Case C-434/03

P. Charles and T.S. Charles-Tijmens

v

Staatssecretaris van Financiën

(Reference for a preliminary ruling from the Hoge Raad der Nederlanden)

(Sixth VAT Directive — Deduction of input tax paid — Immovable property used in part for the business and in part for private purposes)

Opinion of Advocate General Jacobs delivered on 20 January 2005

Judgment of the Court (Grand Chamber), 14 July 2005

Summary of the Judgment

Tax provisions — Harmonisation of laws — Turnover taxes — Common system of value added tax — Deduction of input tax — Capital goods used in part for business purposes and in part for private purposes — National rules which predate the Sixth Directive precluding allocation of goods wholly to the business and the right to deduct in full the tax due on their acquisition — Not permissible

(Council Directives 67/228, Art. 11, and 77/388, Arts 6(2) and 17(2) and (6))

Article 6(2) and Article 17(2) and (6) of Sixth Directive 77/388 on the harmonisation of the laws of the Member States relating to turnover taxes, as amended by Directive 95/7, must be interpreted as precluding national legislation adopted before that directive came into force which does not make it possible for a taxable person to allocate capital goods used in part for business purposes and in part for purposes other than those of his business wholly to his business and, where appropriate, to deduct immediately and in full the value added tax due on the acquisition of those goods.

It is true that Article 17(6) of the Sixth Directive makes it possible for a Member State to retain a national system which existed before that directive came into force. However, that provision presupposes that the exclusions which those States may retain pursuant to it were lawful under Second Directive 67/228, which predates the Sixth Directive. In that respect, by providing that the Member States could exclude from the deduction system ‘certain goods and services … in particular those capable of being exclusively or partially used for the private needs of the taxable person or of his staff’, Article 11(4) of the Second Directive did not confer on Member States an unfettered discretion to exclude all and any goods and services from the system of the right of deduction, in particular, all goods in so far as they are used for the private purposes of the taxable person.

(see paras 31-34, 36, operative part)

JUDGMENT OF THE COURT (Grand Chamber)

14 July 2005 (*)

(Sixth VAT directive – Deduction of input tax paid – Immovable property used in part for the business and in part for private purposes)

In Case C-434/03,

REFERENCE under Article 234 EC for a preliminary ruling from the Hoge Raad der Nederlanden (Netherlands), by decision of 10 October 2003, received at the Court on 13 October 2003, in the proceedings

P. Charles,

T.S. Charles-Tijmens

v

Staatssecretaris van Financiën,

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann, C.W.A. Timmermans, A. Rosas, R. Silva de Lapuerta, K. Lenaerts and A. Borg Barthet, Presidents of Chambers, S. von Bahr (Rapporteur), J.N. Cunha Rodrigues, J. Makarczyk, P. K?ris, E. Juhász and G. Arestis, Judges,

Advocate General: F.G. Jacobs,

Registrar: K. Sztranc, Administrator,

having regard to the written procedure and further to the hearing on 16 November 2004,

after considering the observations submitted on behalf of:

– Mr Charles and Mrs Charles-Tijmens, by E.H. van den Elsen, adviseur, and G. Volkerink, belastingsadviseur,

– the Netherlands Government, by H.G. Sevenster and C. ten Dam, acting as Agents,

– the German Government, by A. Tiemann, acting as Agent,

– the Commission of the European Communities, by L. Ström van Lier and A. Weimar, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 20 January 2005,

gives the following

Judgment

1 The reference for a preliminary ruling concerns the interpretation of Article 6(2) and Article 17(1), (2) and (6) 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), as amended by Council Directive 95/7/EC of

10 April 1995 (OJ 1995 L 102, p. 18) (‘the Sixth Directive’).

2 The reference was made in proceedings between Mr Charles and Mrs Charles-Tijmens on the one hand and the Staatssecretaris van Financiën on the other hand concerning the latter’s refusal to allow their application for a refund of the entire value added tax (‘VAT’) which they paid in respect of a holiday bungalow which was used for letting and private purposes, to the extent of 87.5% and 12.5% of the time respectively.

Relevant provisions

Community legislation

3 Article 6(2) of the Sixth Directive provides:

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

(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;

(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.’

4 Under Article 17(2) and (6) of the Sixth Directive:

‘2. 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 within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person;

…

6. 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.’

