European Union
Belgium

Preliminary ruling in ECJ's case in Promo 54: Did the referring court ask the right question?

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Summary

In April 2022, the Belgian Cassation Court raised a preliminary question to the ECJ which concerns the application of the VAT exemption foreseen under article 135(1)(j), of the VAT Directive (exemption concerning the supply of immovable property) in the specific case of renovated buildings. The question raised may, at first sight, look like a technical question mostly relevant for the Belgian practice. However, in this article the author suggests that this question would be a good occasion for the ECJ to clarify what exactly is the margin of manoeuvre of Member States, when it comes to taxing the supply of renovated buildings.

1. Introduction

Contrary to other Member States, Belgium never laid down in its VAT legislation the criteria that must be used to determine whether a renovated building can be considered as "new" for VAT purposes – and therefore subject to VAT. These criteria are only to be found in the Belgian administrative doctrine (known as the "VAT Commentary"). One could argue that, in the absence of a clear legislative provision, it should be concluded that the supply of a renovated building could never be subject to VAT in Belgium, irrespective of the extent of the renovation.

The question has been raging for many years in Belgium. In 2020, the Belgian Cassation Court (the referring court) had the opportunity to decide on the matter or to raise a question to the Court of Justice of the European Union (ECJ), albeit it refrained from doing so.[1] It eventually did it on 5 April 2022 (date of the application), when it raised the following question in what is now case C-239/22 Promo 54[2]:

> "Must Article 12(1) and (2) and Article 135(1)(j) of Directive 2006/112/EC be interpreted as meaning that, where the Member State has not defined the detailed rules for the application of the criterion of first occupation to converted immovable property, the supply, after conversion, of a building in respect of which, before conversion, there had been first occupation within the meaning of Article 12(1)(a) or

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1 BE: Cass. [Supreme Court], 29 May 2020, ECLI:BE:CASS:2020:CONC.20200529.1F.5.

2 The decision to refer a question to the ECJ is dated 28 March 2022, ECLI:BE:CASS:2022:ARR.20220328.3F.6.

> the third subparagraph of Article 12(2) of the directive remains exempt from value added tax?"

In section 2 of this article the author provides an overview of the applicable rules, both in the VAT Directive (section 2.1.) and in Belgium (Section 2.2.). In section 3, she discusses the possible answers that could be offered by the ECJ to the question raised by the referring court in case Promo 54, as well as to the sub-questions that were (unfortunately) not raised by the referring court but to which, in the author's opinion, an answer of the ECJ would also be most welcome.

2. Relevant provisions in the EU and Belgian law

2.1. EU law

The EU VAT treatment of real estate is complex, as an exemption combined with several options are foreseen under the VAT Directive (2006/112/EC)[3].

The supply of immovable property is in principle VAT exempt under article 135(1)(j), of the VAT Directive.[4] However, there is an exception to the exemption for the supply of buildings "supplied before their first occupation".[5] Article 12(2) second sentence of the VAT Directive provides that Member States may lay down the detailed rules for applying this criteria of "first occupation" (which primarily concerns newly erected buildings) to renovated buildings. [6] In accordance with Article 12(2) third sentence of the VAT Directive, Member States may also adjust the criteria of "first occupation" (both for newly erected or for renovated buildings), for example by setting a deadline starting with the date of first occupation, with the consequence that a building can remain "new" for VAT purposes for several months even after it has started being occupied.[7] Different criteria are therefore likely to be used across the Member States to define "new buildings" (including renovated buildings) for VAT purposes.

Finally, Member States may allow a right of option for taxation of buildings considered as "other than new buildings" under the VAT Directive.[8]

2.2. Belgian Law, administrative guidance and case law

What the law says

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[3] Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax, OJ L347 (2006), Primary Sources IBFD [hereinafter VAT Directive].

[4] Art. 135(1)(j) VAT Directive reads as follows: "1. Member States shall exempt the following transactions: (…) (j) the supply of a building or parts thereof, and of the land on which it stands, other than the supply referred to in point (a) of Article 12(1)".

[5] In accordance with art. 12(1) VAT Directive to which art. 135(1)(j) VAT Directive refers, *see* previous footnote.

[6] Art. 12(2) second sentence VAT Directive reads as follows: "Member States may lay down the detailed rules for applying the criterion referred to in paragraph 1(a) to conversions of buildings (…)".

[7] Art. 12(2) third sentence VAT Directive reads as follows: "Member States may apply criteria other than that of first occupation, such as the period elapsing between the date of completion of the building and the date of first supply, or the period elapsing between the date of first occupation and the date of subsequent supply, provided that those periods do not exceed five years and two years respectively".

