

OPINION OF ADVOCATE GENERAL
SHARPSTON

delivered on 11 December 2008¹

1. In accordance with Community VAT legislation as interpreted by the Court, a person who builds a house for use in part for the purposes of a taxable business and in part for private purposes is entitled to assign the whole house to his business, thus obtaining an immediate right to deduct full input VAT on the building costs. He must then treat his private use of part of the house as a supply for consideration, subject to output VAT. Even so, that arrangement may give him a financial advantage over a person building a similar house for which no taxable business use is envisaged and for which, therefore, no right to deduct input tax arises.

amended on the basis of a mistaken understanding of the Court's case-law.

Relevant Community law

The basic provisions

2. In this reference for a preliminary ruling, the Austrian Verwaltungsgerichtshof (Higher Administrative Court) queries whether that advantage is compatible with the principle of equal treatment or the Community rules on State aid. It also raises questions as to the validity of a national exclusion from the right to deduct predating the entry into force of the Community VAT legislation but subsequently

3. The case before the national court concerns a house built between 2002 and 2004, so that the relevant Community legislation is the Sixth VAT Directive.²

2 — 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, amended on numerous occasions; 'the Sixth Directive'). It has been replaced, with effect from 1 January 2007, by Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1), the aim of which is to present the applicable provisions clearly and rationally in a recast structure and wording without, in principle, bringing about material changes in the existing legislation. Cross-references below to provisions of Directive 2006/112 do not therefore imply identity of wording with the equivalent provisions of the Sixth Directive.

1 — Original language: English.

4. Under Article 2(1) of that directive,³ any 'supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such' is subject to VAT. Pursuant to Article 11A(1)(a),⁴ the taxable amount is, as a general rule, essentially the whole amount of the consideration received.

transactions, that is to say those listed in particular in Article 13 of the Sixth Directive,⁷ or for the purpose of transactions which fall entirely outside the scope of VAT, such as those which are not effected for consideration, or not carried out by a taxable person acting as such.

The problems of mixed use

5. However, pursuant to Article 17(2),⁵ a taxable person is entitled to deduct from the tax which he is liable to pay ('output tax') any VAT due or paid in respect of goods or services supplied or to be supplied to him by another taxable person ('input tax'), in so far as those goods or services are used for the purposes of his taxable (output) transactions. Under Article 17(1),⁶ the right to deduct input tax arises at the time when the deductible tax becomes chargeable (that is to say, essentially, when the inputs are acquired rather than when the outputs are supplied).

7. A number of provisions deal with aspects of the difficulties which could arise from the fact that, for whatever reason, taxed supplies of goods or services made to a taxable person may be used partly for taxed output transactions and partly for other purposes. Clearly, in such situations, it is important to maintain the distinction between taxed and other transactions and the correspondence between deductions of input tax and charging of output tax.

6. Because the right to deduct arises only in respect of supplies used for the purpose of taxed transactions, there is no such right if they are used for the purpose of exempt

8. Two types of mixed use are dealt with. On the one hand, there are situations in which a taxable person acquires supplies in the course

3 — See Article 2(1)(a) and (c) of Directive 2006/112.

4 — See Article 73 of Directive 2006/112.

5 — See Article 168(a) of Directive 2006/112.

6 — See Article 167 of Directive 2006/112.

7 — See Articles 131 to 137 of Directive 2006/112. In particular, Article 13B(b) of the Sixth Directive exempts the leasing and letting of immovable property; however, Article 13C(a) authorises Member States to allow taxable persons a right of option for taxation for such leasing and letting (Articles 135(1)(l) and 137(1)(d) of Directive 2006/112).

of his business and uses them partly for business and partly for non-business purposes. On the other, there are those in which a business makes both outputs which are taxed and outputs which are not taxed.

- (a) the use of goods forming part of the assets of a business for the private use of the taxable person or of his staff or more generally for purposes other than those of his business where the value added tax on such goods is wholly or partly deductible;

9. First, therefore, with regard to private use of business goods and comparable situations, Article 5(6) of the Sixth Directive⁸ provides: 'The application by a taxable person of goods forming part of his business assets for his private use or that of his staff, or the disposal thereof free of charge or more generally their application for purposes other than those of his business, where the value added tax on the goods in question or the component parts thereof was wholly or partly deductible, shall be treated as supplies made for consideration.'

- (b) supplies of services carried out free of charge by the taxable person for his own private use or that of his staff or more generally for purposes other than those of his business.

Member States may derogate from the provisions of this paragraph provided that such derogation does not lead to distortion of competition.'

10. Similarly, as regards services, Article 6(2)⁹ provides:

'The following shall be treated as supplies of services for consideration:

11. Thus, subject to that possibility of a derogation in the case of Article 6(2), those two provisions mean that where a taxable person supplies goods or services to himself from his business but for his non-business use, having deducted the input tax on the supplies he acquired for that purpose, he must in effect charge himself VAT on the transaction.

⁸ — See Article 16 of Directive 2006/112.

⁹ — See Article 26 of Directive 2006/112.

12. The taxable amount in such cases is determined according to Article 11(A)(1)(b) and (c),¹⁰ in accordance with which it is to be:

13. Second, Article 17(5) of the Sixth Directive¹¹ deals with situations where goods or services are used by a taxable person both for transactions in respect of which VAT is deductible and for those in respect of which it is not. In such cases, according to the first subparagraph, ‘only such proportion of the value added tax shall be deductible as is attributable to the former transactions’.

‘ ...

