in open court in Luxembourg on 21 September 1988.

J.-G. Giraud
Registrar

A. J. Mackenzie Stuart
President