National legislation

5 Article 2 of the Law of 1968 on turnover tax (Wet op de omzetbelasting 1968; ‘the Law on VAT’) provides:

‘A trader may deduct from the tax to be paid on supplies of goods and services the tax charged on supplies of goods and services to him, acquisitions of goods effected by him within the Community and imports of goods intended for him.’

6 The right to deduct is stated in Article 15 of the Law on VAT as follows:

‘1. The tax referred to in Article 2 which is deductible by the trader shall be:

(a) the tax which other traders have charged him by means of an invoice issued in accordance with the applicable rules, during the period relating to the return in respect of the goods and services which they supplied to him;

…

in so far as the trader uses the goods and services within the framework of his business …

…

4. Deduction of the tax is made in accordance with the intended use of the goods and services at the time when the tax is invoiced to the trader or at the time when the tax becomes chargeable. If it appears, at the time when the trader is preparing to use the goods or services, that he is deducting the tax relating to them to an extent which is higher or lower than that to which the use of the goods or services entitles him, the excess deducted shall be chargeable from that time. The tax which becomes chargeable shall be paid in accordance with Article 14 [of the Law on VAT].

The amount of tax which could be deducted and was not deducted shall be refunded to him on request.

…’

The main proceedings and the question referred for a preliminary ruling

7 According to the order for reference, Mr Charles and Mrs Charles-Tijmens jointly purchased a holiday bungalow in the Netherlands in March 1997. It was intended both for letting and for private use, and during the period at issue in the main proceedings, namely from 1 April to 30 June 1997 inclusive, the bungalow was so used, to the extent of 87.5% of the time for letting and 12.5% for private purposes.

8 The Hoge Raad der Nederlanden notes that, on account of that letting, Mr Charles and Mrs Charles-Tijmens are taxable persons within the meaning of the Sixth Directive and traders within the meaning of the Law on VAT. Given that the bungalow is let to persons who stay only for very short periods and that the letting is done through a ‘holiday undertaking’, such a letting does not fall within the VAT exemption in the Netherlands for the letting of immovable property under Article 13B(b)(1) of the Sixth Directive.

9 In their VAT declaration for the second quarter of 1997, Mr Charles and Mrs Charles-Tijmens deducted 87.5% of the tax invoiced to them in respect of the bungalow. Consequently they sought a refund of the amount corresponding to that percentage from the inspector of taxes competent to entertain the application (‘the inspector of taxes’).

10 By decision of 1 October 1997, the latter granted Mr Charles and Mrs Charles-Tijmens the refund they had requested. Nevertheless, taking the view that the VAT paid by them was 100% deductible, they submitted an application for the additional refund of the amount relating to the 12.5% of the time that the bungalow was used for private purposes.

11 The inspector of taxes declared that that application was inadmissible. Mr Charles and Mrs Charles-Tijmens therefore brought an appeal before the Gerechtshof te ’s-Hertogenbosch. That

court set aside the decision on inadmissibility but, on the substance, it confirmed the decision of the inspector of taxes, stating that since the bungalow was occupied for private purposes for 12.5% of the total time it was used, the persons concerned were not justified in deducting the entire VAT paid in respect of the bungalow.

12 Mr Charles and Mrs Charles-Tijmens appealed against the judgment of the Gerechtshof te 's-Hertogenbosch before the Hoge Raad der Nederlanden. In support of their appeal, they claim that it follows from Article 6(2) of the Sixth Directive that the private use of the bungalow is a taxable transaction since they chose to allocate the bungalow wholly to the assets of the business, which, in accordance with Article 17(2) of that directive, confers entitlement to deduct the entire VAT charged in that respect (see, in particular, Case C-291/92 *Armbrecht* [1995] ECR I-2775, and Case C-415/98 *Bakcsi* [2001] ECR I-1831).

13 Mr Charles and Mrs Charles-Tijmens add that Article 17(6) of the Sixth Directive does not alter that interpretation because, on the date on which the Sixth Directive came into force, the Netherlands legislation did not provide for any exclusion from the right to deduct within the meaning of that provision, except for vehicles designed for the transport of people.

14 The Hoge Raad der Nederlanden notes that the Netherlands rules concerning goods and services allocated for mixed use such as those at issue in the main proceedings were introduced in the Netherlands in 1969, pursuant to Article 11(1) of Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes – Structure and procedures for application of the common system of value added tax (OJ, English Special Edition 1967, p. 16; 'the Second Directive').