[8] In accordance with art. 137(1)(b) VAT Directive.

Article 44(§3)(1°)(a) of the Belgian VAT Code[9] provides that the supply of immovable property is exempt from VAT, except when the supply:

- is made by a property developer[10] (or by any other taxable person or an occasional taxable person in the sense of article 12(1)(a) of the VAT Directive who opts for taxation); <u>and</u>

- it takes place at the latest on the 31st of December of the second year following the year during which the first occupation took place (which is thus how the Belgian legislator defines "new buildings" for VAT purposes)[11].

As already mentioned above, article 12(2) second sentence of the VAT Directive provides that: "Member States may lay down the detailed rules for applying the criterion [of first occupation] to conversions of buildings (…)". The Belgian VAT legislator has not explicitly implemented this provision. The Belgian VAT legislation does indeed not specify *if* and *under which conditions* renovated buildings can be treated as new buildings subject to a "first use" and whose supply would therefore be subject to VAT.

What the administrative doctrine says

In practice, however, supplies of thoroughly renovated buildings are likely to be subject to VAT in Belgium. Whether these supplies are subject to the tax is decided based on the criteria laid down in the "VAT Commentary", which is the administrative interpretation of the legislation, itself based on two administrative decisions and a Circular dated 28 June 1973[12] (thus adopted 4 years before the Sixth VAT Directive[13] was adopted). Pursuant to this administrative guidance, which is binding for the administration but not for the national courts (and which therefore may be challenged by the taxable persons), three situations must be distinguished.

A first situation concerns buildings which have undergone a "radical change" in their essential elements, namely in their nature, their structure (bearing walls, floors, stairwells or elevators ...) and, if necessary, their destination. In such case the cost of the work is not relevant. Their supply is without any doubt subject to VAT.

A second situation concerns buildings which have undergone works which have not "altered them in their essential elements" but have rather been aimed either at ensuring the conservation of the property or at increasing its comfort (e.g. installation of central heating, of a bathroom, renewal of the roof). The supply of such a building cannot be subject to VAT, even in situations where the cadastral income (i.e. estimated rental value) of the property has

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[9] BE: VAT Code, 1969, Primary Sources IBFD [hereinafter VAT Code].

[10] More exactly someone who regularly supplies immovable property that they have built or acquired from third parties with VAT.

[11] In accordance with the margin of maneuvers that is given to Member States under art. 12(2) third sentence VAT Directive.

[12] Administrative doctrine published in the form of a "VAT commentary", available on the Ministry of Finance website. *See* also BE: Circular 16/73 and decisions E.T. 19/496 of 20 February and 29 April 1976.

[13] Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, OJ L145 (1977), Primary Sources IBFD [hereinafter Sixth VAT Directive].

been increased and the cost of the work undertaken is very high in relation to the value of the building before the renovation.

The administrative guidance then identifies a third situation, in which “it may be accepted” to apply VAT. This situation concerns buildings which have undertaken renovation works that entail “a significant modification”. In this case the VAT Commentary states that: “it is in most cases difficult to assess whether the property has undergone a radical change in its essential elements, within the meaning of what is mentioned in the first case, above”. In these situations, the tax administration considers that the building may be considered as new for VAT purposes if the cost (excluding VAT) of the work carried out reaches at least 60% of the market value of the building to which the work is carried out, excluding land, at the time of completion of the work. When doing this calculation one must take into account, on the one hand, only the value of the material work carried out (i.e. excluding in particular intellectual work, such as the fees of an architect or a safety coordinator), including demolition work essential to the building or the building fraction itself and, on the other hand, the market value of the building. In order for the subsequent supply of that converted building to be subject to VAT, it is also required that the renovation resulted in the modification of the cadastral income that was allocated to the building.

What the domestic case law says

National courts largely cite and follow the administrative guidance outlined above in their decisions, even though they usually recall that the guidance cannot be considered as “binding” for them.[14]

A consistent number of case law by the national courts (largely in line with the administrative VAT Commentary) does admittedly not amount to a clear legal text and the question may thus legitimately be raised whether in these circumstances (i.e. no clear legal text assimilating renovated building to new buildings for VAT purposes), the exemption should not be deemed to apply without exception.

