Conclusions
OPINION OF ADVOCATE GENERAL
GEELHOED
delivered on 25 March 2004(1)

Case C-269/03

État du grand-duché de Luxembourg

and

Administration de l'enregistrement et des domaines
v
Vermietungsgesellschaft Objekt Kirchberg SARL

(Reference for a preliminary ruling from the Cour d'appel (Luxembourg))

(Member State which has allowed taxable persons a right of option for the taxation of transactions of leasing or letting of immovable property – Full deduction of input tax paid conditional upon prior approval of the tax authorities)

I – Introduction

1. The present case concerns the interpretation of Article 13(C) 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) (hereinafter 'the Sixth Directive'). More particularly, the Cour d'appel (Court of Appeal), Luxembourg, asks whether it is compatible with Article 13(C) of the Sixth Directive to make the right of deduction, arising on the exercise of the right of option provided for by that article, conditional upon non-retroactive approval first being obtained. In other words, the national court asks the Court whether the freedom given to Member States to lay down the conditions for the exercise of the right of option ('Member States may restrict the scope of this right of option and shall fix the details of its use') is limited by the VAT principle which consists in the right to deduct.

II – Legal background

A – *Community Legislation*

2. Articles 13(B)(b) and (C) of the Sixth Directive provide:

'B. Other exemptions

Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse:

...

(b) the leasing or letting of immovable property excluding:

...

C. Options
Member States may allow taxpayers a right of option for taxation in cases of:
(a) letting and leasing of immovable property;
...
Member States may restrict the scope of this right of option and shall fix the details of its use.'
B – *National Legislation*
3. Article 1 of the Grand-Ducal Regulation of 7 March 1980 laying down the limits and conditions for the exercise of the right of option to apply value added tax to transactions in immovable property (hereinafter 'the Grand-Ducal Regulation') (3) permits taxpayers to:
'opt to apply value added tax to the transactions in immovable property referred to hereafter:
...
(b)any person who, by written privately negotiated contract, leases or lets immovable property to a taxable person.'
4. Under Article 3 of the Grand-Ducal Regulation:
'The right of option can be exercised only in respect of immovable property which is used exclusively or, in the case of mixed use, mainly by ... the tenant for the pursuit of activities permitting it to deduct input tax …'
5. Article 5 of the Grand-Ducal Regulation provides:
'Any person exercising the right of option must lodge a written declaration of option for approval by the Registration Authority.
...
In the case of letting, application of the tax shall be authorised from the first day of the month following that in which the declaration of option was approved. The administrative decision must be made during the month within which that declaration is received.'
6. Article 7, second paragraph, of the Grand-Ducal Regulation provides:
'In the case of construction of immovable property, the owner may deduct input tax only after the approval of the declaration of option in respect of ... the subsequent letting ... of the immovable property. However, the authorities may authorise the owner to deduct input tax as invoices are received, where it is established with certainty that the condition laid down in Article 3 of this Regulation will be complied with and where the owner has undertaken to lodge a declaration of option on completion of the construction.'

III – Facts

7. The private limited company Vermietungsgesellschaft Objekt Kirchberg (hereinafter 'VOK') deducted, in respect of the years 1993 and 1994, input tax relating to a building which it had let, invoicing VAT, from January 1993.
8. On 29 June 1993, VOK sent to the Registration and Land Authority (hereinafter 'the Authority') a declaration with a view to exercising the right of option for taxation. Approval was given to it on 30 June 1993 with effect from 1 July 1993, but VOK considered that VAT should have been deductible from the start of the letting, that is from 1 January 1993.
9. Pursuant to Article 5 of the Grand-Ducal Regulation, the Authority however refused the deduction of 50% of the input tax paid, on the ground that the right to deduct could be exercised at the earliest only from the date of approval.
10. The Authority accordingly issued notices correcting of its own motion the VAT declarations.
11. Following VOK's complaint to the Director of the Authority, the Director adopted a decision in January 1998 by virtue of which new corrective notices were issued in the month of February following. The Director considered, first, that 1 January 1993 marked the start of the use of the building.
12. Since the option had been effective only from 1 July 1993, the letting was not subject to VAT during the first half of 1993. Only 50% of the input VAT could therefore be deducted, which was the reason for the correction of the 1993 declaration. The Director considered, second, that the exercise of the option should lead to a second correction in 1994, namely that 9/10ths of the VAT which was not deductible in 1993 should be the subject of a correction in VOK's favour. In the

result, 50% of 1/10th of the input VAT paid, that is 5% of the tax, remained non-deductible and therefore payable by VOK.