15 Those rules have a different effect from the rules in the Sixth Directive, which in some cases is more favourable for the taxable person and in others less favourable. That directive confers on the taxable person a right to immediate deduction in full, and there is no adjustment in respect of the private use of goods outside the business until such use takes place. On the other hand, under the system set up by the Law on VAT, the extent of future use of goods outside the business must be established straight away, or at least within the course of the first year.

16 The Hoge Raad der Nederlanden states in that regard that Article 12(3) of the implementing regulation of 1968 concerning turnover tax (Uitvoeringsbeschikking omzetbelasting 1968, Stcrt. 1968, No 169), adopted pursuant to Article 15(6) of the Law on VAT, provides that, at the time when the declaration relating to the final tax period of a given tax year is made, the VAT deducted is to be recalculated on the basis of the data for the entire tax year. No recalculation or revision of that deduction may be made after that tax year.

17 It is in those circumstances that the Hoge Raad der Nederlanden decided to stay the proceedings and refer the following question to the Court for a preliminary ruling:

'Is a statutory scheme … which was already in existence before the Sixth Directive … and under which:

– there is no possibility of choosing to include capital goods, or goods or a service treated as such, wholly in the assets of an undertaking where the acquirer uses those goods or that service both within his undertakings and outside it (in particular for private purposes);

– there is, related to this, also no possibility of deducting directly and wholly the tax charged on the acquisition of those goods or that service; and

– there is no provision for the charging of VAT as intended in Article 6(2)(a) of the Sixth

Directive

compatible with the Sixth Directive – in particular Article 17(1), (2) and (6) and Article 6(2) thereof?'

Consideration of the question referred for a preliminary ruling

18 By its question, the national court asks, essentially, whether Articles 6(2) and 17(2) and (6) of the Sixth Directive must be interpreted as precluding national legislation such as that at issue in the main proceedings, adopted before the Sixth Directive came into force, which does not make it possible for a taxable person to allocate capital goods used in part for business purposes and in part for purposes other than those of his business wholly to his business and which, in such a situation, does not authorise immediate deduction in full of the VAT due on the acquisition of those goods and does not provide that their use for purposes other than those of the business is treated as a supply of services for consideration.

Observations submitted to the Court

19 Mr Charles and Mrs Charles-Tijmens take the view that national legislation such as that at issue in the main proceedings is contrary to the case-law of the Court on VAT, in particular the judgment in Case C-269/00 *Seeling* [2003] ECR I-4101.

20 The Netherlands Government and the German Government submit that Article 17(2) of the Sixth Directive makes it possible for a Member State to exclude from the right to deduct VAT capital goods, or goods or a service treated as such, in so far as the taxable person uses those goods or that service for purposes other than those of his business, in particular for private purposes, when that State, availing itself of the derogation provided for in the second subparagraph of Article 6(2) of that directive, considers that such use is not a taxable transaction.

21 Should the Court hold that Article 17(2) and Article 6(2) of the Sixth Directive do not authorise an exclusion from the right to deduct VAT such as that at issue in the main proceedings, the Netherlands Government submits that Article 17(6) allows a Member State to retain a national system in existence before that directive came into force which excludes from the right to deduct VAT capital goods, or goods or a service treated as such, when the taxable person uses those goods or that service for purposes other than those of his business, in particular for private purposes.

22 The Commission takes the view that a statutory scheme which, in accordance with the power to derogate provided for in the second subparagraph of Article 6(2) of the Sixth Directive, does not levy tax on the use for private purposes of capital goods, or goods or a service treated as such, and therefore does not authorise any deduction in respect of those types of goods or service in so far as they are used for private purposes, is compatible with that directive.

Findings of the Court

23 It is settled case-law 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 (see, to that effect, in particular, *Armbrecht*, paragraph 20; *Bakcsi*, paragraphs 25 and 26; *Seeling*, paragraph 40; and Case C-25/03 *HE* [2005] ECR I-0000, paragraph 46).

24 Should the taxable person choose to treat capital goods used for both business and private

purposes as business goods, the input VAT due on the acquisition of those goods is, in principle, immediately deductible in full (see, in particular, Case C?97/90 *Lennartz* [1991] ECR I-3795, paragraph 26, *Bakcsi*, paragraph 25, and *Seeling,* paragraph 41).

