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61999J0177

Judgment of the Court (Fifth Chamber) of 19 September 2000. - Ampafrance SA v Directeur des services fiscaux de Maine-et-Loire (C-177/99) and Sanofi Synthelabo v Directeur des services fiscaux du Val-de-Marne (C-181/99). - References for a preliminary ruling: Tribunal administratif de Nantes and Tribunal administratif de Melun - France. - VAT - Deduction of tax - Exclusion of the right of deduction - Entertainment costs - Proportionality. - Joined cases C-177/99 and C-181/99.

European Court reports 2000 Page I-07013

Summary

Parties

Grounds

Decision on costs

Operative part

Keywords

1. Tax provisions - Harmonisation of laws - Turnover taxes - Common system of value added tax - Deduction of input tax - Introduction of special derogating measures - Measures to combat tax evasion or avoidance - Decision 89/487 - Exclusion of the right to deduct tax on certain expenditure in respect of accommodation, food, hospitality and entertainment - Breach of the principle of proportionality - Unlawful

(Council Directive 77/388, Art. 27; Council Decision 89/487)

2. Community law - Principle of the protection of legitimate expectations - Reliance on the principle by a Member State to avoid the consequences of a decision of the Court declaring a Community measure invalid - Not permissible

Summary

1. Council Decision 89/487, adopted on the basis of Article 27 of Sixth Directive 77/388 on the harmonisation of the laws of the Member States relating to turnover taxes, which provides that a Member State may be authorised to introduce special measures for derogation from the Sixth Directive in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance, and authorising the French Republic to apply a measure derogating from the second subparagraph of Article 17(6) of the Sixth Directive, is invalid under the general principle of proportionality, in so far as it authorises that State to deny traders the right to deduct the value added tax on expenditure which they are able to show to be of a strictly business nature.

Since the measure excludes as a matter of principle all expenditure in respect of accommodation, hospitality, food and entertainment from the right to deduct value added tax, which is a fundamental principle of the value added tax system established by the Sixth Directive, although appropriate means less detrimental to that principle than the exclusion of the right of deduction in the case of certain expenditure can be contemplated or already exist in the national legal order, it is not a means proportionate to that objective and has a disproportionate effect on the objectives and principles of the Sixth Directive.

(see paras 35, 57, 61-62 and operative part)

2. The principle of the protection of legitimate expectations, which is the corollary of the principle of legal certainty and which is generally relied upon by individuals (traders) in a situation where they have legitimate expectations created by the public authorities, cannot be relied on by a Member State in order to avoid the consequences of a decision of the Court declaring a Community provision invalid, since it would jeopardise the possibility for individuals to be protected against conduct of the public authorities based on unlawful rules.

(see para. 67)

Parties

In Joined Cases C-177/99 and C-181/99,

REFERENCE to the Court under Article 177 of the EC Treaty (now Article 234 EC) by the Tribunal Administratif, Nantes (C-177/99) and the Tribunal Administratif, Melun (181/99) (France) for a preliminary ruling in the proceedings pending before those courts between

Ampafrance SA

and

Directeur des Services Fiscaux de Maine-et-Loire (C-177/99)

and between

Sanofi Synthelabo, formerly Sanofi Winthrop SA,

and

Directeur des Services Fiscaux du Val-de-Marne (C-181/99),

on the validity of Council Decision 89/487/EEC of 28 July 1989 authorising the French Republic to apply a measure derogating from the second subparagraph of Article 17(6) of the Sixth Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes (OJ 1989 L 239, p. 21),

THE COURT (Fifth Chamber),

composed of: D.A.O Edward, President of the Chamber, L. Sevón, P.J.G. Kapteyn, H. Ragnemalm and M. Wathelet (Rapporteur), Judges,

Advocate General: G. Cosmas,

Registrar: H.A. Rühl, Principal Administrator,

after considering the written observations submitted on behalf of:

- Ampafrance SA, by J.-C. Bouchard and O. Cortez, of the Hauts-de-Seine Bar,

- Sanofi Synthelabo, by J.-C. Leroy, Financial Director,

- the French Government, by K. Rispal-Bellanger, Head of Subdirectorate in the Legal Affairs Directorate of the Ministry of Foreign Affairs, and S. Seam, Secretary for Foreign Affairs in the same directorate, acting as Agents,

- the Council of the European Union, by J. Monteiro, Legal Adviser, and M.-J. Vernier, of its Legal Service, acting as Agents,