13. VOK subsequently brought proceedings against the Authority and the État du grand-duché de Luxembourg (State of the Grand Duchy of Luxembourg) before the Tribunal d'arrondissement (District Court), Luxembourg, for annulment of the rectification made by the Authority of its own motion of the declarations of 1993 and 1994. By judgment of 7 November 2001, the Tribunal found in favour of VOK.

14. The Authority and the État du grand-duché de Luxembourg then appealed to the Cour d'appel.

15. By judgment of 18 June 2003, the Cour d'appel decided to stay proceedings and to refer the following question to the Court for a preliminary ruling:

'Does subparagraph (a) of the first paragraph of Article 13(C) 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, permit a Member State which has exercised the power to allow taxpayers a right of option for taxation in cases of letting and leasing of immovable property to make full deduction of the input VAT conditional upon non-retroactive approval of the tax authorities first being obtained?'

16. In accordance with Article 20 of the Statute of the Court of Justice, written observations were lodged by the Authority, the Luxembourg Government, VOK and the Commission.

IV – Appraisal

17. Is it open to a Member State which has exercised the power to allow taxpayers the right, provided for in Article 13(C) of the Sixth Directive, of option for taxation in cases of leasing or letting of immovable property to make taxation of those transactions conditional upon obtaining the prior approval of the tax authorities?

18. The reply to this question depends in essence on the interpretation of Article 13(C), second paragraph, of the Sixth Directive. Does the power given to Member States to restrict the scope of the right of option and to fix the details of its use also include the power to limit the optional application of VAT to transactions taking place after approval is granted?

19. VOK and the Commission, on the one hand, and the Authority and the Luxembourg Government, on the other, have stated views which seem at first sight to be diametrically opposed.

20. The arguments put forward by VOK and the Commission are based on the line of cases decided by the Court according to which the principle of the right to deduct input VAT immediately and fully is one of the basic principles of the VAT system.

21. In this connection, they refer inter alia to *Molenheide and Others*, *Schlossstrasse* and *Breitsohl*. (4)

22. VOK infers from this case?law that the system of prior checks and approval laid down by the Grand-Ducal Regulation is not needed to combat abuse and tax evasion, given that review after the event could be as effective as, or even more effective than, such ex ante control. It follows that this procedure is in breach of the principle of proportionality as reiterated, in particular, in paragraphs 45 and 46 of the judgment in *Molenheide and Others,* cited above.

23. Specifically, VOK submits that Article 13(C) of the Sixth Directive does not allow Member States to introduce a system of approval such as that at issue in the main proceedings.

24. Member States are indeed authorised by Article 13(C) to fix the substantive conditions for the right of option in cases of letting and leasing, but when those conditions are satisfied, as in the present case, the basic principles of VAT, such as the principles of the deductibility of input tax and of proportionality, come into play.

25. VOK therefore submits that Article 13(C), first paragraph, subparagraph (a), does not allow Member States which have exercised the power to allow taxpayers a right of option for taxation in cases of letting and leasing of immovable property to make full deduction of the input VAT conditional upon non-retroactive approval of the tax authorities first being obtained.

26. The Commission comes to the same conclusion as VOK. The Commission submits in particular that the right envisaged by Article 13(C) of the Sixth Directive is not absolute but must

comply with the wording and the spirit of the Sixth Directive. The Commission refers, in this regard, to *Becker* and *Armbrecht*. (5)

27. The Commission concludes from this that prior approval, which allows the national authorities to check whether the conditions prescribed by the State and permitting the exercise of the option are satisfied, seems at first sight legitimate and does not conflict with any principle of the Sixth Directive.

28. By contrast, the rule which states that, when the Authority has found that the right of option may legitimately be exercised, the start of the taxable activity may nevertheless not be the same as the actual start of the activity seems to the Commission clearly to be a disproportionate provision. Thus, in cases such as the present where the declaration is sent to the Authority after the date of the start of the taxable activity, the non-retroactivity of the approval results in the taxpayer being deprived of some of his rights to deduct.