(b) in respect of supplies referred to in Article 5(6) ..., the purchase price of the goods or of similar goods or, in the absence of a purchase price, the cost price, determined [at] the time of supply;

(c) in respect of supplies referred to in Article 6(2), the full cost to the taxable person of providing the services;

14. Under the second subparagraph, that proportion is in principle to be determined in accordance with Article 19¹² — which defines it essentially as a fraction equivalent to turnover in VAT-deductible transactions divided by total turnover.¹³

¹¹ — See Article 173 of Directive 2006/112.

¹² — See Articles 174 and 175 of Directive 2006/112.

¹³ — However, Article 17(5) also allows Member States to vary that rule within certain limits. In particular, there is an option of separate accounting for the taxable and non-taxable parts of the business, and an option of determining the deductible proportion of the input tax according to the use to which the supplies are put — for example, half of the input tax would be deductible in respect of goods half of which were used for taxable outputs and half for non-taxable outputs, regardless of the relative value of the two sets of outputs.

¹⁰ — See Articles 74 and 75 of Directive 2006/112.

15. In addition, Article 20(1) and (2) of the Sixth Directive¹⁴ provides for the amount of deductions of input tax to be adjusted where appropriate:

only in respect of one fifth of the tax imposed on the goods. The adjustment shall be made on the basis of the variations in the deduction entitlement in subsequent years in relation to that for the year in which the goods were acquired or manufactured.

'1. The initial deduction shall be adjusted according to the procedures laid down by the Member States, in particular:

By way of derogation from the preceding subparagraph, Member States may base the adjustment on a period of five full years starting from the time at which the goods are first used.

(a) where that deduction was higher or lower than that to which the taxable person was entitled;

In the case of immovable property acquired as capital goods, the adjustment period may be extended up to 20 years.'

(b) where after the return is made some change occurs in the factors used to determine the amount to be deducted ...

The Court's case-law on mixed use of capital goods

2. In the case of capital goods, adjustment shall be spread over five years including that in which the goods were acquired or manufactured. The annual adjustment shall be made

16. The Court has had several occasions to consider the interpretation of the above provisions of the Sixth Directive with regard

¹⁴ — See Articles 184 to 192 of Directive 2006/112.

to mixed use of capital goods, in particular buildings, most recently in *Wollny*. Other significant judgments are those in *Lennartz*, *Armbrrecht*, *Bakcsi*, *Seeling* and *Charles*.¹⁵

17. In *Lennartz*, the Court established the principle that a taxable person who uses goods for the purposes of an economic activity has a right, on the acquisition of those goods, to deduct input tax in accordance with Article 17 of the Sixth Directive, however small the proportion of business use.¹⁶

18. In *Seeling*, the Court decided that private use by a taxable person of part of a building which is treated as forming, in its entirety, part of the assets of his business must be treated as a taxable supply of services (in accordance with Article 6(2) of the Sixth Directive) and cannot be regarded as a leasing or letting of property (which would have been exempt pursuant to Article 13B(b)).¹⁷

19. In *Charles*, the Grand Chamber confirmed that case-law, in particular stating clearly that, where capital goods are used both for business and for private purposes the taxpayer has the choice, for the purposes of VAT, of (i) allocating those goods wholly to the assets of his business, (ii) retaining them wholly within his private assets, thereby excluding them entirely from the system of VAT, or (iii) integrating them into his business only to the extent to which they are actually used for business purposes. It held, in that context, that Articles 6(2) and 17(2) and (6) of the Sixth Directive preclude national legislation which does not allow a taxable person to allocate such goods wholly to his business and, where appropriate, to deduct immediately and in full the VAT due on their acquisition.¹⁸

20. Finally, in *Wollny*, the Court accepted that, where a building forming part of the taxable person's business assets is used in part for private purposes, the taxable amount for the deemed supply under Article 6(2) of the Sixth Directive may be calculated as, in effect, a percentage of the total cost of acquisition and construction of the building, representing the portion given over to private use, spread over the period for adjustment of the initial deduction under Article 20. Such a solution, it pointed out, serves the interests of equality between taxable persons and final consumers by avoiding certain cases of untaxed end use.¹⁹

15 — Case C-97/90 *Lennartz* [1991] ECR I-3795; Case C-291/92 *Armbrrecht* [1995] ECR I-2775; Case C-415/98 *Bakcsi* [2001] ECR I-1831; Case C-269/00 *Seeling* [2003] ECR I-4101; Case C-434/03 *Charles and Charles-Tijmens* [2005] ECR I-7037; Case C-72/05 *Wollny* [2006] ECR I-8297.

16 — In particular at paragraphs 26 to 28 and 35 of the judgment.

17 — Paragraphs 40 to 56 of the judgment.

18 — Paragraphs 23 and 36 of the judgment.

19 — Paragraphs 20 to 53 of the judgment, in particular paragraphs 48 and 53.

21. It may be noted, however, that the Commission has proposed to the Council the insertion of a new Article 168a in Directive 2006/112,²⁰ to read as follows:

‘In the event of acquisition, construction, renovation or substantial transformation of immovable property, the initial exercise of the right of deduction arising when the tax becomes chargeable shall be limited to the proportion of the property’s effective use for transactions giving rise to a right of deduction.

By way of derogation from Article 26, [²¹] the changes in the proportion of use of immovable property referred to in the first paragraph shall be taken into account under the conditions provided for in Articles 187, 188, 190 and 192 [²²] for adjusting the initial exercise of the right of deduction.

The changes referred to in the second paragraph shall be taken into account during the period defined by the Member States under Article 187(1) [²³] for immovable property acquired as capital goods.’

