Conclusions
OPINION OF ADVOCATE GENERAL
POIARES MADURO
delivered on 10 March 2005(1)

Case C-204/03

Commission of the European Communities
v
Kingdom of Spain

(VAT – Limitation of the right to deduct – Subsidies)

1. This action, brought pursuant to Article 226 EC, seeks a declaration that, by limiting the right to deduct value added tax ('VAT') of taxable persons in receipt of subsidies intended to fund their activities, the Kingdom of Spain has failed to fulfil its obligations under Community law and, in particular, under Articles 17 and 19 of the 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 (2) ('the Sixth Directive').

I – The legal background and the pre-litigation procedure

A – *The relevant provisions of Community law*

2. Article 17 of the Sixth Directive concerns the origin and scope of the right to deduct. According to the fifth paragraph:

'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.'

3. Article 19(1) of the Directive lays down the detailed rules for calculating the deductible proportion 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 Member States may also include in the denominator the amount of subsidies, other than those specified in Article 11A(1)(a).'

4. Article 11A(1)(a) provides that, so far as concerns transactions carried out within the territory of the country, the taxable amount is:

‘in respect of supplies of goods and services …, 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 including subsidies directly linked to the price of such supplies’.

B – *The relevant provisions of national law*

5. It is apparent from the documents before the Court that Spanish Law No 37/1992 of 28 December 1992 on value added tax was amended by Law No 66/1997 of 30 December 1997 (‘the law on VAT’), in order to introduce certain limitations on the right to deduct VAT paid by tradesmen and businessmen in receipt of subsidies which are intended to fund their trade or business activities and which do not form part of the taxable amount of their taxable transactions.

6. Article 102(1) of this Law, as amended, provides:

‘The proportion rule shall apply where the taxable person in the course of his trade or business carries out both supplies of goods or services in respect of which value added tax is deductible and other transactions of a similar nature in respect of which it is not.

The proportion rule shall also apply where the taxable person receives subsidies which, in accordance with Article 78(2)(3) of this Law, do not form part of the taxable amount, inasmuch as they are intended to fund the taxable person’s trade or business activities’.

7. Under Article 104(2) of that Law:

‘Capital subsidies shall be included in the denominator of the proportion, but they may be appropriated in fifths to the tax year during which they were received and the four following tax years. Nevertheless, capital subsidies granted in order to fund the purchase of certain goods or services, acquired in connection with transactions that are taxable and not exempted from VAT will reduce exclusively the amount of the deduction of VAT borne or paid in respect of those transactions, to the precise extent to which they have contributed to their funding’.

C – *The pre-litigation procedure*

8. The Commission of the European Communities sent the Kingdom of Spain a letter on 21 May 1999 requesting information about the interpretation of Article 104 of the Law on VAT. The Kingdom of Spain’s answer took the form of a letter from the Directorate-General of Taxes of the Ministry of the Economy and Finance, dated 14 June 1999. Being unsatisfied with the replies given by the Spanish authorities, the Commission sent them a letter of formal notice on 20 April 2001 and then a reasoned opinion on 27 June 2002. In those several documents, the Commission alleged that, by maintaining in force the abovementioned provisions of Articles 102 and 104 of its Law on VAT, the Kingdom of Spain had failed to comply with the obligations imposed by the Sixth Directive. By letter of 20 September 2002 the Kingdom of Spain provided justification in part of the maintenance of its legislation. In consequence, the Commission has brought this action.

II – Analysis

A – *On the compatibility of Article 102 of the Law on VAT with the Sixth Directive*

9. The effect of the provision at issue is to limit the right to deduct of all taxable persons in receipt of subsidies intended to fund their trade or business activities by application of a proportion the denominator of which includes those subsidies.

10. That extension of the proportion rule clearly runs counter to the Sixth Directive. It follows from the unambiguous wording of Article 17 thereof that a deductible proportion such as that provided for in Article 19 of the directive may be applied to one given class of taxable persons alone. That is the class of ‘mixed’ taxable persons who carry out both transactions in respect of which VAT is deductible and transactions in respect of which it is not. The proportion cannot, therefore, be applied to ‘fully’ taxable persons carrying out only transactions in respect of which VAT is deductible.

11. The Spanish Government maintains, nevertheless, that Article 19 of the Sixth Directive may be applied independently. It is therefore possible, it believes, for the proportion to be applied beyond the conditions laid down in Article 17 of the Sixth Directive.

12. Such an interpretation must be rejected. It follows from the wording of Article 19(1) of the Sixth Directive that the deductible proportion is to apply in the conditions provided for by the first subparagraph of Article 17(5) of that directive. It may not, in consequence, be separated from

those conditions. Its ambit is confined exactly to that of the first subparagraph of Article 17(5), which plainly refers to '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'. (3)

13. Moreover, that interpretation gainsays the spirit of the harmonised system of VAT as defined in the Court's case-law. It is established that, '[i]n 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 ... [T]herefore derogations are permitted only in the cases expressly provided for in the Directive'. (4) To apply the proportion to all taxable persons receiving subsidies amounts precisely to limiting the right to deduct beyond the situations provided for by the directive.

14. The Kingdom of Spain suggests, however, that its interpretation is more in keeping with equity and that it is better able to further equal conditions of competition between economic operators. It argues that the system as the Commission would have it is contrary to equity in that only mixed taxable persons are subject to that limitation of the right to deduct whilst fully taxable persons receiving the same kinds of subsidy escape it. In addition, it gives rise to distortion of competition because it has the effect of giving further advantages to taxable persons receiving subsidies.