29. The refusal to apply normal tax rules from the actual start of the taxable activity by denying the approval retroactive effect is therefore an unjustified measure. Such a measure creates a situation in which the input tax continues to be borne by the taxpayer, which should be avoided.

30. This non-retroactivity, moreover, cannot be justified since, if the Member State were to abolish the rule, both the Member State's checks – through approval – and any adjustment – pursuant to Article 20 of the Sixth Directive – in the event of refusal of approval or amendment of the conditions for the option would still be possible.

31. The Authority and the Luxembourg Government argue that the approval procedure, as envisaged by the Grand-Ducal Regulation, complies with Article 13(C) of the Sixth Directive. That provision confers on Member States the power to provide for their taxpayers the right to opt for taxation and to make that right subject to certain detailed rules for its application, allowing them a wide discretion.

32. To substantiate their argument, they refer to *Becker*, cited above, and *Belgocodex*. (6)

33. The approval procedure is a detailed rule of application, which does not go beyond what is authorised by Article 13(C) of the Sixth Directive. The procedure allows the Authority to check that taxpayer lessors who opt for taxation fulfil the essential conditions, namely, in this case, that the tenant is himself a taxpayer who can deduct the input tax paid.

34. The Luxembourg system is not in breach of the basic principles of VAT, such as the principle of the deductibility of input tax, since the taxpayer has the opportunity to lodge its option declaration in advance and in that event to obtain the approval in time to be able to deduct completely and immediately the input tax paid. It is only in the event that the declaration is lodged after the letting of the building has commenced, six months later in the case in the main proceedings, that the lessor is not able to deduct immediately and completely the input tax paid. He must wait to receive the approval of the Authority and may only subsequently request the correction of the situation.

35. It follows that the limitations on the opportunity for immediate and complete deduction of input VAT are but the indirect result of the right of option, as it is provided for in Article 13(C) of the Sixth Directive and the procedures for using it. Neither the object nor the effect of the approval procedure adopted by the Grand Duchy of Luxembourg is to prejudice the right to deduct VAT envisaged in the Sixth Directive.

36. The Authority and the Luxembourg Government submit that this procedure is justified by the fact that it is important for the lessor to know as soon as possible that he is able to deduct fully the input VAT paid. That makes it possible to avoid financial difficulties emerging after the event. This procedure also serves the purposes of ensuring the correct collection of tax and avoiding evasion and abuse.

37. It appears from the file that the Luxembourg Government wished to exercise the power provided by Article 13(C) of the Sixth Directive, that is, to waive the exemption provided for in Article 13(B) of the Directive in respect of the leasing or letting of immovable property.

38. According to the wording of the Grand-Ducal Regulation, the Luxembourg Government has made the right of option for taxpayers subject to certain limits and conditions.