20 — COM(2007) 677 final of 7 November 2007, proposal for a Council Directive amending VAT Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Article 1(11).

21 — Equivalent to Article 6(2) of the Sixth Directive.

22 — Equivalent to Article 20(2), (3), (4) and (6) of the Sixth Directive.

23 — Equivalent to the second and third subparagraphs of Article 20(2) of the Sixth Directive.

22. The explanatory memorandum indicates that the proposed new provision aims to clarify the exercise of the right to deduct input VAT on the acquisition or construction of immovable property intended for both business and non-business purposes, or on economically comparable transactions concerning such property. Initial deduction would be limited to the actual use of the property for output transactions that give rise to a right of deduction. In cases of mixed use, full and immediate deduction would no longer be possible, but an adjustment system would take account of both increases and reductions in business use. That system would replace the tax on private use under Article 26 of Directive 2006/112 (equivalent to Article 6(2) of the Sixth Directive) during the adjustment period and would function in a manner similar, and apply in parallel, to the existing system for adjusting deductions when the percentage of taxed and exempted transactions varies.

‘Transitional’ provisions concerning exclusion from deductions

23. Article 17(6) of the Sixth Directive²⁴ provides for the Council, acting unanimously on a proposal from the Commission, to decide what expenditure is not to be eligible for deduction of VAT, but specifies that the tax is

24 — See Article 176 of Directive 2006/112.

never to be deductible on expenditure which is not strictly business expenditure, such as luxuries, amusements or entertainment.

expenditure incurred by the taxable person in respect of his private life, including, *inter alia*, expenditure on his own home. That provision has remained unchanged at all relevant times.

24. To cover the situation pending the Council's decision, the second subparagraph of Article 17(6) provides: '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.'

25. The rules in question have not in fact been adopted, so that the transitional provision remains applicable.

28. On the other hand, Paragraph 12(2)(1) governs deductions in relation to immovable property. When the Sixth Directive entered into force in Austria on its accession to the Communities,²⁵ that provision disallowed any deduction of input tax in respect of a part of a building used by a taxable person for his private residential purposes. Following amendment in 1997, mixed-use buildings can be wholly treated as forming part of the assets of a business. However, pursuant to Paragraphs 6(1)(16), 6(2) and 12(3) of the UStG, read together, the use of parts of a building for private residential purposes is a VAT-exempt transaction (thus precluding deduction of input tax).

Relevant Austrian legislation

26. The referring court explains that two overlapping provisions of the Umsatzsteuergesetz (Law on Turnover Tax) 1994 ('the UStG') preclude deduction of input VAT in relation to immovable property used for private purposes.

29. The preparatory documents relating to the amendment expressly state that, as a result of the case-law of the Court of Justice,

27. On the one hand, Paragraph 12(2)(a) precludes deductions of VAT in respect of

25 — Namely, 1 January 1995. It is common ground that, although the UStG 1994 formally entered into force on the same day, the provisions in issue were simply re-enactments of previous provisions which had remained unchanged since 1977. There is consequently no question of their not having been in force (for some considerable time) before the Sixth Directive entered into force in Austria.

buildings used for a taxable person's private residential purposes could benefit from a tax advantage, and that the exemption was intended to prevent such unwanted tax relief in respect of the private sphere.

Facts, procedure and reference for a preliminary ruling

30. It appears that the tax authorities consider that the ruling in *Seeling* (that private use of immovable property forming part of business assets cannot be treated as exempt leasing or letting) does not affect the situation in Austria, because the exclusion from deduction is covered by the second subparagraph of Article 17(6) of the Sixth Directive.

32. Between November 2002 and June 2004, Ms Sandra Puffer had a house with swimming pool built, and informed the tax authority that she would be renting out part of it for office use, subject to VAT. Approximately 11% of the building was used for business purposes. Ms Puffer allocated the whole house to her business assets and, citing *Seeling*, claimed deduction of the full input VAT charged to her in connection with the construction of the building. The tax authority refused to allow any deduction in respect of the swimming pool. For the remainder it allowed deduction only to the extent of the 11% of the property being used for business purposes.

31. It may be mentioned that, since the material time in the present case, the national exemption for private residential use of premises assigned to business use, which precludes deduction of input tax, has been twice amended,²⁶ and the Council has authorised Austria, by way of derogation from Article 17(2) of the Sixth Directive, to exclude expenditure from the right to deduct VAT when over 90% of the goods and services are used for the private purposes of a taxable person, or of his employees, or, more generally, for non-business purposes.²⁷

33. Ms Puffer's appeal has now reached the Verwaltungsgerichtshof.

²⁶ — BGBl I No 134/2003 and BGBl I No 27/2004.

²⁷ — Council Decision 2004/866/EC of 13 December 2004 authorising the Republic of Austria to apply a measure derogating from Article 17 of the Sixth Directive (77/388/EEC) on the harmonisation of the laws of the Member States relating to turnover taxes (OJ 2004 L 371, p. 47), applicable until 31 December 2009. France and Germany also appear to enjoy similar derogations.

34. She argues, first, that, in accordance with the case-law of the Court of Justice, she is entitled to allocate the whole house to her business assets, with full deduction of input tax.