At the same time, the text of the Belgian VAT Code concerning new buildings can be interpreted as including the situation of renovated buildings. In the decision challenged before the Cassation Court, the Court of Appeal had decided that (unofficial translation): “from the concept of “new building” referred to in [the VAT Code] it follows that an old building may become new again and be subject to a first occupation if it has undergone significant transformation; a transposition of Article 12(2) of the VAT Directive is therefore not necessary”.[15]

It is against this background that the Belgian Cassation Court asked the ECJ whether, in the case where a Member State has not defined “the detailed rules” for the application of the

[14] Some judges may however add a nuance to the criteria proposed by the administration. For example, it was recently decided that the criteria of the cost of the renovation as compared to the value of the building before the renovation was not relevant in the case of a classified historic building, because the costs in such case may not accurately reflect the extent of the renovation. Court of Appeal of Liège, decision dated 3 May 2021. Unpublished.

[15] BE: C.A. [Court of Appeal] of Liège, 4 June 2019, ref. 2016/RG/348.

criterion of first occupation to renovated immovable property, one should consider that there can be no exception to the exemption provided for under the VAT Directive.

3. Analysis of the preliminary ruling request and possible answers

Drafting a preliminary question for the ECJ is a difficult exercise. The question should be as clear and complete as possible, because the ECJ might be tempted to restrict itself to only answering the question that was asked without addressing potential “sub-questions” that may be relevant, but that were not formally raised.[16] In other words, it is recommended to ask detailed questions and to add sub-questions if necessary, because the ECJ might not seek to look beyond the consequences of the question formally asked.

In Promo 54, in which the referring court asked whether a Member State should define “detailed rules” to be able to treat renovated buildings as “new buildings” for VAT purposes, the ECJ might simply decide that the wording of the Belgian VAT Code, referring to “first occupation”, is sufficient and can be applied to renovated buildings that are capable of being subject to a “first occupation” under “their new form” without a specific transposition of article 12(2) of the VAT Directive (thereby endorsing the interpretation of the Court of Appeal decision that was challenged before the (referring) Supreme Court, *see* above in section 2.2.).

The ECJ could also decide that in the absence of “detailed rules”, the exception to the exemption may not apply. In that case, we can only hope that the ECJ would also clarify whether the existence of clear administrative guidance consistently applied by the national courts does - or does not - amount to the provision of “detailed rules” by a Member State. One could indeed argue that Belgium does consistently tax the supply of thoroughly renovated buildings based on criteria detailed in the administrative guidance and consistently taken into consideration by the national courts, and that this is a proper way to implement article 12(2), second sentence of the VAT Directive.

This would seem to be in line with previous case law of the ECJ. In its decision in case C-300/95, Commission v. UK (a non-VAT case), the ECJ decided that: “the scope of national laws, regulations or administrative provisions must be assessed in the light of the interpretation

[16] One famous example is the ECJ decision in DK: ECJ, 20 Nov. 2003, Case C-8/01, *Assurandør-Societet, acting on behalf of Taksatorring, v. Skatteministeriet*, Case Law IBFD (accessed 13 Dec. 2022) in which the Court provided answers as to how interpret the condition that the exemption of transactions performed between members of a cost sharing group should not give rise to distortions of competition, without clarifying to the referring court that the exemption in the case that was at stake should not apply anyway, because the members of the cost-sharing group were insurance companies and that taxable persons providing exempt financial services should not be allowed to rely on the cost-sharing exemption. The ECJ only clarified this “small detail” 14 years later in the cases LV: ECJ, 21 September 2017, C-326/15, *DNB BANKA' AS Valsts ienemumu dienests* and PL: ECJ, 21 Sept. 2017, Case C-605/15, *Minister Finansów v. Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*, Case Law IBFD (accessed 13 Dec. 2022), where the question was directly raised. More recently, *see* LT: ECJ, 15 Sept. 2022, Case C-227/21, *'HA.EN.' UAB v. Valstybinė mokesčių inspekcija*, Case Law IBFD (accessed 13 Dec. 2022), the AG raised a key sub-question that was not addressed by the ECJ, which concerns the possibility of netting in the case of VAT payment and that would be of key importance for the referring court to eventually take a decision.

given to them by national courts".[17] One may also remember that in the Comune di Carpaneto Piacentino case[18] the ECJ decided that (emphasis added):

> "Member States are required to ensure that bodies subject to public law are treated as taxable persons in respect of activities in which they engage as public authorities where those activities may also be engaged in, in competition with them, by private individuals, in cases in which the treatment of those bodies as non-taxable persons could lead to significant distortions of competition, <u>but they are not obliged to transpose that criterion literally into their national law</u> or to lay down precise quantitative limits for such treatment".

In Belgium, the criteria to determine whether there might be significant distortion of competition is again not specified in the legislation, but only in the VAT Commentary (the administration considers that there is no risk of distortion when the turnover related to the activity does not exceed EUR 25,000, which is also the threshold for the small businesses exemption) and nobody seems to challenge that way of implementing the VAT Directive.

