OPINION OF ADVOCATE GENERAL

POIARES MADURO

delivered on 10 March 2005 (1)

Case C-243/03

Commission of the European Communities

v

French Republic

(VAT – Limitation of the right to deduct – Capital goods financed by subsidies)

1. In this action, the Commission of the European Communities claims that the Court should declare that, by introducing a special rule limiting the deductibility of value added tax ('VAT') on the purchase of capital goods on the ground that they were financed by subsidies, the French Republic has failed to fulfil its obligations under Community law, 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 stage**

2. In the present case, the Court is asked once again to give judgment on the compatibility of French legislation concerning limitations to the right to deduct VAT with the relevant provisions of the Sixth Directive. (3)

A – *The relevant provisions of Community law*

3. Article 2 of the First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes (4) states that 'the principle of the common system of value added tax involves the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged. 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 amount of value added tax borne directly by the various cost components …'.

4. Article 17 of the Sixth Directive concerns the origin and scope of the right to deduct. In subparagraph 2 it sets out the general principle that, '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 … value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person …'. (5)

5. The case of taxable persons who carry out both taxable transactions and exempt transactions is provided for in Article 17(5) of the Sixth Directive which states:

'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'.

6. Article 19(1) of the Sixth 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)'.

7. Article 11A(1)(a) of the Sixth Directive 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*

8. The provisions of French law, the compatibility of which with the uniform rules of the Sixth Directive is challenged by the Commission, are the result of an administrative instruction of 8 September 1994 of the tax law department ('the instruction').

9. Paragraph 151 of the instruction, which is part of Title 2 entitled 'Rules applicable to taxable persons who do not exclusively carry out transactions in respect of which value added tax is deductible' of Book 2 on the right to deduct, specifies that 'tax on investments financed by the subsidy can in fact be deducted in normal conditions where the person liable to tax includes the depreciation allowances for the goods either completely or partially financed by this subsidy within the price of its transactions. If it becomes apparent that the condition relating to the passing on of the depreciation of these goods in prices has not been respected, the VAT in respect of these same goods cannot be deducted for the proportion of the amount financed by the equipment subsidy'.

10. Paragraph 150 of the same Title 2 defines equipment subsidies as being ‘non-taxable subsidies which are, at the time of provision, granted for the financing of a given capital asset’.

C – *Pre-litigation procedure*

11. After receiving a complaint relating to an action concerning a French taxable person who benefited from debt write-offs, the Commission was of the opinion that the French Republic infringed Article 17(2) and (5) as well as Article 19 of the Sixth Directive in so far as the system set up by the instruction for equipment subsidies restricted the right to deduct in cases not provided for by the Sixth Directive. A letter of formal notice was sent to the French Government on 23 April 2001. Not having received a response to this formal notice within the time-limit laid down, the Commission issued a reasoned opinion on 21 December 2001. The French Government’s response to the letter of formal notice of 7 January 2002 reached the Commission on 14 January 2002, namely, after the reasoned opinion had already been sent.

12. In order to take those observations into account, the Commission issued a further reasoned opinion on 26 June 2002. The French Government responded to this further reasoned opinion by a letter of 21 August 2002 in which it contested the basis of the Commission’s complaint and contended that it could be accused of having infringed Articles 17 and 19 of the Sixth Directive. Not agreeing with this analysis, the Commission decided to bring an action before the Court in the present action.

II – **Analysis**

13. Article 17 of the Sixth Directive clearly shows that the only condition in order for a taxable person to be able to deduct VAT is the use of the good for the purposes of its taxable activities. The French provision in dispute adds a prerequisite to the deductibility of VAT in relation to purchasing capital goods financed by subsidies, namely, that the taxable person is to reflect the depreciation allowances of these subsidised capital goods in the price of its input transactions. That is not provided for in the Sixth Directive. The origin of the funds used to obtain the goods or the taxable person’s method of calculating prices are alien to the harmonised system of VAT.

14. It remains beyond doubt that such a condition relating to the repercussions of the depreciation of these goods on prices actually limits certain subsidised taxable persons’ right to deduct and is incompatible with the wording of the Sixth Directive.

15. In this respect, according to the Court’s settled case-law, ‘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. Such limitations on the right of deduction must be applied in a similar manner in all the Member States and therefore derogations are permitted only in the cases expressly provided for in the Directive’. (6)

16. The only provisions of the Sixth Directive which prescribe the taking into consideration of subsidies on the levy of VAT owed by taxable persons are Article 11A(1)(a) and Article 19.