35. The referring court points out that, according to *Seeling*, a taxable person can deduct input VAT in respect of parts of a building used for private purposes if the rest of the building is used for taxable purposes. If he builds a house for private use, he may thus deduct full input VAT if at least one room is used for his business. VAT is charged on private use under Article 6(2) of the Sixth Directive, but is spread over 10 years. Treatment thus differs depending on whether the person concerned is a taxable person or not. Both cases involve end use, but the Sixth Directive gives taxable persons an advantage amounting to some 5% of the cost of the house and around 25% of total input VAT, whereas no such advantage is available to other citizens in respect of identical end use.²⁸ The referring court therefore queries whether the provisions of the Sixth Directive are contrary to the Community principle of equal treatment. If such a provision had been adopted by the Austrian legislature, it would probably have contravened the principle of equal treatment in Article 7(1) of the Federal Constitution. Moreover, even as between taxable persons, the domestic legislation transposing the Sixth Directive differentiates between private residential properties of those whose turnover is taxed and of those (such as doctors) whose turnover is exempt, thus distorting competition, since a taxable person whose turnover is entirely exempt cannot deduct input tax on private home on account of the business use of

a single room. That could be contrary to Article 87 EC, which prohibits State aid.

36. Ms Puffer argues, second, that this is not a case in which Austria is entitled to retain an existing exclusion from deduction under Article 17(6) of the Sixth Directive.

37. The referring court notes that Paragraph 12(2)(2)(a) of the UStG has remained unchanged since the Sixth Directive entered into force in Austria (and is thus in its view covered by the standstill clause in Article 17(6) of the Sixth Directive). Paragraph 12(2)(1) has been amended, but with the intention of retaining the same exclusion from deduction for parts of buildings in private use. Only subsequently did it emerge, from *Seeling*, that the private use of buildings cannot be treated as an exempt transaction. According to *Holböck*,²⁹ an amended provision may be covered by a

28 — At the hearing, the Austrian Government explained how the referring court may have arrived at its figures (of 5% of the cost and 25% of the input tax) on the basis of Austria's VAT rate of 20% and adjustment period of 10 years, coupled with a 10% annual financing cost which would have allowed the person concerned to borrow and repay over the 10-year period a sum equal to the amount of VAT immediately deducted. Clearly, each of the basic factors — and thus the precise result — may vary as between Member States and over time.

29 — Case C-157/05 [2007] ECR I-4051, paragraph 41.

standstill clause if it is identical in substance to earlier legislation. The amended version of Paragraph 12(2)(1) of the UStG, read in conjunction with Paragraph 6(1)(16), is identical in substance to the original version and is based on identical intentions on the part of the legislature. But if the amended version is not covered by the standstill clause, the question arises whether the amendment could also affect the validity of the overlapping rules in Paragraph 12(2)(2)(a).

less than other taxable persons who do not use their private dwellings, even minimally, in connection with their business?

38. In that context, the Verwaltungsgerichtshof asks:

- (1) Does [the Sixth Directive], in particular Article 17 thereof, infringe fundamental rights under Community law (the Community-law principle of equal treatment) because it has the effect of enabling taxable persons to acquire ownership of residential properties for their own private residential purposes (consumption) for approximately 5% less than other EU citizens, with the final value of that advantage rising indefinitely in line with the level of acquisition and construction costs of the residential property in question? Does such an infringement arise also as a result of the fact that taxable persons can acquire ownership of residential properties used for their own private residential purposes — where such properties are used, even minimally, in connection with their business — for approximately 5%
- (2) Does national legislation implementing the Sixth Directive, in particular Article 17 thereof, infringe Article 87 EC because, while the legislation does allow taxable persons who carry out taxable transactions the advantage referred to in Question 1 in respect of properties which they use for private residential purposes, that advantage is not available to taxable persons whose transactions are exempt?
- (3) Does Article 17(6) of the Sixth Directive continue to have effect if the national legislature amends a national provision for the exclusion from the right to deduct (in this case, Paragraph 12(2)(1) of the [UStG]), which is based on Article 17(6) of the Sixth Directive, with the express intention of retaining that exclusion from the right to deduct, and national law would indeed result in the retention of an exclusion from the right to deduct, but — owing to an error in the interpretation of Community law (in this case Article 13B(b) of the Sixth Directive) which was only subsequently identified — the national legislature introduced a provision which, viewed in isolation, would,

according to Community law (Article 13B(b) of the Sixth Directive as interpreted in [*Seeling*]), allow a deduction to be made?

and the Commission have submitted both written and oral observations to the Court. At the hearing, the Austrian Government supported the submissions of the Unabhängiger Finanzsenat.

- (4) If the answer to Question 3 is in the negative, could the effect of an exclusion from the right to deduct (Paragraph 12(2)(2)(a) of the UStG 1994) which is based on the “standstill clause” (Article 17(6) of the Sixth Directive) be restricted if the national legislature amends one of two overlapping national provisions excluding deductions (Paragraph 12(2)(2)(a) of the [UStG] and Paragraph 12(2)(1) of the [UStG]) and subsequently does not proceed further because it finds that it has erred in law?’

40. Quite apart from the answers which they propose to the questions, those parties differ significantly in their basic approach. Ms Puffer and the Commission accept that the Sixth Directive allows taxable persons to choose to allocate capital goods entirely to business assets, with full and immediate deduction of input tax. By contrast, the Unabhängiger Finanzsenat and the Austrian Government (‘the Austrian authorities’) submit that the Community legislation does not require such a choice to be available, but allows deduction only in respect of the proportion of the cost corresponding to business use.

Assessment

39. Ms Puffer, the Unabhängiger Finanzsenat (respondent in the main appeal proceedings)

41. I shall therefore examine the Austrian authorities’ position before addressing the questions as raised.

The Austrian authorities' position

42. The Unabhängiger Finanzsenat claims that the wording of the Sixth Directive requires no elucidation, and does not bear the interpretation which the Court has given it.