- the Commission of the European Communities, by E. Traversa, Legal Adviser, and H. Michard, of its Legal Service, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Ampafrance SA, represented by J.-C. Bouchard and O. Cortez, of Sanofi Synthelabo, represented by B. Geneste and O. Davidson, of the Hauts-de-Seine Bar, of the French Government, represented by S. Seam, of the Council, represented by J. Monteiro and M.-J. Vernier, and of the Commission, represented by H. Michard, at the hearing on 27 January 2000,

after hearing the Opinion of the Advocate General at the sitting on 23 March 2000,

gives the following

Judgment

Grounds

1 By judgments of 3 December 1998 and 11 May 1999, received at the Court on 14 and 17 May 1999 respectively, the Tribunal Administratif (Administrative Court), Melun (C-181/99) and the Tribunal Administratif, Nantes (C-177/99) each referred a question for a preliminary ruling under Article 177 of the EC Treaty (now Article 234 EC) on the validity of Council Decision 89/487/EEC of 28 July 1989 authorising the French Republic to apply a measure derogating from the second subparagraph of Article 17 (6) of the Sixth Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes (OJ 1989 L 239, p. 21).

2 Those questions were raised in two sets of proceedings between first, Ampafrance SA (hereinafter Ampafrance) (C-177/99) and, second, Sanofi Winthrop SA, which, following a merger and take-over, became Sanofi on 12 May 1998 and then Sanofi Synthelabo on 18 May 1999 (hereinafter Sanofi) (C-181/99) and the tax authorities concerning tax adjustments applied to those companies based on the exclusion of the right to deduct value-added tax (hereinafter VAT) on expenditure in respect of accommodation, food, hospitality and entertainment.

Legal background

Community legislation

3 According to the second paragraph of Article 2 of First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes (OJ, English Special Edition 1967, p. 14, hereinafter the First Directive):

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 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, hereinafter the Sixth Directive), which governs the right of taxable persons to deduct the VAT paid on inputs, provides in paragraph 2(a):

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.

5 Article 17(6) of the Sixth Directive contains a freezing (or standstill) clause, which provides for the retention of national exclusions from the right to deduct VAT which were applicable before the Sixth Directive entered into force, that is before 1 January 1979. That provision is worded as follows:

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.

6 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.

7 Article 27 of the Sixth Directive provides:

1. The Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance. Measures intended to simplify the procedure for charging the tax, except to a negligible extent, may not affect the amount of tax due at the final consumption stage.

2. A Member State wishing to introduce the measures referred to in paragraph 1 shall inform the Commission of them and shall provide the Commission with all relevant information.

3. The Commission shall inform the other Member States of the proposed measures within one month.

4. The Council's decision shall be deemed to have been adopted if, within two months of the other Member States being informed as laid down in the previous paragraph, neither the Commission nor any Member State has requested that the matter be raised by the Council.

5.

National legislation

8 In France expenditure in respect of accommodation, food, hospitality and entertainment was gradually excluded from the right to deduct VAT between 1967 and 1979.

9 The provisions excluding the right to deduct VAT charged on certain goods and services which were applicable before 1 January 1979, the date on which the Sixth Directive entered into force, were set out in Articles 7 and 11 of Decree No 67-604 of 27 July 1967 (JORF, 28 July 1967, p. 7541, hereinafter Decree No 67-604).

10 Article 7 of that decree provided:

The tax on expenditure incurred in order to provide accommodation or lodging for the management and staff of undertakings shall not be deductible.

However, that exclusion shall not apply to the tax on expenditure incurred in order to provide free accommodation at the place of work for employees responsible for the security or supervision of an industrial or commercial complex or a works site.

11 Article 11 of Decree No 67-604 provided:

The tax on expenditure incurred in order to satisfy the personal needs of the management and staff of undertakings, and in particular the tax on the cost of providing hospitality, food and entertainment, shall not be deductible.

However, that exclusion shall not apply to expenditure in respect of:

Goods which constitute fixed assets and are specially allocated at the actual places of work for the collective satisfaction of the needs of the staff;

Work clothes or protective clothing which an undertaking provides for its staff.

12 Decree No 79-1163 of 29 December 1979 (JORF, 31 December 1979, p. 3333, hereinafter Decree No 79-1163), which was adopted after the Sixth Directive had entered into force, provided that Article 236 of Annex II to the General Tax Code was to be replaced by the following:

Tax on goods or services used by persons not employed by the undertaking, or by the management or staff of the undertaking, such as accommodation or lodging, the cost of hospitality, food or entertainment or any expenditure directly or indirectly connected with travel or residence shall not be deductible.

However, that exclusion shall not apply to work clothes or protective clothing, premises and equipment provided to staff at the workplace, or to accommodation provided free of charge for security or supervisory staff at the workplace.

13 In its judgment of 3 February 1989 in Compagnie Alitalia (hereinafter the judgment in Alitalia), the Conseil d'État (Council of State) held that Article 25 of Decree No 79-1163 was invalid in that it excluded the right to deduct the VAT on all goods and services used by persons not employed by the undertaking, thus disregard[ing] the objective of not extending existing exclusions defined in Article 17(6) of the Sixth Directive.