25 It follows from Article 6(2)(a) of the Sixth Directive that when the input VAT paid on goods forming part of the assets of a business is wholly or partly deductible, their use for the private purposes of the taxable person or of his staff or for purposes other than those of his business is treated as a supply of services for consideration. That use, which is therefore a taxable transaction within the meaning of Article 17(2) of that directive is, under Article 11A(1)(c) thereof, taxed on the basis of the cost of providing the services (see, to that effect, *Lennartz*, paragraph 26, *Bakcsi,* paragraph 30, and *Seeling*, paragraph 42).

26 In respect of the second subparagraph of Article 6(2) of the Sixth Directive, it should be noted at the outset that exceptions to harmonisation must be defined strictly. Any recourse to schemes which derogate from VAT gives rise to differences in levels of the tax burden between the Member States.

27 Next, the second subparagraph of Article 6(2) must generally be interpreted as meaning that the Member States may refrain from treating certain supplies or uses as supplies of services for consideration, in particular in order to simplify administrative procedures relating to collection of VAT (see, to that effect, Case C-155/01 *Cookies World* [2003] ECR I-8785, paragraph 59).

28 On the other hand, the second subparagraph of Article 6(2) of the Sixth Directive cannot have the result that it is possible for the Member States to refuse to allow taxable persons who have chosen to treat capital goods used both for business and private purposes as business goods to deduct immediately and in full the input VAT due on the acquisition of those goods, which they are entitled to do in accordance with the settled case-law cited in paragraph 24 of this judgment. Such a restriction on the right to deduct would be contrary to that provision.

29 In addition, a general waiver based on the second subparagraph of Article 6(2) of the Sixth Directive of the right to tax the partial use of capital goods for the private purposes of a taxable person, when that person has been able to deduct in full the input VAT due on the acquisition of the goods concerned, would also be contrary to that provision since it would inevitably lead to distortion of competition.

30 Accordingly, a taxable person has, first, the right to choose to allocate wholly to his business capital goods which he uses in part for the purposes of the business and in part for purposes other than those of his business and, where appropriate, the right to immediate deduction in full of the VAT due on the acquisition of those goods and, second, the corresponding obligation to pay VAT on the amount of expenditure incurred for the use of those goods for purposes other than those of the business (see, to that effect, *Seeling*, paragraph 43).

31 As regards Article 17(6) of the Sixth Directive, it is true that, as the Netherlands Government maintains, that provision makes it possible for a Member State to retain a national system which existed before the Sixth Directive came into force. However, that provision presupposes that the exclusions which Member States may retain pursuant to it were lawful under the Second Directive, which predated the Sixth Directive (see Case C-305/97 *Royscot and Others* [1999] ECR I-6671, paragraph 21).

32 While Article 11(1) of the Second Directive introduced the right of deduction, Article 11(4) provided that the Member States could exclude from the deduction system ‘certain goods and services … in particular those capable of being exclusively or partially used for the private needs of the taxable person or of his staff’.

33 The latter provision did not therefore confer on Member States an unfettered discretion to exclude all and any goods and services from the system of the right of deduction and thereby negate the system established by Article 11(1) of the Second Directive (see *Royscot*, paragraph 24).

34 Therefore, although Article 11(4) of the Second Directive authorised Member States to exclude from the deduction system certain goods, such as motor vehicles, that provision did not make it possible for them to exclude from such a system all goods in so far as they are used for the private purposes of the taxable person.

35 It follows that Article 17(6) of the Sixth Directive, read in conjunction with Article 11(4) of the Second Directive, does not authorise Member States to retain a general exclusion from the deduction system of all goods of the taxable person in so far as they are used for his private purposes.

36 The answer to the question asked must therefore be that Article 6(2) and Article 17(2) and (6) of the Sixth Directive must be interpreted as precluding national legislation such as that at issue in the main proceedings, adopted before that directive came into force, which does not make it possible for a taxable person to allocate capital goods used in part for business purposes and in part for purposes other than those of his business wholly to his business and, where appropriate, to deduct immediately and in full the VAT due on the acquisition of those goods.

Costs

37 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) hereby rules:

Article 6(2) and Article 17(2) and (6) 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, as amended by Council Directive 95/7/EC of 10 April 1995, must be interpreted as precluding national legislation such as that at issue in the main proceedings, adopted before that directive came into force, which does not make it possible for a taxable person to allocate capital goods used in part for business purposes and in part for purposes other than those of his business wholly to his business and, where appropriate, to deduct immediately and in full the value added tax due on the acquisition of those goods.

[Signatures]

* Language of the case: Dutch.