Case C-184/04

Proceedings brought by

Uudenkaupungin kaupunki

(Reference for a preliminary ruling from the Korkein hallinto-oikeus)

(VAT – Deduction of input tax – Capital goods – Immovable property – Adjustment of deductions)

Summary of the Judgment

1. *Tax provisions – Harmonisation of laws – Turnover taxes – Common system of value added tax – Deduction of input tax*

(Council Directive 77/388, Arts 20(2) and (5))

2. *Tax provisions – Harmonisation of laws – Turnover taxes – Common system of value added tax – Deduction of input tax*

(Council Directive 77/388, Arts 13(C), 17 and 20)

3. *Tax provisions – Harmonisation of laws – Turnover taxes – Common system of value added tax – Exemptions provided for in the Sixth Directive*

(Council Directive 77/388, Arts 13(C) and 17(6))

1. Article 20 of Sixth Directive 77/388 on the harmonisation of the laws of the Member States relating to turnover taxes must be interpreted as meaning that, subject to the provisions of Article 20(5) thereof, it requires Member States to make provision for adjustment of deductions of value added tax on capital goods.

(see para. 35, operative part 1)

2. Article 20 of Sixth Directive 77/388 on the harmonisation of the laws of the Member States relating to turnover taxes must be interpreted as meaning that the adjustment provided for therein is also applicable where the capital goods were first used in non-taxable activity that was not eligible for deduction and were then used in activity, subject to value added tax, during the adjustment period.

Application of the adjustment mechanism depends on the existence of a right to deduct based on Article 17 of the Sixth Directive. The use to which capital goods are put merely determines the extent of the initial deduction and the extent of any adjustments in the course of the following periods, but does not affect whether a right to deduct arises. It follows that the immediate use of the goods for taxable supplies does not in itself constitute a condition for the application of the system of adjustment of deductions. Furthermore, adjustment of the deduction also applies necessarily where alteration of the right to deduct depends on a deliberate choice on the part of the taxpayer, such as exercise of the option provided for in Article 13(C) of the Sixth Directive.

(see paras 37, 39-40, 42, operative part 2)

3. The second subparagraph of Article 13(C) and Article 17(6) of Sixth Directive 77/388 on the harmonisation of the laws of the Member States relating to turnover taxes must be interpreted as meaning that a Member State which gives its taxable persons the right to opt for taxation of the letting of a property is not permitted by those provisions to exclude deduction of value added tax on immovable property investments made before that right of option is exercised, where the application to exercise that option has not been made within six months of the property being brought into use.

Since under the first subparagraph of Article 13(C) of the Sixth Directive it is possible for taxable persons to opt for taxation of the letting of immovable property, the exercise of that option must lead not only to taxation of the letting but also to deduction of the relevant input taxes on the property concerned. Moreover, restricting deductions in connection with taxable transactions after the right of option has been exercised would affect, not the 'scope' of the right of option which Member States may restrict pursuant to the second subparagraph of Article 13(C) of the Sixth Directive, but the consequences of exercising that right. That provision does not therefore permit Member States to restrict the right to deduct provided for in Article 17 of the Sixth Directive or the need to adjust such deductions under Article 20 of that directive.

As regards the option given to Member States by the second subparagraph of Article 17(6) of the Sixth Directive, it applies only to maintaining exclusions from deduction with regard to categories of expenditure defined by reference to the nature of the goods or services acquired rather than by reference to the use to which they are put or the way in which they are used.

(see paras 44, 46-47, 49, 51, operative part 3-4)

JUDGMENT OF THE COURT (First Chamber)

30 March 2006 (*)

(VAT – Deduction of input tax – Capital goods – Immovable property – Adjustment of deductions)

In Case C-184/04,

REFERENCE for a preliminary ruling under Article 234 EC from the Korkein hallinto-oikeus (Finland), made by decision of 16 April 2004, received at the Court on 19 April 2004, in the proceedings brought by

Uudenkaupungin kaupunki,

THE COURT (First Chamber),

composed of P. Jann, President of the Chamber, K. Schiemann (Rapporteur), N. Colneric, J.N. Cunha Rodrigues and E. Levits, Judges,