14 Following the judgment in Alitalia, the French Republic, by letter of 13 April 1989, requested authorisation from the Council pursuant to Article 27(1) of the Sixth Directive to introduce, pending the entry into force of the final provisions of Article 17(6) of the Sixth Directive, a derogation from that article in order to introduce into its legislation a provision excluding the deduction of expenditure in respect of accommodation, food, hospitality and entertainment.

15 The French Government stated:

That special measure is intended to prevent tax evasion and avoidance resulting from the failure to charge [VAT] on expenditure in respect of what by nature constitutes final consumption. The risks of tax evasion and avoidance are significant, since undertakings will be tempted to make supplies, in the form of benefits in kind or gifts, in circumstances which constitute final consumption without charging [VAT], and not to distinguish properly between expenditure incurred for the benefit of management and staff and that incurred for the benefit of persons other than employees.

However, the exclusion would not apply to:

- expenditure incurred by a taxable person in respect of the supply by him of accommodation, meals, food or drink for consideration;*
- expenditure on accommodation provided free of charge for security, caretaking or supervisory staff on works, sites or business premises;*
- expenditure incurred by a taxable person in carrying out his contractual or legal responsibility towards his customers (for example: expenditure incurred by an airline on accommodation and food for passengers owing to a prolonged stop at an airport).*

16 On 28 July 1989 the Council adopted Decision 89/487. According to the second and third recitals in the preamble,

... by letter, receipt of which was recorded by the Commission on 17 April 1989, the French Republic requested authorisation to introduce a special measure derogating from the second subparagraph of Article 17(6) of the Sixth Directive;

... certain supplies made to a taxable person concerning in particular his representational expenditure are excluded in France from the right of deduction, in accordance with Article 17(6), second subparagraph, of the Sixth Directive; ... this measure is aimed at excluding other expenditure in respect of accommodation, restaurants, hospitality and entertainment from the right to deduct VAT previously charged, in order to prevent tax evasion and avoidance; ... the exclusion does not concern expenditure incurred by a taxable person in respect of the supply by him of accommodation, meals, food or drink for consideration, expenditure on accommodation provided free of charge for security, caretaking or supervisory staff on works, sites or business premises, or expenditure incurred by a taxable person in carrying out his contractual or legal responsibility towards his customers.

17 Article 1 of Decision 89/487 provides:

1. By way of derogation from the second subparagraph of Article 17(6) of the Sixth Directive, the French Republic is hereby authorised, on a temporary basis and until such time as Community rules determining the treatment of expenditure referred to in the first subparagraph of that paragraph come into force, to exclude expenditure in respect of accommodation, food, hospitality and entertainment from the right to deduct value added tax previously charged.

2. The exclusion referred to in paragraph 1 shall not apply to:

- expenditure incurred by a taxable person in respect of the supply by him of accommodation, meals, food or drink for consideration,*
- expenditure on accommodation provided free of charge for security caretaking or supervisory staff on works, sites or business premises,*
- expenditure incurred by a taxable person in carrying out his contractual or legal responsibility towards customers.*

18 Following the adoption of Decision 89/487 the French Government, by Article 4 of Decree No 89-885 of 14 December 1989 (JORF, 15 December 1989, p. 15578), amended Article 236 of Annex II to the General Tax Code. That article now reads as follows:

... As a temporary measure, the value added tax charged on expenditure in respect of accommodation, food, hospitality and entertainment shall be excluded from the right of deduction.

However, that exclusion shall not apply to:

- expenditure incurred by a taxable person in respect of the supply by him of accommodation, meals, food or drink for consideration;*
- expenditure on accommodation provided free of charge for security caretaking or supervisory staff on works, sites or business premises;*
- expenditure incurred by a taxable person in carrying out his contractual or legal responsibility towards customers.*

The main proceedings

Case C-177/99

19 *In the course of its commercial activities, Ampafrance incurs expenditure in respect of accommodation, food, hospitality and entertainment. It deducted the VAT charged on expenditure in respect of lodging, food, hospitality and entertainment incurred, both for its staff and for persons other than employees, in June 1993.*

20 *On 30 November 1993 the tax authorities sent Ampafrance a tax demand in the amount of FRF 252 086, corresponding to the VAT deducted in respect of the abovementioned expenditure. That adjustment was based on Article 236 of Annex II to the General Tax Code, which transposed Decision 89/487 into French law and excluded the right to deduct VAT charged on expenditure in respect of accommodation, food, hospitality and entertainment.*

