JUDGMENT OF THE COURT (Third Chamber)

18 October 2012 (*)

(Taxation ? VAT ? Right of deduction ? Contribution in kind ? Destruction of property ? New buildings — Adjustment)

In Case C-234/11,

REFERENCE for a preliminary ruling under Article 267 TFEU from the Administrativen sad Varna (Bulgaria), made by decision of 3 May 2011, received at the Court on 16 May 2011, in the proceedings

TETS Haskovo AD

v

Direktor na Direktsia ‘Obzhalvane i upravlenie na izpalnenieto’ — Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite,

THE COURT (Third Chamber),

composed of R. Silva de Lapuerta (Rapporteur), acting as President of the Third Chamber, K. Lenaerts, E. Juhász, T. von Danwitz and D. Sváby, Judges,

Advocate General: J. Kokott,

Registrar: K. Sztranc-S?awiczek, Administrator,

having regard to the written procedure and further to the hearing on 10 May 2012,

after considering the observations submitted on behalf of:

– TETS Haskovo AD, by M. Dimitrov, advokat,

– the Direktor na Direktsia ‘Obzhalvane i upravlenie na izpalnenieto’ — Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite, by S. Avramov,

– the Bulgarian Government, by Y. Atanasov and T. Ivanov, acting as Agents,

– the European Commission, by C. Soulay and D. Roussanov, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 14 June 2012,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Article 185 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1) (‘the Directive’).

2 The reference has been made in proceedings between TETS Haskovo AD (‘TETS Haskovo’) and the Direktor na Direktsia ‘Obzhalvane i upravlenie na izpalnenieto’ — Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite (Director of the Appeals and Management Directorate, Varna, at the Central Administration of the National Revenue Agency) (‘the Direktor’) concerning the adjustment to a deduction of value added tax (‘VAT’).

European Union Law

3 The second subparagraph of Article 1(2) of Directive 2006/112 provides:

‘On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components.’

4 Article 168 of Directive 2006/112 provides:

‘In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:

(a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person;

...’

5 Article 184 of Directive 2006/112 provides that the initial deduction is to be adjusted where it is higher or lower than that to which the taxable person was entitled.

6 Article 185 of Directive 2006/112 is worded as follows:

‘(1) Adjustment shall, in particular, be made where, after the VAT return is made, some change occurs in the factors used to determine the amount to be deducted, for example where purchases are cancelled or price reductions are obtained.

(2) By way of derogation from paragraph 1, no adjustment shall be made in the case of transactions remaining totally or partially unpaid or in the case of destruction, loss or theft of property duly proved or confirmed, or in the case of goods reserved for the purpose of making gifts of small value or of giving samples ...

However, in the case of transactions remaining totally or partially unpaid or in the case of theft, Member States may require adjustment to be made.’

7 Article 186 of Directive 2006/112 provides that Member States are to lay down the detailed rules for applying Articles 184 and 185 thereof.

Bulgarian Law

8 The Law on valued added tax (Zakon za danak varhu dobavenata stoynost, DV No 63, 4 August 2006) (‘the ZDDS’) entered into force on 1 January 2007.

9 Article 5 of the ZDDS provides:

‘“Goods” within the meaning of this Law means any fixed or immovable property, including electricity, gas, water, heat or cooling energy and the like, as well as standard software.’

10 Article 6(1) of the ZDDS provides:

‘“Supply of goods” within the meaning of this Law means the transfer of the right of ownership or another right in rem to the goods.’

11 Under Article 10 of the ZDDS:

‘(1) No supply of goods or provision of services shall be deemed to have taken place where the supply or the service to the transferee by the person being transformed, making the transfer or making the contribution results from

…

3. a non-cash contribution to a commercial company.

(2) In the cases covered by Paragraph 1, the person receiving the goods or services shall enter into legal succession in respect of all related rights and obligations under this Law, including the right to deduct VAT and the obligation to adjust the deduction made.

...’

12 Adjustments to an exercised right of deduction, with the exception of cases of a modification of the tax base or of the nature of the supply or the service, are regulated in Article 79 of ZDDS which provides:

‘…

(3) Any registered person who has wholly or partly deducted input tax in respect of any goods produced, purchased, acquired or imported by him shall calculate and be liable for tax in the amount of the deduction made, where the goods were destroyed, shrinkages were established or the goods were classified as wastage, or their intended use was modified and the new intended use no longer gives entitlement to deduction.

(4) The adjustment … shall be made in the tax period during which the relevant circumstances have occurred...

…

(6) ... [T]he taxable person shall be liable, in respect of goods and services which are capital goods within the meaning of the Law on corporation tax...’