Advocate General: C. Stix-Hackl,

Registrar: H. von Holstein, Deputy Registrar,

having regard to the written procedure and further to the hearing on 22 June 2005,

after considering the observations submitted on behalf of:

– Uudenkaupungin kaupunki, by M. Pikkujämsä, asianajaja,

– the Finnish Government, by T. Pynnä and E. Bygglin, acting as Agents,

– the Italian Government, by I.M. Braguglia, acting as Agent, and P. Gentili, avvocato dello Stato,

– the Commission of the European Communities, by L. Ström van Lier and I. Koskinen, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 15 September 2005,

gives the following

Judgment

1 The reference for a preliminary ruling concerns the interpretation of the second subparagraph of Article 13(C), the second subparagraph of Article 17(6) and Article 20 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), as amended by Council Directive 95/7/EC of 10 April 1995 (OJ 1995 L 102, p. 18) (‘the Sixth Directive’).

2 In essence, it raises the question whether, in the light of the Sixth Directive, adjustment of the deduction of input value added tax (‘VAT’) paid in respect of capital goods should be permitted where immovable property has first been used in non-taxable activity and then in taxable activity after the right of option within the meaning of Article 13(C) of the Sixth Directive has been exercised.

3 The reference has been made in the course of an appeal on a point of law brought by Uudenkaupungin kaupunki (the town of Uusikaupunki, ‘Uusikaupunki’) against a decision of the Helsingin hallinto-oikeus (Helsinki Administrative Court), by which the latter dismissed Uusikaupunki’s appeal against two decisions taken by the Lounais-Suomen verovirasto (South-West Finland Tax Office) on applications submitted by Uusikaupunki for the adjustment of deductions and a refund of VAT.

Legal context

The Sixth Directive

4 Article 5(6) and (7) of the Sixth Directive reads as follows:

‘6. The application by a taxable person of goods forming part of his business assets for his private use or that of his staff, or the disposal thereof free of charge or more generally their application for purposes other than those of his business, where the value added tax on the goods in question or the component parts thereof was wholly or partly deductible, shall be treated as supplies made for consideration. However, applications for the giving of samples or the making of gifts of small value for the purposes of the taxable person’s business shall not be so treated.

7. Member States may treat as supplies made for consideration:

(a) the application by a taxable person for the purposes of his business of goods produced, constructed, extracted, processed, purchased or imported in the course of such business, where the value added tax on such goods, had they been acquired from another taxable person, would not be wholly deductible;

(b) the application of goods by a taxable person for the purposes of a non-taxable transaction, where the value added tax on such goods became wholly or partly deductible upon their acquisition or upon their application in accordance with subparagraph (a);

(c) except in those cases mentioned in paragraph 8, the retention of goods by a taxable person or his successors when he ceases to carry out a taxable economic activity where the value added tax on such goods became wholly or partly deductible upon their acquisition or upon their application in accordance with subparagraph (a).’

5 Article 6(2) and (3) of the Sixth Directive provides:

‘2. The following shall be treated as supplies of services for consideration:

(a) the use of goods forming part of the assets of a business for the private use of the taxable person or of his staff or more generally for purposes other than those of his business where the value added tax on such goods is wholly or partly deductible;

(b) supplies of services carried out free of charge by the taxable person for his own private use or that of his staff or more generally for purposes other than those of his business.

Member States may derogate from the provisions of this paragraph provided that such derogation does not lead to distortion of competition.

3. In order to prevent distortion of competition and subject to the consultations provided for in Article 29, Member States may treat as a supply of services for consideration the supply by a taxable person of a service for the purposes of his undertaking where the value added tax on such a service, had it been supplied by another taxable person, would not be wholly deductible.’

6 Under Article 13(B)(b) of the Sixth Directive, Member States are to exempt the letting of immovable property from VAT. Under Article 13(C) of that directive, Member States may allow taxpayers a right of option for taxation in cases of letting of immovable property. According to the second subparagraph of that Article 13(C), however, Member States may restrict the scope of that right of option and are to fix the details of its use.