39. Article 3 of the Regulation states the main restriction on the power to opt for taxation: the right of option can be exercised only in respect of immovable property which is used exclusively or, in the case of mixed use, mainly by the tenant for the pursuit of activities permitting it to deduct input tax.
40. There is an inseparable connection between the limiting conditions of Article 7 and the prior approval procedure provided by Article 5 of the Grand?Ducal Regulation, in that the Luxembourg Authority must be in a position to check in advance whether the economic transactions for which the application of VAT is requested satisfy the conditions laid down in Article 7 of the Regulation.
41. In their written observations, both the Authority and the Luxembourg Government as well as the Commission have highlighted this connection between, on the one hand, the restriction of the right of option and, on the other, the need to check whether the conditions for the exercise of the right of option are satisfied.
42. They have concluded from that that since the approval procedure is the logical consequence of the competence of the Member States to restrict the scope of the right of option, it is not as such disproportionate.
43. This conclusion seems to me entirely justified in the light of the scheme of Article 13(B) and (C) of the Sixth Directive, where the power to allow a right of option, provided for by Article 13(C), constitutes an exception to the wider exceptions in Article 13(B).
44. The differences of opinion between the Luxembourg authorities on the one hand and VOK and the Commission on the other centre in particular on Article 5, final paragraph, of the Grand-Ducal Regulation of 7 March 1980. The application of this provision could have the effect of depriving the taxpayer of some of his rights to deduct, laid down in Article 17 of the Sixth Directive. That could happen, in particular, in cases such as the present where the declaration of option is sent to the Authority after the date of the start of the taxable transaction.
45. The Commission and VOK have pointed out, citing the extensive case?law of the Court, the importance of the right of deduction as one of the principles of the VAT system, which the Member States may prejudice only in cases of overriding necessity. There is no such situation of overriding necessity in this case. It follows that the non-retroactivity clause of Article 5, final paragraph, of the Grand-Ducal Regulation should be characterised as a disproportionate interference with the principle of the right of deduction and thus be regarded as contrary to Community law.
46. Although I agree with the reflections of the Commission on the importance of the right to deduct, a keystone of the VAT system, I cannot support the conclusion which the Commission derives from it in this case.
47. As the Court has affirmed on several occasions, (7) the Member States enjoy a wide discretion within the framework of Article 13(C).
48. In general, it is permissible for Member States to limit the material and temporal scope of the right of option for taxpayers, as has been done in this case. The material limitation is prescribed in Article 7 of the Grand-Ducal Regulation, while the temporal limitation is found in Article 5 of that Regulation.
49. From the point of view of legal certainty, the Grand-Ducal Regulation appears to me to be beyond reproach: taxpayers are able to ascertain in advance the types of transactions for which the right of option has been made available, the time from which the tax will be applied and, lastly, the formalities which they must fulfil for that purpose.
50. Considered in the light of the principle of deduction, legislation like that in this case appears to me likewise beyond question. Any taxpayer who satisfies the clear conditions of the Grand-Ducal Regulation and fulfils in due time the formalities can be certain of being able to deduct input tax paid. As long as the approval procedure is complied with, this regulation is therefore in no way in breach of the principle of deduction.
51. A provision such as the final paragraph of Article 5 of the Grand-Ducal Regulation has no objective other than to establish the time at which the right of option, once exercised and approved, takes effect. As the Luxembourg Government has rightly observed, this provision has neither the purpose nor the effect of restricting the right of deduction. In cases where taxpayers

effect transactions which fall within the scope of the tax, but fail to make the declaration of option for the tax in good time and are therefore without the approval provided for by the national legislation, the application of this provision does have an effect on the right of deduction, but that effect must not be attributed to the national provisions but rather to the conduct of the taxpayers.

52. In those circumstances, national legislation such as that at issue does not make the right of deduction conditional on prior non-retroactive approval. To the extent that compliance with the approval procedure allows the taxpayers affected to obtain the immediate and complete deduction of input tax, the procedure cannot be described as disproportionate. It remains within the limits of what is necessary to achieve the objectives of ensuring the correct collection of the tax and avoiding evasion and abuse. Moreover, this procedure satisfies the requirements of the principle of legal certainty.

Conclusion

53. Having regard to the considerations set out above, I propose that the Court should reply to the question referred by the national court as follows:

Subparagraph (a) of the first paragraph of Article 13(C) 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 does not preclude a Member State which has exercised the power to allow taxpayers a right of option for taxation in cases of leasing or letting of immovable property from making the application of the tax subject to prior approval of the option where the approval procedure is directed solely at checking that the statutory conditions have been fulfilled, and it is designed in particular to prevent cases of evasion or abuse. Such an approval procedure is not in breach of the principle of the right of deduction where compliance with it guarantees to the taxpayer immediate and complete deduction of input tax.

1 – Original language: Dutch.

2 – OJ 1977 L 145, p. 1.

3 – .*Mémorial* 1980 A, p. 242.

4 – Joined Cases C-286/94, C-340/95, C-401/95 and C-47/96 [1997] ECR I?7281, paragraph 47, Case C-396/98 [2000] ECR I-4279, paragraph 36, and C?400/98 [2000] ECR I-4321, paragraph 34.

5 – Case 8/81 [1982] ECR 53, paragraph 38, and Case C-291/92 [1995] ECR I?2775.

6 – Case C-381/97 [1998] ECR I-8153, paragraph 17.

7 – Inter alia *Becker*, cited in footnote 5, paragraph 38, and *Belgocodex*, cited in footnote 6, paragraph 17.