21 *Ampafrance lodged a complaint against that decision. That complaint was rejected by decision of the Maine-et-Loire tax authorities and Ampafrance brought an action against that decision before the Tribunal Administratif, Nantes.*

22 *In its action, Ampafrance sought repayment of the sum which it had paid by way of VAT in respect of its operations in June 1993 and, in the alternative, requested that a reference be made to the Court of Justice for a preliminary ruling on the validity of Decision 89/487.*

Case C-181/99

23 *In 1995 the tax authorities, also acting in reliance on Article 236 of Annex II to the General Tax Code, sent the Choay, Millot Solac and Clin Midy laboratories tax demands in the amounts of, respectively, FRF 260 524 for the Choay laboratory, FRF 661 796 for the Millot Solac laboratory and FRF 635 422 for the Clin Midy laboratory, corresponding to the VAT on expenditure on hospitality for suppliers and customers which they had incurred in November and December 1993 which they had deducted.*

24 *Since the complaints lodged against those demands were rejected by decisions of the Director of Tax Services of Val-de-Marne, Sanofi, which had assumed the rights and obligations of the Choay, Millot Solac and Clin Midy laboratories, brought an action against those decisions before the Tribunal Administratif, Paris. Following the establishment of the Tribunal Administratif, Melun, the case was referred to that court, which had jurisdiction in the districts concerned.*

25 *Before the Tribunal Administratif, Melun, Sanofi maintained, in particular, that Decision 89/487, on which Article 236 of Annex II to the General Tax Code is based, was invalid. In that regard, it put forward five grounds of invalidity, four of which were rejected by the court. By its fifth plea Sanofi maintained that Decision 89/487 infringed the Community principle of proportionality.*

The questions referred to the Court

26 *In Case C-177/99 the Tribunal Administratif, Nantes, decided to stay the proceedings and to refer the following question to the Court:*

Since the resolution of this dispute depends on whether the provisions of the decision of the Council of the European Communities of 28 July 1989 authorising the French Government to derogate from the standstill introduced by Sixth Directive 77/388/EEC of the Council of the European Communities of 17 May 1977 and to extend to third parties exclusions of expenditure on accommodation, food, hospitality and entertainment from the right to deduct tax is compatible, first, with the objectives of the Sixth Directive and in particular Article 27 thereof, which states that "the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce special measures for derogation from the provisions of this directive, in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion and

avoidance", and, second, with the principle of proportionality between the tax objective pursued and the means employed; only the answer to that question, the solution of which is not obvious, will enable an assessment to be made of whether the pleas in this application are well founded.

27 In Case C-181/99 the Tribunal Administratif, Melun, held that:

It is common ground that the temporary authorisation to exclude from the right to deduct tax charged on all expenditure in respect of accommodation, food, hospitality and entertainment borne by a taxable person was not based on a finding of systematic tax evasion or avoidance resulting from such expenditure, but on the presumption arising from the mixed nature of the expenditure which makes it easily open to such abuse. Although the administrative authorities none the less cite as justification for that measure of systematic exclusion [of the right to deduct the VAT charged on such expenditure] the difficulty of putting in place an effective system for verifying the business nature of that expenditure, the deduction of the expenditure from profits subject to corporation tax or income tax, which is allowed under Article 39(5)(b) and (f) of the General Tax Code, is subject to such verification, by checks on the documents or on the premises, by the tax authorities subject to review by the court with jurisdiction in tax matters, the arrangements for which can clearly be transposed, notwithstanding the difference in the conditions of declaration and collection of the taxes in question. The objective pursued could also be achieved by a fixed limit on the amount of deductions authorised. Thus, having regard to the fact that that measure of derogation, which is general and absolute, precludes deduction of the tax charged on expenditure whose strictly business nature is not challenged, there is serious doubt as to whether the derogation granted to the French Republic by [Decision 89/487] is strictly necessary and proportionate to the objectives pursued.

28 It therefore decided to:

stay proceedings in the application for a refund of the taxes at issue pending a preliminary ruling by the Court of Justice of the European Communities on the validity, in the light of the principle of proportionality, of ... Decision [89/487].

29 By order of the President of the Fifth Chamber of 18 November 1999, the two cases were joined for the purposes of the oral procedure and the judgment.

The questions for the Court

30 By the questions which they have referred to the Court, both national courts essentially request the Court to rule on the validity of Decision 89/487.

31 Before examining the validity of Decision 89/487, it is appropriate to define its scope.

The scope of Decision 89/487

32 The plaintiffs in the main proceedings maintain that it follows from the actual wording of Decision 89/487, which reproduces the French Government's request for a derogation, that the derogation granted is general in scope and aimed at all expenditure in respect of accommodation, hospitality, food and entertainment, without distinguishing between whether it was incurred for the benefit of the management or staff of the undertaking or for that of persons not employed by the undertaking, or between whether it was incurred for business purposes or to satisfy private needs. Consequently, a ruling by the Court that Decision 89/487 is invalid would have the effect of rendering the exclusion of the right to deduct VAT charged on that type of expenditure wholly inapplicable in France.