43. Under Article 17(2)(a), input tax is deductible *in so far as the goods and services to which it relates are used for the purposes of taxable output transactions*. Under Article 6(2)(a), private use of business assets is to be treated as a taxable output transaction *where the input tax on the assets is deductible*.³⁰ Consequently, it is necessary first to establish the proportions of business and private use, which will determine the proportion of deductible input tax. Private use will then be a taxable output only to the extent that it concerns goods falling within the propor-

tion acquired for business use, in respect of which a right to deduct could be exercised.³¹ Allocation to business assets cannot on its own give rise to a right to deduct, or the proviso 'where the value added tax on such goods is wholly or partly deductible' would be meaningless. The Austrian authorities reason, therefore, that capital goods may be allocated entirely to business assets as soon as they are acquired, giving rise to a right to deduct in respect of the proportion given over at that time to taxable business use (which may even be 0%), subject to adjustment of the initial deduction in accordance with Article 20 of the Sixth Directive, to reflect changes in the proportions of business and private use during the deduction period.

44. On that basis, the Austrian authorities take issue with the Court's statements³² to the effect that a person who uses goods partly for business and partly for private purposes and who deducted all or part of the input VAT on acquisition is deemed to use the goods entirely for the purposes of his taxable transactions within the meaning of Article 17(2), and is therefore entitled to full and immediate deduction of input tax. They consider that the Court has introduced an unwarranted and

30 — The Austrian authorities point out that, of the six languages in which the Sixth Directive was adopted, only the English uses the present tense ('is deductible'). All the others use a formulation which would translate into English as 'has given rise to the right to deduct', indicating a chronological order. Moreover, in English, Article 26(1)(a) of Directive 2006/112 now refers to input tax which 'was' deductible.

31 — The Austrian authorities refer to Joined Cases C-322/99 and C-323/99 *Fischer and Brandenstein* [2001] ECR I-4049, concerning Article 5(6) of the Sixth Directive, in which the Court considered essentially that, when a car had been acquired without deduction of input tax but allocated to a taxable business, when VAT-deductible work was performed on the car, and when the car was subsequently allocated to the taxable person's private assets, the taxable amount for the 'self-supply' could be only the value in respect of which a right to deduct had arisen.

32 — They refer to *Lennartz*, paragraph 26, and *Seeling*, paragraph 43, both cited in footnote 15 above.

circular interpretation of the legislation, inferring the right to deduct input tax from the subsequent taxable output in the form of private use.

45. In addition, the Austrian authorities seek to refute a number of other arguments which, they consider, might be seen as supporting the right to full deduction in the case of mixed use. The comparative explanation of, on the one hand, Articles 5(6) and 6(2) and, on the other hand, Article 17(5) of the Sixth Directive given by Advocate General Jacobs in *Charles*³³ is inconsistent and devised simply to get round the difficulties which arise from full deduction. His conclusion in *Seeling*,³⁴ from the explanatory memorandum to the Commission's proposal for the Sixth Directive, that the output tax charge under Article 6(2)(a) was specifically chosen as an alternative to a restriction on the right to deduct input tax, did not support deduction in full for all mixed use goods. And, in the event of mixed use of a building by a taxable person making only exempt outputs, the output tax on private use would vary from year to year depending on the turnover generated by those outputs (in accordance with the pro rata system of Article 17(5)) rather than on the proportion of private use, which would be an absurd result.

46. I can understand the Austrian authorities' reference to an apparent circularity of reasoning in paragraph 26 of *Lennartz*. There, the Court states that 'a person who uses goods partly for the purposes of taxable business transactions and partly for private use and who, upon acquiring the goods, recovered all or part of the input VAT, is deemed to use the goods entirely for the purposes of his taxable transactions within the meaning of Article 17(2). Consequently, such a person is in principle entitled to a right of total and immediate deduction of the input tax paid on purchasing the goods.' However, that wording has never been repeated by the Court. References to it have been paraphrased as 'if the taxable person chooses to treat capital goods used both for business and private purposes as business goods, the VAT due as input tax on the acquisition of those goods is in principle wholly and immediately deductible'.³⁵ That, it seems to me, is all the Court has ever meant, despite a possibly unfortunate formulation in *Lennartz*.

47. The main issue, however, is the basic difference in approach as between the Court's established case-law and the alternative analysis put forward by the Austrian authorities, both of which seek to solve the problem of reconciling the right to full and immediate deduction of input tax on goods to be used for the purposes of taxable outputs with the inevitability that some goods will ultimately

³³ — At points 59 and 60 of his Opinion.

³⁴ — At point 41 of his Opinion; see also point 59 of his Opinion in *Lennartz*.

³⁵ — *Seeling*, cited in footnote 15, paragraph 41; Case C-17/01 *Sudholz* [2004] ECR I-4243, paragraph 37; *Charles*, cited in footnote 15, paragraph 24.

be used for purposes other than that originally intended.

48. In that regard, I do not consider the provisions of the Sixth Directive to be so clear that the Court's interpretation of them is superfluous. It seems disingenuous of the Austrian authorities to argue that, while at the same time putting forward their own proposed interpretation over several pages of closely-argued written observations. Had there been such clarity, it would have been enough to cite the provisions themselves.