7 Article 17 of the Sixth Directive, entitled ‘Origin and scope of the right to deduct’, provides:

‘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;

…

6. Before a period of four years at the latest has elapsed from the date of entry into force of this Directive, the Council, acting unanimously on a proposal from the Commission, shall decide what expenditure shall not be eligible for a deduction of value added tax. Value added tax shall in no circumstances be deductible on expenditure which is not strictly business expenditure, such as that on luxuries, amusements or entertainment.

Until the above rules come into force, Member States may retain all the exclusions provided for under their national laws when this Directive comes into force.'

8 The Community rules referred to in the first subparagraph of Article 17(6) of the Sixth Directive have still to be adopted, since agreement has not been reached within the Council on the expenditure in respect of which an exclusion from the right to deduct VAT may be contemplated.

9 Article 18(1) and (2) of the Sixth Directive lays down certain rules governing the exercise of the right to deduct. Article 18(3) provides in that regard that the conditions and procedures whereby a taxable person may be authorised to make a deduction which he has not made in accordance with the provisions of Article 18(1) and (2) are to be determined by the Member States.

10 Article 20 of the Sixth Directive, entitled 'Adjustments of deductions', contains the following provisions:

'1. The initial deduction shall be adjusted according to the procedures laid down by the Member States, in particular:

(a) where that deduction was higher or lower than that to which the taxable person was entitled;

(b) where after the return is made some change occurs in the factors used to determine the amount to be deducted, in particular where purchases are cancelled or price reductions are obtained; however, adjustment shall not be made in cases of transactions remaining totally or partially unpaid and of destruction, loss or theft of property duly proved or confirmed, nor in the case of applications for the purpose of making gifts of small value and giving samples specified in Article 5(6). However, Member States may require adjustment in cases of transactions remaining totally or partially unpaid and of theft.

2. In the case of capital goods, adjustment shall be spread over five years including that in which the goods were acquired or manufactured. The annual adjustment shall be made only in respect of one-fifth of the tax imposed on the goods. The adjustment shall be made on the basis of the variations in the deduction entitlement in subsequent years in relation to that for the year in which the goods were acquired or manufactured.

By way of derogation from the preceding subparagraph, Member States may base the adjustment on a period of five full years starting from the time at which the goods are first used.

In the case of immovable property acquired as capital goods, the adjustment period may be extended up to twenty years.

…

4. For the purposes of applying the provisions of paragraphs 2 and 3, Member States may:

– define the concept of capital goods,

– indicate the amount of the tax which is to be taken into consideration for adjustment,

– adopt any suitable measures with a view to ensuring that adjustment does not involve any unjustified advantage,

– permit administrative simplifications.

5. If in any Member State the practical effect of applying paragraphs 2 and 3 would be insignificant, that Member State may, subject to the consultation provided for in Article 29, forego application of these paragraphs, having regard to the need to avoid distortion of competition, the overall tax effect in the Member State concerned and the need for due economy of administration.

…'

11 Article 29 of the Sixth Directive set up an 'Advisory Committee on value added tax', composed of representatives of the Member States and of the Commission, which is empowered to examine questions concerning the application of the Community provisions on VAT.

National legislation

12 The provisions relating to the tax treatment of the letting of immovable property are contained in Paragraphs 27 to 30 of the VAT Law (Arvonlisäverolaki, Law No 1501 of 30 December 1993, the 'AVL'). Under the first subparagraph of Paragraph 27 of that law, VAT is not payable on the letting of immovable property. The first subparagraph of Paragraph 30 of the AVL gives taxable persons a right of option for taxation of letting of immovable property where the property is used by the State or is continuously used for an activity giving the right to deduct, that is to say, in taxable activity.

13 Under Paragraph 33 of the AVL, work carried out in connection with a new building or the restoration of immovable property is regarded as a supply for private use even if the economic operator sells the property or puts it to a use other than one giving the right to deduct, where the service provision or the acquisition of the immovable property has given rise to deduction or the service itself has been provided in connection with an activity giving the right to deduct.

14 The provisions relating to the right to deduct are contained in Paragraphs 102 to 118 of the AVL. Under point (1) of the first subparagraph of Paragraph 102 of that law, which concerns the general right to deduct, a taxable person may deduct the tax payable on goods or services he acquires from another taxable person for the purposes of taxable activity. Under Paragraph 106 of the AVL, which concerns the right to deduct in connection with building services, if an owner of a property has applied to become liable to VAT pursuant to Paragraph 30 of the AVL he may in principle make the deduction referred to in Paragraph 102 of the law in respect of services or goods which he has acquired for the purposes of the taxable letting of that property.