33 The French Government and the Commission contend that even though Decision 89/487, which reproduces the French Government's request for a derogation, is aimed generally at

expenditure in respect of accommodation, hospitality, food and entertainment, in reality it is of more limited scope and aimed only at expenditure in respect of accommodation, hospitality, food and entertainment incurred for the benefit of persons not employed by the undertaking. That restrictive interpretation is based on the judgment in Alitalia, where the Conseil d'État held that Article 25 of Decree No 79-1163 was incompatible with Article 17(6) of the Sixth Directive only in so far as it excluded from the right to deduct VAT expenditure in respect of accommodation, food, hospitality and entertainment incurred for the benefit of persons not employed by the undertaking.

34 It should be pointed out that, according to the fundamental principle which underlies the VAT system, and which follows from Article 2 of the First and Sixth Directives, VAT applies to each transaction by way of production or distribution after deduction has been made of the VAT which has been levied directly on transactions relating to inputs (Case C-62/93 BP Soupergaz v Greek State [1995] ECR I-1883, paragraph 16). It is settled case-law that the right of deduction provided for in Article 17 et seq. of the Sixth Directive is an integral part of the VAT scheme and in principle may not be limited. That right must be exercised immediately in respect of all the taxes charged on transactions relating to inputs (see, in particular, the judgment in BP Soupergaz, cited above, paragraph 18, and Joined Cases C-110/98 to C-147/98 Gabalfrija and Others v AEAT [2000] ECR I-1577, paragraph 43). Any limitation on the right of deduction affects the level of the tax burden and must be applied in a similar manner in all the Member States. Consequently, derogations are permitted only in the cases expressly provided for in the directive (judgment in BP Soupergaz, cited above, paragraph 18).

35 It is against that background that the Court must assess the scope of Decision 89/487, which was adopted on the basis of Article 27 of the Sixth Directive, which provides that a Member State may be authorised to introduce special measures for derogation from the Sixth Directive in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance.

36 That decision authorises the French Republic to derogate from the rules of the Sixth Directive as regards the general principle of the right to deduct VAT set out in Article 17 of that directive.

37 In so far as it is based on Article 27 of the Sixth Directive, it must be held that Decision 89/487, notwithstanding the general terms of the derogation granted to the French Republic, authorises the latter to introduce in its national legal order, in relation to expenditure in respect of accommodation, hospitality, food and entertainment, certain exclusions from the right to deduct VAT which were not provided for in its laws when the Sixth Directive entered into force.

38 Such an interpretation is based on the wording of Article 27 of the Sixth Directive, which uses the word introduce and must be read in conjunction with the second subparagraph of Article 17(6) of that directive, which authorises Member States to retain the exclusions from the right of deduction provided for under their national laws when the Sixth Directive entered into force.

39 In that regard, it must be pointed out that the exclusions from the right to deduct VAT in existence prior to the entry into force of the Sixth Directive were subsequently retained unaltered in French law, which, moreover, extended the exclusion from the right of deduction to certain other situations. In those circumstances, expenditure which was already excluded from the right to deduct VAT pursuant to Decree No 67-604 must be regarded as being covered by the standstill clause in the second subparagraph of Article 17(6) of the Sixth Directive.

40 The derogation granted by Decision 89/487 therefore concerns in reality, first, expenditure in respect of accommodation, hospitality, food and entertainment incurred for the benefit of persons not employed by the undertaking, who were not referred to in Decree No 67-604, and, second, the part of the expenditure of the same type incurred for the benefit of the management and staff of the undertaking which was not covered by the exclusion resulting from Decree No 67-604. In that regard, it is significant that Decree No 67-604 excluded from the right to deduct VAT expenditure incurred in order to provide accommodation for the management or staff of the undertaking,

without distinguishing between expenditure incurred for business purposes and that incurred to satisfy individual needs, and expenditure in respect of hospitality, food and entertainment incurred to satisfy the individual needs of the management or staff of the undertaking.

41 Having defined the scope of the derogation granted by Decision 89/487, the Court will now consider the question of the validity of that decision in the light of the principle of proportionality, as requested by the national courts.

The validity of Decision 89/487

42 It should be pointed out at the outset that since the principle of proportionality has been consistently recognised by the Court as forming part of the general principles of Community law (see, in particular, Case 265/87 Schröder v Hauptzollamt Gronau [1989] ECR 2237, paragraph 21), the validity of acts of the Community institutions may be reviewed on the basis of that general principle of law (Case C-27/95 Bakers of Nailsea [1997] ECR I-1847, paragraph 17).