49. It seems to me that the difference in approach is based on a different understanding of the concept of allocating goods to business assets. Although Articles 5(6) and 6(2)(a) of the Sixth Directive both refer to goods forming part of business assets, the legislation in fact does not define the concept of *allocation* of goods to such assets. The notion has developed in the case-law, starting with *Lennartz*. To paraphrase that judgment, allocation occurs when a taxable person acting as such (thus, not in a private capacity) acquires goods for the purposes of his economic activity (which may of course comprise both taxable and exempt transactions).

50. For the Court, such allocation (provided that it can be established as genuine in the

light of all the circumstances, but regardless of the actual proportion of business use³⁶) determines the right to deduct — and requires subsequent private use to be taxed. The capacity in which a person acts when acquiring goods and the purpose for which they are acquired determine whether those goods are placed within the sphere of economic activity, and are thus subject to the rules of VAT, or in the private sphere, where no further VAT rules apply. In the former case, they may still be transferred to the private sphere, subject to payment of output tax (to the extent that input tax was deductible because the economic activity is taxable), thus maintaining tax neutrality for the taxable person. In the latter case, any transfer to the business sphere carries a penalty: the input tax which could not be deducted because the acquisition was for private purposes is definitively irrecoverable, but the value of the goods (including that irrecoverable input tax) will form part of the taxable amount if they are used for taxable output purposes.³⁷

51. The Austrian authorities consider, however, if I have understood them correctly, that allocation to business assets can be merely a 'holding' action. To the extent that goods are intended for private use, they may none the less be allocated to the taxable person's economic activity but will give rise (via the adjustment mechanism) to a right to deduct only if they are in fact subsequently used for business purposes.

³⁶ — *Lennartz*, cited in footnote 15, paragraphs 21 and 35.

³⁷ — See also points 79 and 80 of the Opinion of Advocate General Jacobs in *Charles*.

52. Such an interpretation is not without points in its favour. It avoids the disadvantages inherent in transfers from the private to the business sphere, and it avoids the financial advantages for taxable persons which are at the heart of this case. Nor does it seem to pose any serious problem of inconsistency with the essence of the VAT system, as may be seen from its similarity to the amendment currently proposed by the Commission.³⁸

53. However, it denies taxable persons a right to immediate deduction in cases of deferred business use with intermediate private use. And, while capable of fitting into the overall VAT system, it is by no means obviously preferable in that regard to the interpretation contained in the Court's consistent case-law and is certainly not dictated by the clear wording of the legislation.

54. Nor do I consider that the Austrian authorities' criticisms of the current case-law are justified.

55. In the Court's approach, goods allocated to business assets must be treated as used for

business purposes. Any private use thus becomes a taxable business use, with the taxable person supplying himself in the same way as he would any other final consumer. That is true, however, only where there was an initial right to deduct, and the extent of that right depends on the proportions of taxable and exempt transactions which the taxable person makes overall. It is that which explains the proviso 'where the value added tax on such goods is wholly or partly deductible' and the explanation set out by Advocate General Jacobs at points 59 and 60 of his Opinion in *Charles*. Moreover, it seems to me to be a misunderstanding of that point which leads the Austrian authorities to find any absurdity in the fact that, where a taxable person carries out both taxable and exempt transactions, his deduction of input tax in respect of a property he uses for both business and private purposes can be adjusted on the basis of the taxable/exempt ratio and will not be determined solely by the business/private ratio. Finally, as regards Advocate General Jacobs's references to the explanatory memorandum to the proposal for a Sixth Directive, whilst the passages which he cited may not explicitly state an intention to allow full deduction in the case of mixed-use goods, they are certainly consistent with and suggestive of such an intention.

56. In conclusion on this issue, I am not convinced that the Austrian authorities' arguments provide any reason to reverse the Court's established case-law in this field. At most, they set out an alternative analysis which is not without attraction but which is by

³⁸ — See points 21 and 22 above.

no means, as they seek to present it, the sole and inescapable interpretation of the legislation. If the Court were none the less to consider a reversal possible, that would require the case to be referred to a larger formation, with a reopening of the oral procedure. In such an event, it would be preferable to invite the other Member States to submit observations, since it is a matter which concerns the whole VAT system. However, I note that no Member State other than Austria has found it necessary to react to the Unabhängiger Finanzsenat's written observations in this case.

output tax progressively on his private use of those goods, may enjoy an identifiable financial advantage over another person acquiring similar goods in a private capacity and thus unable to deduct any input tax.³⁹ That advantage will always be present, though its precise extent will depend on several variables.⁴⁰ It is therefore unnecessary to take any view on the referring court's calculation that it can attain 25% of total VAT or 5% of total cost in the case of immovable property in Austria. Suffice it to acknowledge that there is a non-negligible difference in treatment.

57. I shall therefore examine the referring court's four questions on the basis that the Court's interpretation of the Sixth Directive with regard to mixed-use goods is not in question.

59. The principle of equal treatment requires that similar situations must not be treated differently unless differentiation is objectively justified.⁴¹ In the circumstances in issue, are the taxable person and the private individual in similar situations, or is the differentiation between them objectively justified?

The first question: equal treatment

58. It cannot be disputed that a taxable person entitled to full and immediate deduction of input tax on goods which he acquires and allocates to his business, then paying

60. The system of taxation of private use of business assets is designed specifically to obviate the — much more substantial — inequality of treatment which would arise if taxable persons were able to put assets, in respect of which they had enjoyed full

39 — See, for example, point 39 et seq. of the Opinion of Advocate General Jacobs in *Seeling*, and point 74 et seq. of his Opinion in *Charles*, both cited in footnote 15 above.

40 — See point 35 and footnote 28 above.