15 It is not possible, however, to deduct VAT on immovable property investments made prior to exercising the option to become liable to tax unless that option has been exercised within six months of bringing the property into use. The AVL does not allow deductions in respect of restoration, new building or acquisition of a property to be revised or adjusted to the taxpayer's

advantage if the application to become liable to tax has been submitted after the abovementioned period has expired, where the property was initially brought into use in connection with an activity exempt from VAT before being used in taxable activity.

The main proceedings and the questions referred for a preliminary ruling

16 Uusikaupunki renovated a building which it owns and let space in it to the Finnish State, one part from 1 June 1995 and the other part from 1 September 1995. From 31 August 1995, Uusikaupunki also let an industrial building which it had built to an undertaking liable to VAT. The costs for both projects included VAT amounting to FIM 2 206 224.

17 On 4 April 1996 Uusikaupunki applied to the Turun lääninverovirasto (Turku Province Tax Office) under Paragraph 30 of the AVL to become liable to VAT with respect to the letting of the two properties at issue in the main proceedings. The tax authority approved that application with effect from the date on which the application was made, since the application had not been made within six months of bringing the property into use, as laid down in Paragraph 106 of the AVL.

18 By two applications, dated 8 September 1998 and 30 March 2000, Uusikaupunki applied to the Lounais-Soumen verovirasto, under Article 20 of the Sixth Directive, for adjustment of the tax deductions and a refund of part of the VAT paid in connection with building and restoration work for the years 1996 to 1999. The sum applied for was FIM 1 651 653, plus interest at the statutory rate.

19 By decisions dated 3 May 2000, the Lounais-Suomen verovirasto rejected those applications on the grounds that deduction of VAT paid in connection with building and restoration work was possible under Paragraph 106 of the AVL only if the option to become liable to that tax had been exercised within six months of the properties being brought into use.

20 Uusikaupunki brought an unsuccessful appeal before the Helsingin hallinto-oikeus for those decisions to be set aside. The appellant in the main proceedings then appealed against that judgment to the Korkein hallinto-oikeus (Supreme Administrative Court).

21 The Korkein hallinto-oikeus is uncertain whether the conditions to which the AVL makes the deduction of VAT subject are contrary to the Sixth Directive in so far as Finnish law does not permit adjustment of deductions of VAT in connection with the letting of a property where that property was initially brought into use in non-taxable activity before being used in taxable activity unless the application for the letting to become liable to tax was submitted within six months of the property being brought into use.

22 According to the referring court, there is no doubt that Uusikaupunki acted as a taxable person with regard to the acquisitions made in respect of the new building and restoration work in question, and that those acquisitions were made for the purposes of the appellant’s economic activity.

23 It was in those circumstances that the Korkein hallinto-oikeus decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

‘(1) Is Article 20 of [the Sixth Directive] to be interpreted as meaning that the adjustment of deductions in accordance with that article is mandatory for Member States in the case of capital goods unless it follows otherwise from Article 20(5)?

(2) Is Article 20 of the [Sixth] Directive to be interpreted as meaning that the adjustment of deductions in accordance with that article is applicable even where the capital goods, in this case

immovable property, were first used in non-taxable activity, in which case an initial deduction could not have been made at all, and only later in taxable activity during the adjustment period?

(3) May the second subparagraph of Article 13(C) of the [Sixth] Directive be interpreted as meaning that a Member State may restrict the right to deduct for acquisitions relating to immovable property investments in the manner laid down in the Finnish Arvonlisäverolaki, where the right to deduct is excluded altogether in situations such as the present one?

(4) May the second subparagraph of Article 17(6) of the [Sixth] Directive be interpreted as meaning that a Member State may restrict the right to deduct for acquisitions relating to immovable property investments in the manner laid down in the Finnish Arvonlisäverolaki, where the right to deduct is excluded altogether in situations such as the present one?'