43 In order to do so, it is necessary to consider whether the provisions of Decision 89/487 are necessary and appropriate for the attainment of the specific objective which they pursue and whether they have the least possible effect on the objectives and principles of the Sixth Directive.

44 Ampafrance and Sanofi, which submit that Decision 89/487 is invalid, maintain, first, that it employs disproportionate means in order to combat tax evasion and avoidance in so far as it introduces a general and systematic exclusion from the right to deduct VAT, based on the presumption of a risk of tax evasion or avoidance based on the mixed (private and business) nature of the expenditure concerned. They contend that it is disproportionate to exclude certain expenditure from the right of deduction on the ground that such exclusion constitutes an anti-tax-evasion or avoidance measure without being required to prove that a risk of tax evasion or avoidance actually exists or allowing the taxable person to demonstrate the absence of tax evasion or avoidance by establishing that the expenditure was indeed incurred for business purposes.

45 Ampafrance further states that, in accordance with Case C-63/96 Finanzamt Bergisch Gladbach v Skripalle [1997] ECR I-2847, paragraph 30, the Council could not authorise the introduction of national derogations whose purpose was to attain objectives other than those restrictively listed in Article 27 of the Sixth Directive. In seeking authorisation from the Council to derogate from the rules of the Sixth Directive, the French authorities were not seeking to combat the risks of tax evasion and avoidance, but to put in place a mechanism which would obviate the requirement to check whether certain expenditure was incurred for business purposes or not.

46 Ampafrance and Sanofi maintain, second, that Decision 89/487 is incompatible with the principle of proportionality because the objective which it pursues could be attained by other means less detrimental to the principles and objectives of the Sixth Directive. Thus, there are other measures in French law which would allow the tax authorities to deal effectively with the problem of tax evasion and avoidance and which would be less onerous for taxable persons than a general and systematic exclusion from the right to deduct the VAT charged on the expenditure at issue.

47 In that regard, the plaintiffs in the main proceedings observe first of all that there was already a provision in French law which had the effect that VAT on expenditure incurred by taxable persons for private purposes was not deductible. Article 230(1) of Annex II to the General Tax Code thus provides that the VAT charged on goods and services which taxable persons acquire or supply to themselves is deductible only if those goods and services are necessary to the business.

48 Next, Ampafrance claims that French law incorporates a system for the effective control of the expenditure concerned, namely the system which makes it compulsory to attach a detailed return of general expenditure (Form No 2067) to the annual statement of results. That return includes five

categories of general expenditure, including the cost of food and entertainment.

49 Then, the plaintiffs observe that, in accordance with the provisions of French law on corporation tax (Article 39.1.1 of the General Tax Code), expenditure in respect of accommodation, food, hospitality and entertainment of a business nature may be deducted from profits before corporation tax is assessed where it is shown that the expenditure was incurred in the interests of the undertaking. It follows from the judgment making the reference in Case C-181/99 that where such expenditure is deducted from taxable profits the tax authorities may verify the business nature of the expenditure, either by examining the relevant documents or by visiting the taxable person's premises, subject to review by the court with jurisdiction in tax matters.

50 Last, according to Sanofi, it follows from the fourth recital in the preamble to Decision 89/487 that the authorisation granted to the French Republic to introduce measures derogating from the rules of the Sixth Directive on the right to deduct VAT could be granted only on a temporary basis and until such time as the Community rules determining expenditure not eligible for a deduction of VAT enter into force. The fact that the Council has been unable to adopt the provisions referred to in the first subparagraph of Article 17(6) of the Sixth Directive has caused that temporary situation to endure, in such a way that the derogation has inevitably become disproportionate to the aims which it pursued.

51 The French Government, the Council and the Commission dispute those arguments.

52 First, the Council and the French Government contend that Decision 89/487 is justified independently of the finding of intended or actual systematic tax evasion or avoidance. By its very nature, expenditure in respect of accommodation, hospitality, food and entertainment can be used as a means of tax evasion and avoidance owing to the risk that final consumption will not be subject to VAT, which is difficult for the authorities to control since it is not easy to determine whether such expenditure was incurred in order to satisfy business or private needs. It is relevant in that regard that the first subparagraph of Article 17(6) of the Sixth Directive provides that under the Community rules to be adopted VAT is in no circumstances to be deductible from expenditure which is not strictly business expenditure, such as that on luxuries, amusements or entertainment.