15. Those arguments cannot be accepted. In the first place, it is to be noted, as the Commission has done, that under Article 19 of the Sixth Directive including subsidies not linked to price in the deductible proportion is merely an option afforded to the Member States. It was quite permissible for the Kingdom of Spain not to make use of that option and so avoid the negative consequences it claims to find in it. In the second place, it is established that that option was introduced into the Sixth Directive in order to prevent a subsidised body which was not authorised to carry out taxable transactions from being able, by performing a purely symbolic taxable activity, to obtain reimbursement of VAT. Having been introduced for such a purpose, that option cannot be extended and exploited as a general mechanism designed to level the conditions of competition between taxable operators. Furthermore, it might be thought that the Member States have available to them a good number of other means by which to restore the conditions of competition between taxable persons in receipt of subsidies and taxable persons not in receipt of subsidies.

16. Finally, and in any case, it is not for the national authorities to undertake to alter the sense of clear provisions of law. The provisions of Article 17 of the Sixth Directive clearly specify the conditions giving rise to the right to deduct, the extent of that right and the conditions for its limitation. As the Court has earlier had occasion to declare, '[t]hey do not leave the Member States any discretion as regards their implementation'. (5) In those circumstances, it is a matter of importance that limitations of the right to deduct should be applied in a similar manner in all the Member States. (6)

B – *On the compatibility of Article 104 of the Law on VAT with the Sixth Directive*

17. The provision at issue consists of limiting the right to deduct of certain taxable persons in receipt of subsidies simply by reducing the amount of the deduction of VAT due.

18. There appears to be no doubt that such a provision is incompatible with the terms of the Sixth Directive.

19. As the foregoing explanations make clear, under Articles 17 and 19 of the Sixth Directive limitation of the right to deduct by reason of the grant of subsidies not linked to price affects mixed taxable persons only and, so far as they are concerned, may be imposed only in accordance with the proportion rules fixed in Article 19. In this respect, the Law on VAT effects a twofold extension: on the one hand, it extends the limitation to taxable persons who are not subject to it and, on the other, for those who are subject to it, the Law provides a limitation which falls outside the rules fixed by the Sixth Directive.

20. Now, I would recall that it is settled case-law that 'derogations [from the right to deduct] are permitted only in the cases expressly provided for in the Directive'. (7)

21. In this connection the Kingdom of Spain repeats its arguments based on economic equity

and the need to avoid distortion of competition. However, the Court has had occasion to observe that, while the rules on the deductibility of VAT drawn up by the Community legislature are not perfect, none the less there may exist no possibility of derogating or departing from them. (8) The same is true of the rules on limitation of the right to deduct. The Member States are prohibited from creating limitations beyond what the directive itself makes possible even if, in certain cases, such limitations might seem to be economically defensible. (9) To decide otherwise would compromise the harmonising objective pursued by the Sixth Directive.

III – The effects in time of a judgment establishing a breach of obligations

22. As an ancillary point, the Kingdom of Spain requests the Court, if it should make a finding of failure to fulfil obligations, to limit the effects in time of its judgment.

23. It has to be borne in mind that 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 limit the future effects of its judgments. Such a possibility, generally applied in references for a preliminary ruling, has not been excluded in relation to a judgment given on the basis of Article 226 EC. (10)

24. It is still necessary for it to be possible to establish that the State authorities were prompted to adopt legislation or conduct contrary to Community law because of objective and significant uncertainty regarding the implications of the Community provisions concerned. (11) Now, in the circumstances of this case, it is apparent that the relevant provisions of Community law leave no doubt as to their correct interpretation. The Kingdom of Spain could not have been unaware that its legislation was incompatible with the provisions of the Sixth Directive.

25. The request that the effects of the judgment to be given should be limited in time must therefore be rejected.

IV – Conclusion

26. In the light of the foregoing considerations, I suggest that the Court should declare as follows:

‘By limiting the right to deduct value added tax in the conditions defined by Articles 102(1) and 104(2) of Law No 37/1992 of 28 December 1992 on value added tax as amended by Law No 66/1997 of 30 December 1997, the Kingdom of Spain has failed to fulfil its obligations under Articles 17 and 19 of the 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.’

1 – Original language: Portuguese.

2 – OJ 1977 L 145, p. 1.

3 – It will be observed that the Conseil d’État (Council of State) (France) has held to this effect that the deductible proportion of VAT including subsidies received is applicable, pursuant to national law compatible with Community law, exclusively to taxable persons carrying out both transactions in respect of which VAT is deductible and transactions in respect of which it is not (decision of 26 November 1999 *Syndicat mixte pour l’aménagement et l’exploitation de l’aéroport Rodez-Marcillac* , given following an opinion to that effect of Commissaire du gouvernement (law officer presenting impartial report to an administrative court) Courtial).

4 – Case C-37/95 *Ghent Coal Terminal* [1998] ECR I-1, paragraph 16; Case C-62/93 *BP Soupergaz* [1995] ECR I-1883, paragraph 18; Case C-97/90 *Lennartz* [1991] ECR I-3795, paragraph 27, and Case 50/87 *Commission* v *France* [1988] ECR 4797, paragraph 17.

5 – .*BP Soupergaz*, cited in footnote 4, paragraph 35.

6 – .*Commission* v *France*, cited in footnote 4, paragraph 17.

7 – See the cases cited in footnote 4.

8 – Case C-338/98 *Commission* v *Netherlands* [2001] ECR I-8265, paragraphs 55 and 56.

9 – See, by analogy, Advocate General Sir Gordon Slynn’s Opinion in *Commission* v *France*, cited in footnote 4, ECR 4811.

10 – See, to this effect, Case C-426/98 *Commission* v *Greece* [2002] ECR I?2793, and Case C-359/97 *Commission* v *United Kingdom* [2000] ECR I?6355.

11 – See *Commission* v *United Kingdom*, cited in footnote 10, paragraph 92.