The first question

24 First, according to the structure of the system introduced by the Sixth Directive, input taxes on goods or services used by a taxable person for his taxable transactions may be deducted. The deduction of input taxes is linked to the collection of output taxes. 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. However, where goods or services are used for the purposes of transactions that are taxable as outputs, deduction of the input tax on them is required in order to avoid double taxation.

25 The period laid down in Article 20 of the Sixth Directive for adjustment of deductions makes it possible to avoid inaccuracies in the calculation of deductions and unjustified advantages or disadvantages for a taxable person where, in particular, changes occur in the factors initially taken into consideration in order to determine the amount of deductions after the declaration has been made. The likelihood of such changes is particularly significant in the case of capital goods, which are often used over a number of years, during which the purposes to which they are put may alter. The Sixth Directive therefore provides for an adjustment period of five years, extendable to 20 years in the case of immovable property, with varying deductions staggered over the whole period.

26 The system of adjustment of deductions is an essential element of the system introduced by the Sixth Directive in that its purpose is to ensure the accuracy of deductions and hence the neutrality of the tax burden. Article 20(2) of the Sixth Directive concerning capital goods, which are relevant in the main proceedings, is moreover drafted in terms which leave no doubt as to its binding nature.

27 It also follows from settled case-law that limitations on the right of deduction, and hence adjustments to deductions, must be applied in a similar manner in all the Member States and derogations are permitted only in the cases expressly provided for in the Sixth Directive (see, to that effect, Case C-97/90 *Lennartz* [1991] ECR I-3795, paragraph 27). The fact that Article 20(5) of the Sixth Directive lays down very specific conditions that must be met in order for a Member State to be able, by way of derogation, to refrain from applying Article 20(2) strengthens the binding nature of the latter provision. It should be noted in this connection that there was disagreement at the hearing, between the Finnish Government and the Commission, over whether the committee set up under Article 29 of the Sixth Directive had been consulted, as provided for in Article 20(5) of that directive, and what the outcome had been. However, the purpose of the questions referred by the national court is clearly not to ascertain whether the conditions for applying that derogation are met in the present case.

28 As regards the Finnish Government's argument that Article 20(4) of the Sixth Directive allows Member States to define the term 'capital goods' and that the provision of building services

need not necessarily be covered by that term, suffice it to say the Finnish Government acknowledges that that term has not been defined in Finnish law, since the procedure laid down in Article 20(2) to (5) of the Sixth Directive has not been transposed into national law. It is clear from the Court's case-law that a Member State which has failed to transpose the provisions of a directive into national law cannot rely, as against Community citizens, upon limitations that might have been laid down on the basis of those provisions (see, to that effect, Joined Cases C-6/90 and C-9/90 *Francovich and Others* [1991] ECR I-5357, paragraph 21, and Case C-142/04 *Aslanidou* [2005] ECR I-0000, paragraph 35).

29 Moreover, contrary to what the Finnish Government contends, the adjustment of deductions of input tax under Article 20 of the Sixth Directive is not merely an alternative to applying Articles 5(6) and 6(2) of that directive, which concern the taxing of applications and services effected by a taxable person for his private use, and so Member States do not have a choice between transposing either the adjustment mechanism or the mechanism for making applications for private use liable to tax since both are mandatory.

30 Although Article 20, on one hand, and Articles 5 and 6, on the other hand, are, according to their wording, liable to apply in principle in a situation where goods, the use of which is eligible for deduction, are then put to a use which is not eligible for deduction, and even though the two mechanisms have the same economic effect in that situation (see, to that effect, Joined Cases C-487/01 and C-7/02 *Gemeente Leusden and Holin Groep* [2004] ECR I-5337, paragraph 90), that is not the case in the reverse situation, which is relevant here in the main proceedings, where goods the use of which is not eligible for deduction are then put to a use which is so eligible. Eligibility for adjustment of deductions for the benefit of a taxable person, which is relevant in the second situation, may only be based soley on the provisions of Article 20 of the Sixth Directive and not on those of Articles 5 and 6 of that directive. In such situations, application of the provisions of Article 20 of the Sixth directive is therefore essential, irrespective of the application under national law of Articles 5 and 6 thereof.