53 Second, the French Government, the Council and the Commission contend that the exclusion of the right to deduct VAT charged on expenditure in respect of accommodation, hospitality, food and entertainment is not a disproportionate means in the light of the objective of combating tax evasion and avoidance defined in Article 27 of the Sixth Directive since, in the present case, the exclusion of the right of deduction was expressly limited to situations in which there were genuine risks of tax evasion and avoidance, which correspond to situations in which it is impossible to determine whether the expenditure was of a business or a private nature.

54 The French Government and the Commission claim, on that point, that in their request for a derogation the French authorities limited the exclusion from the right to deduct VAT to expenditure in respect of which there is a serious risk of tax evasion and avoidance, since they requested that the authorisation to exclude the right to deduction should not apply to three situations in which such a risk of tax evasion or avoidance does not exist. On the basis of the same arguments, the Council submits that Decision 89/487, which reproduces the French Government's request word for word, satisfies the requirements formulated by the Court concerning proportionality between the means employed and the objectives pursued.

55 Last, according to the Council and the French Government, exclusion from the right to deduct the VAT charged on the expenditure referred to in Decision 89/487 is a necessary means of effectively attaining the objective pursued. The Council acknowledges that other means might have been contemplated, such as limiting authorised deductions to a fixed amount. The Council does not consider that method to be effective, however, since it could either have a minimum impact on the taxable person's situation where the amount is fixed at a very low level or fail to

attain the objective pursued in the opposite case of a very high amount. The French Government claims that the exclusion of the right to deduct VAT charged on expenditure in respect of accommodation, hospitality, food and entertainment is necessary for attaining the objective of combating tax evasion and avoidance defined in Article 27 of the Sixth Directive, since no other satisfactory means which exists would allow the nature of the expenditure in question to be checked.

56 As regards the argument that the exclusion of the right of deduction is justified by the fact that it is impossible to control effectively the business or other nature of the expenditure at issue and that it is therefore designed to combat tax evasion and avoidance, it should be pointed out that it may prove difficult to distinguish between the private element and the business element of expenditure such as that relating to accommodation, food, hospitality and entertainment, even where it is incurred in connection with the normal operation of the undertaking. It cannot be disputed that there may be a risk of tax evasion or avoidance justifying special measures of the type which Member States may be authorised to introduce pursuant to Article 27 of the Sixth Directive. However, that risk does not exist where it follows from objective evidence that the expenditure was incurred for strictly business purposes.

57 For that reason, the arguments put forward by the French Government, the Council and the Commission and set out in paragraphs 53 and 54 of this judgment cannot be accepted. The fact is that, notwithstanding the three exceptions referred to in Article 1(2), Decision 89/487 authorises the French Republic to deny traders the right to deduct the VAT charged on expenditure which they are able to show to be of a strictly business nature.

58 It follows that the application of the system of exclusion of the right of deduction authorised by Decision 89/487 may have the effect that undertakings are unable to deduct the VAT charged on business expenditure which they have incurred and that VAT is thus charged on certain forms of intermediate consumption, contrary to the principle of the right to deduct VAT, which ensures the neutrality of that tax.

59 As regards the necessary nature of the requested exclusion of the right to deduct, it must be pointed out, first, that Decision 89/487 does not state the reasons for which the derogation requested by the French Government was necessary to prevent certain tax evasion or avoidance.

60 Second, it should be observed that in order for a Community measure concerning the VAT system to be compatible with the principle of proportionality, the provisions which it embodies must be necessary for the attainment of the specific objective which it pursues and have the least possible effect on the objectives and principles of the Sixth Directive.

61 A measure which consists in excluding as a matter of principle all expenditure in respect of accommodation, hospitality, food and entertainment from the right to deduct VAT, which is a fundamental principle of the VAT system established by the Sixth Directive, although appropriate means less detrimental to that principle than the exclusion of the right of deduction in the case of certain expenditure can be contemplated or already exist in the national legal order, does not appear to be necessary in order to combat tax evasion and avoidance.

62 Although it is not for the Court to comment on the appropriateness of other means of combating tax evasion and avoidance which might be contemplated, including limiting authorised deductions to a fixed amount or introducing a control modelled on that employed in connection with income tax or corporation tax, it must be pointed out that, as Community law now stands, national legislation which excludes from the right to deduct VAT expenditure in respect of accommodation, hospitality, food and entertainment without making any provision for the taxable person to demonstrate the absence of tax evasion or avoidance in order to take advantage of the right of deduction is not a means proportionate to the objective of combating tax evasion and avoidance and has a disproportionate effect on the objectives and principles of the Sixth Directive.

63 Consequently, the answer to the questions referred by the Tribunal Administratif, Nantes, and the Tribunal Administratif, Melun, must be that Decision 89/487 is invalid.

Limitation of the temporal effects of the judgment

64 At the hearing, the French Government referred to the possibility that, in the event that the Court should rule that Decision 89/487 was contrary to the principle of proportionality, it might limit the temporal effects of the present judgment.