41 — See, for a recent example, Case C-309/06 *Marks & Spencer* [2008] ECR I-2283, paragraph 51.

deduction of input tax, to private use without having to account any further for VAT. However, the existence of a lesser inequality of treatment cannot be justified simply by the absence of a greater inequality. It must still be shown to derive from an objective difference in situation which is relevant to the difference in treatment.

61. In the present case, I would agree with the Commission that the taxable person and the private owner are in different situations. For the private owner, the property is given over entirely and definitively to private use. For the taxable person, it is used in part for business purposes, with the possibility of changing the proportion of that use. Where VAT is a component element in the cost of acquiring and maintaining goods, including capital goods and immovable property, it must be borne definitively by the final 'consumer' — the person using the goods for private purposes — but must remain completely neutral as regards the taxable person. A taxable person acquiring goods in a private capacity must bear, definitively, the same VAT burden as a non-taxable person. If he subsequently wishes to use the goods for business purposes, he cannot free himself of that tax, which therefore burdens his business activity in turn, in a manner which is incompatible with the requirement of VAT neutrality for taxable persons and which places him at a disadvantage vis-à-vis other competing taxable persons.⁴² It is precisely for that reason — and, as Ms Puffer points out, in full awareness of the consequences — that the Court has made it clear that a taxable person must have the option of allocating mixed-use

goods to business assets with subsequent taxation of private use.

62. The Commission draws attention also to the fact that taxable persons are not only economic operators who contribute to the European Community's aim of promoting the development of economic activities and in that context take certain risks with their assets but also, specifically, collectors of VAT responsible for ensuring its payment to the tax authorities. Those simply using or consuming goods for their private purposes cannot insist on identical treatment with them in all matters of VAT.

63. I would therefore answer the referring court's first question in the negative.

The second question: State aid

64. The referring court also wishes to know whether the same advantage, in so far as it is enjoyed by taxable persons whose output transactions are subject to VAT but not by those whose output transactions are exempt, can constitute State aid prohibited by

⁴² — See the Opinion of Advocate General Jacobs in *Charles*, point 75 et seq.

Article 87 EC. More precisely, it asks whether national legislation implementing the Sixth Directive so as to provide such a relative advantage infringes Article 87 EC.

65. The formulation of the question calls for two preliminary remarks.

66. First, the information presented to the Court suggests that the Austrian legislation as it stands *does not* allow such a result. Indeed, it is only if the legislation precludes immediate and full deduction of input tax in the circumstances in issue that the national court's third and fourth questions appear relevant. If that is so, the second question, as formulated, would appear to be purely hypothetical. However, it is for the national court to interpret national law, and I shall therefore address this question on the assumption that its basic premiss is correct.

67. Second, Article 4(1) and (2) of the Sixth Directive defines a taxable person as 'any person who independently carries out in any place any economic activity', namely, all activities of producers, traders and persons supplying services including mining and agricultural activities, activities of the professions and the exploitation of tangible or

intangible property for the purpose of obtaining income therefrom on a continuing basis, 'whatever the purpose or results of that activity'. Consequently, a person carrying out only exempt transactions remains a 'taxable person' within the meaning of the legislation. However, he has none of the rights or duties of one who carries out taxed transactions and is subject to none of the effects which VAT has for the latter. In short, as far as VAT is concerned, he is in practically the same position as he is in his private life.

68. The question itself, I consider, can only be answered in the negative.

69. Article 87(1) EC provides that 'any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market'. It is settled case-law that classification as State aid for the purposes of that provision requires that all the conditions set out are fulfilled. First, there must be intervention by the State or through State resources. Second, the

intervention must be liable to affect trade between Member States. Third, it must confer an advantage on the recipient. Fourth, it must distort or threaten to distort competition.⁴³

exempt supplies, so that any difference in treatment as between operators making the two types of supply will not, in most cases,⁴⁵ distort competition.

70. Here, the difference in treatment between economic operators making only taxable supplies and those making only exempt supplies (with, it may be added, a range of intermediate treatments for those making both taxable and exempt supplies) cannot be ascribed to one State rather than another. It is an integral part of the VAT system set up by Community harmonising legislation which must be implemented in the same way by all Member States. Consequently, there is no 'intervention by the State' or effect on trade between Member States. The Commission adds that the advantage conferred on the recipient must, in the Court's case-law, be selective, which is not the case of a measure which, although conferring an advantage on its recipient, is justified by the nature or general scheme of the system of which it is part.⁴⁴ Since the first three conditions are thus not fulfilled, the difference in treatment cannot infringe Article 87 EC.

The third question: amendment of Paragraph 12(2)(1) of the UStG

72. As it stood on and before 1 January 1995, Paragraph 12(2)(1) of the UStG provided: 'Supplies or other services connected with the acquisition, construction or maintenance of buildings are regarded as being for business purposes in so far as the consideration given for them constitutes operating costs or professional expenses under the rules governing income tax.'

71. I also note that the system of exemptions is designed in such a way as to minimise competition between taxed supplies and

73. To the extent that such a provision constituted an exclusion from the right to deduct input VAT at that time, it could be maintained, in compliance with Article 17(6) of the Sixth Directive, until such time — as yet unknowable — as the Council may decide what expenditure is not to be eligible for deduction.

43 — See, most recently, Joined Cases C-341/06 P and C-342/06 P *Chronopost and La Poste* [2008] ECR I-4777, paragraphs 121 and 122.

44 — See, for example, Case C-308/01 *GIL Insurance* [2004] ECR I-4777, paragraph 66 et seq.