31 Contrary to what the Finnish Government contends, even in situations where goods are put to another use, changing from a use that is eligible for deduction to a use that is not eligible for deduction, and where there is, as a consequence, a risk that the provisions of those articles might overlap, this does not give rise to any conflict that would justify not implementing the procedure for adjustment of deductions laid down in Article 20 of the Sixth Directive.

32 At the hearing the Finnish Government cited the example of a property which after being acquired in taxable activity, is put, one year after its acquisition, to use in non-taxable activity for the next four years. That Government observes that in principle both Article 20 of the Sixth Directive, on one hand, and Articles 5(6) and 6(2) of that directive, on the other hand, are applicable in such a situation, but that application of those articles leads to different and irreconcilable outcomes. Under Article 20(2) of the Sixth Directive, adjustment of the deduction of VAT on the purchase price from the second year onwards results in keeping the deductible tax at one fifth of the purchase price, a fraction which corresponds to the property's first year of use. Application of Articles 5(6) and 6(2) of the Sixth Directive, by contrast, results in taxation of the full value of the property at the time of the change in its use.

33 In that regard, it should be noted immediately that Articles 5(6) and 6(2) apply only where the goods concerned are put to private use, not where the goods are put to another use in non-taxable activity.

34 The applicability of each of the provisions in question will depend on whether the taxable person has decided to use the property in question permanently for his private use or rather envisages the possibility of using it in future for the purposes of his business and therefore decides

to keep it as one of the assets of that business. In the first case, Articles 5(6) and 6(2) of the Sixth Directive will apply, and in the second case, Article 20 of the directive will apply. The fact that it is possible for a taxable person to choose whether or not to integrate into his business, for the purposes of applying the Sixth Directive, part of an asset which is given over to his private use follows from settled case-law (see, in particular, Case C-291/92 *Armbrecht* [1995] ECR I-2775, paragraph 20, and Case C-434/03 *Charles and Charles-Tijmens* [2005] ECR I-0000, paragraph 23). In the example cited by the Finnish Government, there is therefore no real conflict.

35 In the light of the foregoing considerations, the answer to the first question must be that Article 20 of the Sixth Directive must be interpreted as meaning that, subject to the provisions of Article 20(5) thereof, it requires Member States to make provision for adjustment of VAT deductions on capital goods.

The second question

36 The second question seeks to determine whether the fact that the relevant activity was originally non-taxable and deductions were therefore totally excluded has any impact on that adjustment.

37 As the Advocate General observed in points 36 and 37 of her Opinion, application of the adjustment mechanism depends on the existence of a right to deduct based on Article 17 of the Sixth Directive.

38 Pursuant to Article 17(1) of the Sixth Directive, which is entitled ‘Origin and scope of the right to deduct’, the right to deduct VAT arises at the time when the deductible tax becomes chargeable. Consequently, only the capacity in which a person is acting at that time can determine the existence of the right to deduct (*Lennartz*, paragraph 8).

39 The Court has also held that the use to which capital goods are put merely determines the extent of the initial deduction to which the taxable person is entitled under Article 17 of the Sixth Directive and the extent of any adjustments in the course of the following periods, but does not affect whether a right to deduct arises. It follows that the immediate use of the goods for taxable supplies does not in itself constitute a condition for the application of the system of adjustment of deductions (*Lennartz*, paragraphs 15 and 16).

40 Lastly, contrary to what the Italian Government contends, adjustment of the deduction under Article 20 of the Sixth Directive also applies necessarily where alteration of the right to deduct depends on a deliberate choice on the part of the taxpayer, such as exercise of the option provided for in Article 13(C) of the Sixth Directive. Exercise of that option has no effect on the inception of the right to deduct, which, as stated above, is governed by Article 17(1) of the Sixth Directive. Since the letting of a property is taxable after the option to become liable to tax has been exercised, an adjustment of the deductions becomes necessary in order to avoid double taxation of the input costs, irrespective of the fact that that taxation is the consequence of a deliberate choice by the taxpayer.