13 The limitations to adjustments provided for in Article 80(2) of the ZDDS are worded as follows:

‘Adjustments under Article 79(3) shall not be made in the following cases:

1. destruction, shrinkage or wastage caused by force majeure, as well as in the case of the destruction of excisable goods under administrative control in accordance with the Law on excise duties and tax warehouses;

2. destruction, shrinkage or wastage caused by accidents or disasters which the person can

prove were not caused through his fault;

…

4. technological wastage within permissible limits, established by the technological documentation for the production or activity concerned;

5. wastage due to expiry of the service life, determined according to the requirements of a statutory instrument;

6. write-off of capital goods within the meaning of the Law on accounting, where the balance sheet value is less than 10 per cent of the cost of acquisition.

...’

The dispute in the main proceedings and the questions referred for a preliminary ruling

14 TETS Haskovo is engaged in energy production as well as transporting and distributing heat. It operates a thermal power station in Haskovo (Bulgaria).

15 On 2 April 2008, Finans inzhenering AD (‘Finans inzhenering’) acquired a set of buildings from the Municipality of Haskovo which included, inter alia, three buildings for energy production (a cooling tower, a chimney and a production building). That acquisition was subject to VAT.

16 On 4 July 2008, TETS Haskovo increased its share capital in the form of a non-cash contribution. That contribution included the set of buildings owned by Finans inzhenering which had been acquired from the Municipality of Haskovo.

17 The transfer made by Finans inzhenering was not considered by the revenue office at the regional directorate of the National Revenue Agency in Varna to be a supply of goods as that company had transferred a set of buildings that represented a set of assets.

18 On 29 July 2009, TETS Haskovo obtained a building permit in connection with work to modernise the Haskovo thermal power station, including demolishing some of the buildings contributed by Finans inzhenering to the share capital of TETS Haskovo, namely a cooling tower, a chimney and a production building. Another company was engaged to demolish the buildings, which took place between 1 January and 28 February 2010. The scrap metal salvaged from the demolition was resold and that transaction was subject to VAT.

19 During April 2010, TETS Haskovo was the subject of a tax inspection covering the period from 1 November 2009 to 28 February 2010. In the course of that inspection it was found that, before being contributed as a non-cash contribution to the share capital of TETS Haskovo, the buildings in question had been acquired by Finans inzhenering, which had already made a deduction of VAT paid upon the acquisition of the property.

20 In the light of those findings and having regard, in particular, to the fact that some of the buildings in question in the main proceedings had been demolished, the revenue office at the regional directorate of the National Revenue Agency in Varna considered that there were grounds for adjustment of the VAT deducted as input tax by Finans inzhenering.

21 By an amended tax assessment notice of 19 July 2010, that office considered that TETS Haskovo, as the legal successor of Finans inzhenering, was liable for a sum of BGN 1 268 581 in respect of the adjustment of the VAT deduction made by Finans inzhenering, and interest on that sum in the amount of BGN 45 606.

22 An action was brought against that tax assessment notice before the Direktor in which TETS Haskovo claimed that no adjustment should be made in so far as the buildings in question were demolished with the sole aim of creating new buildings in their place which would be used for taxable transactions. On 1 December 2010, the Direktor dismissed the action.

23 TETS Haskovo thus brought an action against that decision before the Administrativen sad Varna.

24 The Administrativen sad Varna states that national law differentiates between the voluntary destruction of assets and destruction due to external factors, with the obligation on the part of the taxable person to adjust the deduction being waived only in the second case. In those circumstances, the Administrativen sad Varna decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

‘1. How is the expression “destruction of property” for the purposes of Article 185(2) of [the Directive] to be interpreted, and are the motives for the destruction and/or the conditions under which it takes place relevant for the purposes of the adjustment to the deduction made upon acquisition of the property?

2. Is the demolition of capital assets, duly proved, with the sole aim of creating new, more modern capital assets with the same purpose to be regarded as a modification of the factors used to determine the amount to be deducted within the meaning of Article 185(1) of [the Directive]?

3. Is Article 185(2) of [the Directive] to be interpreted as permitting the Member States to make adjustments in the case of the destruction of property where its acquisition remained totally or partially unpaid?

4. Is Article 185(1) and (2) of [the Directive] to be interpreted as precluding a national provision like Article 79(3) of the Law on VAT and Article 80(2)(1) of the [ZDDS], which provides for an adjustment of the deduction made in cases of destruction of property upon the acquisition of which a total payment of the basic amount and the tax calculated was made, and which makes the non-adjustment of a deduction dependent on a condition other than payment?

5. Is Article 185(2) of [the Directive] to be interpreted as ruling out the possibility of an adjustment to the deduction in the case of the demolition of existing buildings with the sole aim of creating new, more modern buildings in their place which fulfil the same purpose as the demolished buildings and are used for transactions which give entitlement to deduction of input VAT?’