A decision of the ECJ as to whether detailed administrative guidance consistently applied by the national courts constitutes a proper implementation of Article 12(2), second sentence of the VAT Directive would thus be welcome if the ECJ were to decide that "detailed rules" are needed for the exception to the exemption to apply.

Going further, in the author's view, a key question that should be clarified by the ECJ in this case is whether, under a proper interpretation of article 12(2), of the VAT Directive, the taxation of the supply of thoroughly renovated building is an *option* or an *obligation* for the Member States. In other words: is the exclusion of renovated building from the scope of the exemption merely *a possibility* left to the Member States?, or is it *required* by the VAT Directive?, only leaving the Member States the choice of the criteria to be used to define how renovated buildings become "new" for VAT purposes.

In the author's opinion, this latter interpretation (i.e. the Member States must tax the supply of thoroughly renovated buildings but may chose the criteria to be used to assimilate renovated buildings to new buildings for VAT purposes) is the correct one. Exemptions are exceptions to the general principle of taxation of supplies of goods and services and, for that reason, their scope of application should be interpreted strictly and taking into account the reason of the exemption. As clarified by the ECJ in Kozuba[19], the *ratio legis* for the exemption of the supply of immovable property is:

> "(…) the relative lack of added value generated by the sale of an old building. Even though it raises the concept of 'economic activity', within the meaning of Article 9 of the VAT Directive, the sale of a building following its first supply to a final consumer, which marks the end of the production process, does not generate any significant

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[17] UK: ECJ, 29 May 1997, Case C-300/95, *Commission v. United Kingdom*, para. 37, with reference to UK: ECJ, 8 June 1994, *Commission v United Kingdom*, para. 36, ECR I-2435.

[18] IT: ECJ, 17 Oct. 1989, Case C-231/87, *Ufficio distrettuale delle imposte dirette di Fiorenzuola d'Arda e.a v Comune di Carpaneto Piacentino and Others*, ECLI:EU:C:1989:381.

[19] PL: ECJ, 16 Nov. 2017, Case C-308/16, *Kozuba Premium Selection sp. z o.o v. Dyrektor Izby Skarbowej w Warszawie*, Case Law IBFD (accessed 13 Dec. 2022).

added value and must therefore, as a rule, be exempt (see, to that effect, judgment of 4 October 2001, *'Goed Wonen'*, C-326/99, EU:C:2001:506, paragraph 52)."[20]

In other words, it is the absence of added value when an "old building" is sold that justifies the exemption. Logically, therefore, thoroughly renovated buildings should not benefit from the exemption, as in this case there is indeed an addition of value through the renovation works.

Following this reasoning, Belgium would in fact have no choice but to tax the supply of thoroughly renovated buildings, and failure to do so might expose it to an action for infringement. Such a decision would then be relevant for all Member States (as it would mean that none of them actually have the possibility not to tax these supplies)[21].

4. Conclusion

In this article, the author argued that the question raised in case C-239/22 Promo 54 would be a good opportunity for the ECJ to clarify what exactly is the margin of manoeuvre of Member States when it comes to taxing with VAT the supply of renovated buildings.

The author fears however that, because of the way the question was raised by the referring court, the answer that will be given by the ECJ might not be entirely useful, as the ECJ might fail to clarify (as it was not expressly asked to) whether a consistent number of case law interpreting a general provision of the Belgium VAT Code amounts to a proper implementation of the VAT Directive.

The ECJ may also fail to clarify (as it was not asked to) whether taxing the supply of thoroughly renovated buildings is – or is not – an option under the VAT Directive. In view of the *ratio legis* of the exemption, the author suggests that Member States are in fact not allowed to exempt thoroughly renovated buildings that can be subject to a first use under their new form.

Accordingly, the questions that should, in the author's view, have been raised to the ECJ in the Promo 54 case are, in essence, the following:

- Should Belgium expressly foresee in its VAT legislation the conditions under which thoroughly renovated buildings are to be subject to VAT or should we consider that a consistent practice and case law is a suitable implementation of article 12(2) second sentence of the VAT Directive?
- If a legislative provision is needed,
    - does the absence of such a legislative provision mean that the supply of thoroughly renovated buildings should always be VAT exempt?; or
    - should Belgium remedy this omission, because it does not have the option to not tax the supply of thoroughly renovated buildings?

We may still hope that the ECJ will, in the interest of harmonisation and with a view to enable the referring Court to take the appropriate decision, answer all these questions.

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[20] *Kozuba Premium Selection* (C-308/16), para 31.

[21] In this sense *see* article …., which analyses similar challenges arising from the interpretation of the exemption on "old buildings" given by Spain.