41 Article 18(3) of the Sixth Directive, cited by the Italian Government, is irrelevant in this connection since that paragraph concerns a situation in which a taxpayer has not made deductions which he was entitled to make, which cannot be the case before the option provided for in Article 13(C) of the Sixth Directive has been exercised. As the extent of the initial deduction was nil, it is only after exercising that option that the taxpayer’s right to deduct acquires a genuine value which may be subject to deduction.

42 The answer to the second question must therefore be that Article 20 of the Sixth Directive

must be interpreted as meaning that the adjustment provided for therein is also applicable where the capital goods were first used in non-taxable activity that was not eligible for deduction and were then used in activity, subject to VAT during the adjustment period.

The third question

43 By its third question, the referring court is seeking in essence to ascertain whether the second subparagraph of Article 13(C) of the Sixth Directive must be interpreted as meaning that a Member State which gives its taxable persons the right to opt for taxation of the letting of a property is permitted to exclude deduction of VAT on immovable property investments made before that right of option is exercised, where the application for that option has not been made within six months of the property being brought into use.

44 As stated in paragraph 24 above, according to the structure of the system introduced by the Sixth Directive, it must be possible for input taxes on goods or services used by a taxable person for his taxable transactions to be deducted. Therefore, since under the first subparagraph of Article 13(C) of the Sixth Directive it is possible for taxable persons to opt for taxation of the letting of immovable property, the exercise of that option must lead not only to taxation of the letting but also to deduction of the relevant input taxes on the property concerned.

45 The Member States are of course free to lay down the procedural requirements under which a right of option may be exercised, which includes the possibility of providing that taxation will be effective only after the application has been made and that only after that date will deduction of input taxes be possible (Case C-269/03 *Vermietungsgesellschaft Objekt Kirchberg* [2004] ECR I-8067, paragraph 23). However, such rules must not result in restricting the right to deduct in connection with taxable transactions where the right of option has been properly exercised in accordance with those rules. In particular, application of national procedural rules must not result in restricting the period in which deductions may be made to a period that is shorter than that laid down in the Sixth Directive for the adjustment of deductions.

46 Moreover, restricting deductions in connection with taxable transactions after the right of option has been exercised would affect, not the ‘scope’ of the right of option, referred to in the second subparagraph of Article 13(C) of the Sixth Directive, but the consequences of exercising that right. That provision does not therefore permit Member States to restrict the right to deduct provided for in Article 17 of the Sixth Directive or the need to adjust such deductions under Article 20 of that directive.

47 The answer to the third question must therefore be that the second subparagraph of Article 13(C) of the Sixth Directive must be interpreted as meaning that a Member State which gives its taxable persons the right to opt for taxation of the letting of a property is not permitted by that provision to exclude deduction of VAT on immovable property investments made before that right of option is exercised, where the application to exercise that option has not been made within six months of the property being brought into use.

The fourth question

48 By this last question, the referring court is asking in essence whether Article 17(6) of the Sixth Directive must be interpreted as meaning that a Member State which gives its taxable persons the right to opt for taxation of the letting of a property is permitted to exclude deduction of VAT on immovable property investments made before that right of option is exercised, where the application to exercise that option has not been made within six months of the property being brought into use.

49 Analysis of the origin of Article 17(6) of the Sixth Directive shows that the option given to Member States by the second subparagraph of that provision applies only to maintaining exclusions from deduction with regard to categories of expenditure defined by reference to the nature of the goods or services acquired rather than by reference to the use to which they are put or the way in which they are used (see, to that effect, Case C-305/97 *Royscot and Others* [1999] ECR I-6671, paragraphs 21 to 25).

50 As the Advocate General observed in point 79 of her Opinion, it is apparent that point (1) of the first subparagraph of Paragraph 102 of the AVL expressly provides that in certain circumstances it is possible to deduct VAT on immovable property investments, such as building costs and purchases related to such property. The exclusion in question relating to costs incurred before the option to become liable to VAT is exercised does not therefore fall within the derogation provided for in the second subparagraph of Article 17(6) of the Sixth Directive.

51 The answer to the fourth question must therefore be that Article 17(6) of the Sixth Directive must be interpreted as meaning that a Member State which gives its taxable persons the right to opt for taxation of the letting of a property is not permitted by that provision to exclude deduction of VAT on immovable property investments made before that right of option is exercised, where the application to exercise that option has not been made within six months of the property being brought into use.