45 — It is true that some cases of competition between the two categories exist, as the referring court points out (see, for example, Case C-401/05 *VDP Dental Laboratory* [2006] ECR I-12121), but they are rare and the present case is not among them.

74. The Court has stated that where, after the entry into force of the Sixth Directive, a Member State amends its legislation so as to reduce the scope of existing exclusions, thereby bringing it more closely into line with the general regime of deduction set out in Article 17(2) of the Sixth Directive, that legislation must be considered to be covered by the derogation in the second subparagraph of Article 17(6).⁴⁶ By contrast, if an amendment has the effect of increasing the extent of existing exclusions, thus diverging from the objective of the directive, it is not covered by the second subparagraph of Article 17(6) and thus breaches Article 17(2).⁴⁷

76. The Verwaltungsgerichtshof refers to paragraph 41 of *Holböck*,⁴⁸ in which the Court confirmed its case-law to the effect that a national measure adopted after a date fixed in a standstill clause is not automatically excluded from the derogation laid down in the Community measure in question. If it is, in substance, identical to the previous legislation, or limited to reducing or eliminating an obstacle to the exercise of Community rights and freedoms in the earlier legislation, it will be covered by the derogation. 'By contrast, legislation based on an approach which differs from that of the previous law and establishes new procedures cannot be treated as legislation existing at the date fixed in the Community measure in question.'

75. What appears to have happened in the present case, however, according to the order for reference, is that an exclusion from the right to deduct input tax in cases where output tax was in principle chargeable (namely, private use of goods allocated to business assets) was subsequently transformed into an exemption from output tax entailing the impossibility of deducting input tax.

77. I can only agree with the Commission that the change to the Austrian legislation described in the order for reference appears to fall within the category envisaged in the last sentence of the paragraph cited above. In that regard, it seems irrelevant whether the national legislature made the change on the basis of a correct or incorrect interpretation of Community law. However, the ruling in *Seeling*, to the effect that private use of immovable business assets on which input

46 — Case C-345/99 *Commission v France* [2001] ECR I-4493, paragraphs 22 to 24; Case C-409/99 *Metropol and Stadler* [2002] ECR I-81, paragraph 45.

47 — Case C-40/00 *Commission v France* [2001] ECR I-4539, paragraphs 17 to 20; *Metropol and Stadler*, paragraph 46.

48 — Cited in footnote 29 above.

tax was deducted cannot be regarded as exempt leasing or letting but must be treated as a taxable self-supply, does preclude the change which appears to have been made.

The fourth question: implications for Paragraph 12(2)(2)(a) of the UStG

78. The national court wishes to know, if the amendment to Paragraph 12(2)(1) of the UStG means that it is not covered by the standstill clause in Article 17(6) of the Sixth Directive, whether that implies that the ‘overlapping’ exclusion from deduction in Paragraph 12(2)(2)(a) also loses the protection of that clause.

79. Ms Puffer asserts that Paragraph 12(2)(2)(a) — which provides in effect, by reference to the legislation on income tax, that expenditure on subsistence, including that on private accommodation, cannot give rise to a right to deduct — does not in fact apply to expenditure on the construction of a house or, in any event, was not originally interpreted in that way.

80. It is of course for the national court to determine the import of the provision in question. In its order for reference, it describes Paragraph 12(2)(1) and (2)(2)(a) as ‘overlapping’ provisions, but does not explain to what extent they may be interdependent or self-standing. It seems to me clear that, if the exclusion from the right to deduct in subparagraph (2)(2)(a) is dependent, for its interpretation and/or application, on the existence of the exclusion in subparagraph (2)(1), and if the latter is incompatible with the provisions of the Sixth Directive and not covered by the standstill clause, then subparagraph (2)(2)(a) will be affected correspondingly. If, however, it is a self-standing exclusion from the right to deduct, which was in existence before 1995 and has not since been modified, then it is covered by the standstill clause.

81. Finally, I would point out again that the referring court’s third and fourth questions appear to be based on a premiss different from that which underpins its second question. The second question assumes that the Austrian legislation allows taxable persons to allocate immovable property to business assets, and enjoy full and immediate deduction to the extent that the business makes taxable supplies, whereas the third and fourth questions assume that the Austrian legislation precludes such deduction. It is for the national court to resolve such matters.

Conclusion

82. In the light of the foregoing considerations, I suggest that the Court should answer the questions referred to the following effect:

- (1) There is no infringement of the principle of equal treatment in the fact that the Community VAT directives entitle a taxable person to full and immediate deduction of input tax on property which he acquires and allocates to his business, then paying output tax progressively on his private use of that property, even if he thus enjoys an identifiable financial advantage over another person acquiring similar property in a private capacity and thus unable to deduct any input tax.
- (2) National legislation implementing the Community VAT directives so as to allow taxable persons such an advantage does not infringe Article 87 EC.
- (3) The standstill clause in Article 17(6) of the Sixth VAT Directive does not cover cases in which a previous exclusion from the right to deduct input tax where output tax was in principle chargeable is subsequently transformed into an exemption from output tax, entailing the impossibility of deducting input tax.

- (4) If a previous exclusion from the right to deduct is thus transformed into an exemption and is therefore not covered by the standstill clause in Article 17(6) of the Sixth Directive, any other exclusion which is dependent for its interpretation and/or application on the existence of the previous exclusion will also not be covered by the standstill clause. However, a self-standing exclusion which was in existence when that directive came into force in the Member State concerned and has not since been modified remains covered by the clause.