17. Outside of these provisions, the Sixth Directive does not allow any limitation on the right to deduct as regards the granting of subsidies however appropriate or economically justified it may appear. (7)

18. Instead of following the specific arrangements for limitations as regards calculation of the deductible proportion as defined in Article 19(1) of the Sixth Directive, the French legislature

introduced a different limitation which operates even before any application of the deductible proportion and independently of it, which results in a reduction in the amount deductible. Nowhere does the harmonised VAT system prescribe, as a prerequisite for the deductibility of the VAT paid on outputs at the time of purchase of the capital goods financed by subsidies, that the taxable person is to reflect the depreciation allowances for the goods in the price of his transactions subject to VAT on outputs, nor that, in the absence of verification of this condition relating to the passing on of the depreciation of these goods in prices, VAT on these same goods cannot be deducted for the proportion of the amount financed by the equipment subsidy.

19. 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, 'they do not leave the Member States any discretion as regards their implementation'. (8) In those circumstances, it is a matter of importance that limitations of the right to deduct are to be interpreted strictly (9) which is essential so that they can be applied in a uniform manner in all the Member States. It would be completely contrary to the Sixth Directive's objective of harmonising national laws to allow each Member State to make exceptions or justifications not provided for in the text. (10)

20. The French Republic's main argument that this requirement that the effects of depreciation of these goods should be reflected in the prices of its output transactions merely amounts to the implementation of the general conditions of the right to deduct defined in Article 2(2) of the First Directive which, according to the French Republic, Article 17(2) of the Sixth Directive does no more than adapt, cannot be accepted. The Court has already had the opportunity, in *Commission* v *France*, (11) to reject this argument also in the context of another limitation to the right to deduct which the French Republic had laid down, finding that Article 2 of the First Directive 'merely lays down the principle of the right to deduction, and the conditions applicable thereto are laid down in the abovementioned provisions [Articles 17 and 20] of the Sixth Directive'. (12)

21. The French Government's attempts to justify its position, in particular, the prerequisite that depreciation of these goods should be reflected in prices is not in itself any less unfavourable than the system prescribed in Article 19(1) of the Sixth Directive, lack relevance.

22. Even if the condition that depreciation must be passed on in prices were to be considered more reasonable or advantageous in general terms for taxable persons than the possibility of restriction offered to the Member States in Article 19(1) of the Sixth Directive, namely to include equipment subsidies in the calculation of the proportion, it would in any case remain a different sort of restriction not provided for in that directive. It would merely be part of an imaginary common VAT system. The action was brought before the Court for the latter to rule on the conformity of the French legislation with the harmonised system of the Sixth Directive and not on the conformity of this legislation with another virtual VAT system which might be better.

23. In this respect, the Court has pointed out that the Member States are required to apply the Sixth Directive even if they consider it to be perfectible. Thus, the Court held in *Commission* v *Netherlands*(13) that, 'it is true that the solution thus imposed by the wording of Article 17(2)(a) of the Sixth Directive may not appear fully consistent with the purpose of that provision and with certain objectives pursued by the Sixth Directive, such as fiscal neutrality and the avoidance of double taxation. The fact remains, however, that, in the absence of intervention by the Community legislature, the system for deduction of VAT which it has created, as defined by the Sixth Directive, does not provide any basis for a right entitling taxable persons to deduct VAT … or enable any detailed rules for the application of such a right to be established'. This reasoning is valid whether it be the case of a piece of national legislation which sets up a more favourable system of

deduction for taxable persons or whether it be the case of a piece of legislation which limits the recognition of this right beyond the cases expressly provided for by the Sixth Directive.

24. For the reasons given above, it must be held that the French Republic has failed to fulfil its obligations under Community law.

III – **Conclusion**

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

By introducing a special rule limiting the deductibility of value added tax on the purchase of capital goods on the ground that they were financed by subsidies, the French Republic has failed to fulfil its obligations under Community Law, and in particular 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 – See Case 50/87 *Commission* v *France* [1988] ECR 4797.

4 – OJ, English Special Edition 1967, p.14.

5 – As amended by Council Directive 95/7/EC of 10 April 1995 (OJ 1995 L 102, p. 18).

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

7 – See in particular Advocate General Sir Gordon Slynn's Opinion in *Commission* v *France* ([1988] ECR 4811) stating that 'Thus, the directive provides certain options [of limiting the right to deduct] to deal with particular economic circumstances … There is no power to create a further option however convenient or defensible economically that may appear. Member States must choose between the options laid down in the directive to achieve so far as possible the result they desire'.

8 – *BP Soupergaz*, paragraph 35.

9 – See in particular Advocate General Jacobs's Opinion in *Lennartz*, paragraph 79.

10 – See paragraph 15 of the cited conclusions and the case-law cited within.

11 – *Commission* v *France*, cited in footnote 3.

12 – Ibid., paragraph 23. See also Sir Gordon Slynn's Opinion in the cited case affirming that 'It follows that the Member State is not entitled to limit the right to deduct if it can prove that the deduction relates to goods and services the cost of which will not be passed on in the price of the taxed transaction'.

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