Limitation of the temporal effect of this judgment

52 The Finnish Government has requested the Court, in the event that it does not agree with its line of argument, to limit the temporal effects of the present judgment to the period following its delivery.

53 According to settled case-law, the interpretation which, in the exercise of the jurisdiction conferred on it by Article 234 EC, the Court gives to a rule of Community law clarifies and defines, where appropriate, the meaning and scope of that rule as it must be, or ought to have been, understood and applied from the time it was brought into force. It follows that the rule as thus interpreted may, and must, be applied by the courts even to legal relationships which arose and were established before the judgment ruling on the request for interpretation, provided that in other respects the conditions for bringing a dispute relating to the application of that rule before the competent courts are satisfied (see, in particular, Case 24/86 *Blaizot* [1988] ECR 379, paragraph 27, and Case C-415/93 *Bosman* [1995] ECR I-4921, paragraph 141).

54 Also according to settled case-law, individuals are entitled to obtain repayment of national charges levied in breach of Community provisions (see, in particular, Case 199/82 *San Giorgio* [1983] ECR 3595, paragraph 12, and Joined Cases C-192/95 to C-218/95 *Comateb and Others* [1997] ECR I-165, paragraph 20).

55 It is only exceptionally that the Court may, in application of the general principle of legal certainty inherent in the Community legal order, be moved to restrict the possibility for any person concerned of relying on a provision it has interpreted with a view to calling in question legal relationships established in good faith. Two essential criteria must be fulfilled before such a limitation can be imposed, namely that those concerned should have acted in good faith and that there should be a risk of serious difficulties (see, in particular, Case C-57/93*Vroege* [1994] ECR I-4541, paragraph 21, and Case C-402/03 *Skov and Bilka* [2006] ECR I-0000, paragraph 51).

56 In the present case, it should be noted, as the Advocate General rightly did in point 87 of her Opinion, that the Finnish Government has only mentioned the practical difficulties that would have

to be taken into account if the effects of the present judgment were not limited in time.

57 It should also be observed in this connection that the Finnish Government stated that it had invoked the derogation provided for in Article 20(5) of the Sixth Directive. The applicability of that provision was, according to its actual wording, conditional, in particular, on the effect of applying the system of adjustment of deductions being ‘insignificant’. Irrespective of whether the consultations provided for in Article 29 of the Sixth Directive took place, there are grounds for finding that the very fact that the Finnish Government invoked Article 20(5) of that directive casts doubt on whether retroactive application of the system of adjustment of deductions would have any serious repercussions.

58 Moreover, it may be noted, as has been stated in paragraph 26 above, that Article 20(2) of the Sixth Directive, concerning adjustment of the deductions in question, is drafted in terms which leave no doubt as to its binding nature. The Finnish Government’s argument that the relevant provisions of the Sixth Directive are vague, causing uncertainty regarding their application, must therefore be rejected.

59 It is therefore not appropriate to limit the temporal effects of the present judgment.

Costs

60 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 (First Chamber) hereby rules:

1. **Article 20 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, must be interpreted as meaning that, subject to the provisions of Article 20(5) thereof, it requires Member States to make provision for adjustment of deductions of value added tax on capital goods.**

2. **Article 20 of Sixth Directive 77/388 must be interpreted as meaning that the adjustment provided for therein is also applicable where the capital goods were first used in non-taxable activity that was not eligible for deduction and were then used in activity, subject to value added tax during the adjustment period.**

3. **The second subparagraph of Article 13(C) of Sixth Directive 77/388 must be interpreted as meaning that a Member State which gives its taxable persons the right to opt for taxation of the letting of a property is not permitted by that provision to exclude deduction of value added tax on immovable property investments made before that right of option is exercised, where the application to exercise that option has not been made within six months of the property being brought into use.**

4. **Article 17(6) of Sixth Directive 77/388 must be interpreted as meaning that a Member State which gives its taxable persons the right to opt for taxation of the letting of a property is not permitted by that provision to exclude deduction of value added tax on immovable property investments made before that right of option is exercised, where the application to exercise that option has not been made within six months of the property being brought into use.**

[Signatures]

* Language of the case: Finnish.