65 In support of that request, the French Government referred to the legitimate expectation which it was entitled to entertain as to the compatibility with Community law of Decision 89/487. In that regard, it observes that it complied with the framework prescribed in Article 27 of the Sixth Directive and first obtained an endorsement from the Commission and then a decision from the Council authorising the French authorities to apply, by way of derogation and pending the adoption of the harmonised system on exclusions from the right to deduct VAT, an exclusion of the right of deduction concerning expenditure in respect of accommodation, food, hospitality and entertainment incurred for the benefit of persons not employed by the undertaking. The Commission's endorsement and the Council decision led the French Government to entertain unfounded hopes that Decision 89/487 was compatible with Community law.

66 It should be observed 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 restrict for any person concerned the opportunity of relying upon the provisions thus interpreted with a view to calling in question legal relationships established in good faith. As the Court has consistently held, such a restriction may be allowed only in the actual judgment ruling upon the interpretation sought. In determining whether or not to limit the temporal effect of a judgment it is necessary to bear in mind that although the practical consequences of any judicial decision must be weighed carefully, the Court cannot go so far as to diminish the objectivity of the law and compromise its future application on the ground of the possible repercussions which might result, as regards the past, from a judicial decision (judgments in Case 24/86 *Blaizot v University of Liège and Others* [1988] ECR 379, paragraphs 28 and 30, and Case C-163/90 *Administration des Douanes et Droits Indirects v Legros and Others* [1992] ECR I-4625, paragraph 30).

67 As regards the present references for a preliminary ruling, it should be observed that this is the first time that the principle of legitimate expectations has been invoked by a Government in support of a request to limit the temporal effects of a judgment. That principle, which is the corollary of the principle of legal certainty (judgments in Case C-63/93 *Duff and Others v Minister for Agriculture and Food, Ireland, and the Attorney General* [1996] ECR I-569, paragraph 20, and Case C-107/97 *Rombi and Arkopharma* [2000] ECR I-3367, paragraph 66), is generally relied upon by individuals (traders) in a situation where they have legitimate expectations created by the public authorities (see, for example, the judgment in *Duff and Others*, cited above, paragraph 22, and the case-law cited there). As the Advocate General observes in point 83 of his Opinion, the principle of legitimate expectations cannot be relied on by a Government in order to avoid the consequences of a decision of the Court declaring a Community provision invalid, since it would

jeopardise the possibility for individuals to be protected against conduct of the public authorities based on unlawful rules.

*68 In any event, even though in the present case the Commission and the Council endorsed the French authorities' request to derogate from the rules of Article 17 of the Sixth Directive for reasons associated with the fight against tax evasion and avoidance, the case-law of the Court clearly requires that secondary law must comply with the general principles of law, and in particular the principle of proportionality (see, in that regard, the judgments in Case 114/76 *Bela-Mühle v Grows-Farm* [1977] ECR 1211, paragraphs 5 to 7, and Case C-361/96 *Grandes Sources d'Eaux Minérales Françaises v Bundesamt für Finanzen* [1998] ECR I-3495, paragraph 30). In particular, the Court has already held that a measure based on Article 27 of the Sixth Directive and designed to prevent tax evasion or avoidance could not derogate from a principle laid down in the Sixth Directive, except within the limits strictly necessary for attaining that objective (see, in that regard, Case 324/82 *Commission v Belgium* [1984] ECR 1861, paragraph 29), and was therefore required to observe the principle of proportionality.*

69 In the present case the French authorities largely contributed to the determination of the content of Decision 89/487, which reproduced word for word their request for a derogation (points 9 and 10 of the letter of 13 April 1989), with the effect that there were authorised, as a special measure intended to prevent tax evasion and avoidance, to exclude the exclusion from the right of deduction the VAT paid on inputs even where the expenditure concerned is demonstrably of a strictly business nature. In those circumstances, the French authorities could not fail to be aware that, by its content, Decision 89/487 was not compatible with the principle of proportionality and, consequently, cannot argue that they could reasonably believe that that decision was valid.

70 In those circumstances, it is not appropriate to limit the temporal effects of the present judgment.

Decision on costs

Costs

71 The costs incurred by the French Government, the Council and the Commission which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national courts, the decision on costs is a matter for that courts.

Operative part

On those grounds,

THE COURT (Fifth Chamber)

in answer to the questions referred to it by the Tribunal Administratif, Melun, by judgment of 3 December 1998 and by the Tribunal Administratif, Nantes, by judgment of 11 May 1999, hereby rules:

Council Decision 89/487/EEC of 28 July 1989 authorising the French Republic to apply a measure derogating from the second subparagraph of Article 17(6) of the Sixth Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes is invalid.