Consideration of the questions referred

The second question

25 By its second question, which it is appropriate to answer first, the national court asks, in essence, whether Article 185(1) of the Directive is to be interpreted as meaning that the destruction, such as that at issue in the main proceedings, of several buildings intended for energy production and their replacement by more modern buildings which fulfil the same purpose as the demolished buildings constitutes a change, after the VAT return was made, in the factors used to

determine the amount of VAT to be deducted as input tax, and, therefore, leads to an obligation to adjust the deduction made.

26 In order to answer that question, it must be noted at the outset that Articles 184 to 186 of the Directive constitute the scheme applicable with regard to any entitlement of the tax authority to require adjustment to be made by a taxable person, including adjustment of deductions made in respect of capital goods.

27 Furthermore, it should be recalled that the deduction scheme established by the Directive is meant to relieve the operator entirely of the burden of the VAT paid or payable in the course of all his economic activities. Thus, the common system of VAT seeks to ensure complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject, in principle, to VAT (see Case C-153/11 *Klub* [2012] ECR, paragraph 35 and the case-law cited).

28 It follows from Article 168 of the Directive that, in so far as the taxable person, acting as such at the time when he acquires goods, uses the goods for the purposes of his taxable transactions, he is entitled to deduct the VAT paid or payable in respect of the goods. That right to deduct arises at the time when the deductible tax becomes chargeable, namely when the goods are delivered (see *Klub*, paragraph 36 and the case-law cited).

29 So far as concerns the impact on that deduction of any events occurring after the deduction is made, it is clear from the case-law that the use to which the goods or services are put, or are intended to be put, determines the extent of the initial deduction to which the taxable person is entitled and the extent of any adjustments in the course of the following periods, which must be made under the conditions laid down in Articles 185 to 187 of the Directive (see, to that effect, Case C-63/04 *Centralan Property* [2005] ECR I-11087, paragraph 54 and the case-law cited).

30 The adjustment provided for in those articles of the Directive is an integral part of the VAT deduction scheme established by that directive.

31 It should be noted in that regard that the rules laid down by the Directive in respect of adjustment are intended to enhance the precision of deductions so as to ensure the neutrality of VAT, with the result that transactions effected at an earlier stage continue to give rise to the right to deduct only to the extent that they are used to make supplies subject to VAT. By those rules, the Directive thus aims to establish a close and direct relationship between the right to deduct input VAT and the use of the goods and services concerned for taxable output transactions (see *Centralan Property*, paragraph 57).

32 As regards the coming into existence of an obligation to make an adjustment of an input VAT deduction, Article 185(1) of the Directive establishes the principle that such an adjustment must be made inter alia when changes to factors which were taken into consideration for the determination of the amount of such a deduction occurred after the VAT return.

33 In those circumstances, the question arises whether, in a case such as that in the main proceedings, where the demolition of immoveable property occurred in connection with work to modernise a thermal power station and with a view to the pursuit of economic activities whose object is producing energy, it must be found that there are such changes, within the meaning of Article 185(1) of the Directive, and whether, consequently, the very principle of the adjustment scheme applies.

34 In that regard, in a situation such as that at issue in the main proceedings, the replacement of old buildings with more modern buildings which fulfil the same purpose and, consequently, are

used for taxable output transactions in no way breaks the direct link between the input acquisition of the buildings at issue, on the one hand, and the economic activities carried out thereafter by the taxable person, on the other. The acquisition of the buildings at issue and their subsequent destruction with a view to modernising them can, therefore, be regarded as a series of linked transactions for the purposes of subsequent taxable transactions in the same way as the acquisition of new buildings and their direct use.

35 That interpretation must apply *a fortiori* where the buildings acquired were only partially destroyed, new buildings were built on the same land which had been acquired previously, and certain waste arising from the demolition of the old buildings was sold, which gave rise to taxable output transactions.

36 In those circumstances, the answer to the second question is that Article 185(1) of the Directive must be interpreted as meaning that the destruction, such as that at issue in the main proceedings, of several buildings intended for energy production and their replacement by more modern buildings which fulfil the same purpose as the demolished buildings does not constitute a change, after the VAT return was made, in the factors used to determine the amount of VAT to be deducted as input tax, and, therefore, does not lead to an obligation to adjust the deduction made.

37 In view of the answer to the second question, which rules out a change in the factors relevant to VAT in circumstances such as those in the main proceedings, there is no need to answer the other questions referred.

Costs

38 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 (Third Chamber) hereby rules:

Article 185(1) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as meaning that the destruction, such as that at issue in the main proceedings, of several buildings intended for energy production and their replacement by more modern buildings which fulfil the same purpose as the demolished buildings does not constitute a change, after the VAT return was made, in the factors used to determine the amount of VAT to be deducted as input tax, and, therefore, does not lead to an obligation to adjust the deduction made.

[Signatures]

* Language of the case: Bulgarian.