Provisional text

JUDGMENT OF THE COURT (First Chamber)

14 September 2017 (*)

(Reference for a preliminary ruling — Taxation — Common system of value added tax — Directive 2006/112/EC — Article 26(1)(b) and Articles 168 and 176 — Deduction of input tax — Services relating to construction or improvement of a property belonging to a third party — Use of services by the third party and by the taxable person — Service supplied free of charge to the third party — Entry of costs incurred for services carried out in the accounts as part of the taxable person's general costs — Determination of the existence of a direct and immediate link with the economic activity of the third party or the economic activity of the taxable person)

In Case C?132/16,

REQUEST for a preliminary ruling under Article 267 TFEU from the Varhoven administrativen sad (Supreme Administrative Court, Bulgaria), made by decision of 8 December 2015, received at the Court on 1 March 2016, in the proceedings

Direktor na Direktsia 'Obzhalvane i danachno-osiguritelna praktika' — Sofia

v

'Iberdrola Inmobiliaria Real Estate Investments' EOOD,

THE COURT (First Chamber),

composed of R. Silva de Lapuerta, President of the Chamber, E. Regan, A. Arabadjiev, C.G. Fernlund (Rapporteur) and S. Rodin, Judges,

Advocate General: J. Kokott,

Registrar: R. Schiano, Administrator,

having regard to the written procedure and further to the hearing on 1 December 2016,

after considering the observations submitted on behalf of:

– the Direktor na Direktsia 'Obzhalvane i danachno-osiguritelna praktika' — Sofia, by I. Kirova, acting as Agent,

– 'Iberdrola Inmobiliaria Real Estate Investments' EOOD, by T. Todorov and Z. Naumov, advokati,

– the Bulgarian Government, by M. Georgieva and E. Petranova, acting as Agents,

– the European Commission, by L. Lozano Palacios and G. Koleva and by D. Roussanov, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 6 April 2017,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Article 26(1) and Articles 168 and 176 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1).

2 The request has been made in proceedings between the Direktor na Direktsia 'Obzhalvane i danachno-osiguritelna praktika' — Sofia (the Director of the 'Appeals and Tax and Social Insurance Practice' Directorate of Sofia, Bulgaria) and 'Iberdrola Inmobiliaria Real Estate Investments' EOOD ('Iberdrola') concerning two adjusted tax notices addressed to the latter and relating to the entitlement to deduct input value added tax (VAT).

Legal context

EU law

3 Article 26 of Directive 2006/112 states:

'1. Each of the following transactions shall be treated as a supply of services for consideration:

…

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

2. Member States may derogate from paragraph 1, provided that such derogation does not lead to distortion of competition.'

4 Article 168 of that directive 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 176 of that directive provides:

'The Council, acting unanimously on a proposal from the Commission, shall determine the expenditure in respect of which VAT shall not be deductible. VAT shall in no circumstances be deductible in respect of expenditure which is not strictly business expenditure, such as that on luxuries, amusements or entertainment.

Pending the entry into force of the provisions referred to in the first paragraph, Member States may retain all the exclusions provided for under their national laws … or, in the case of the Member States which acceded to the Community after that date, on the date of their accession.'

Bulgarian law

6 Article 68 of the Zakon za danak varhu dobavenata stoynos (Law on value added tax) (DV No 63 of 4 August), in the version applicable to the dispute in the main proceedings ('the ZDDS'), states, in paragraph 1:

'Input tax is the amount of tax which a registered person is entitled to deduct from his tax liabilities in accordance with the present legislation in respect of:

(1) taxable supplies of goods or services received by that person;

… '

7 Under Article 69(1) of the ZDDS:

'Where the goods and services are used for the purposes of taxable supplies effected by the registered taxable person, that person may deduct the following:

(1) the tax on the goods and services which the supplier, where that supplier is also a registered taxable person in accordance with the present legislation, has supplied to him or is obliged to supply to him;

… '

8 Article 70 of the ZDDS states:

'1. Even where the requirements of Article 69 or Article 74 are satisfied, the right of deduction does not apply if:

…

(2) the goods or services are intended to be supplied free of charge or for activities other than the economic activity of the taxable person;

… '

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

9 The municipality of Tsarevo (Bulgaria), acting as a developer, obtained a building permit in order to reconstruct a waste-water pump station serving a holiday village located in its territory.

10 Iberdrola is a private investor who purchased several parcels of land in that holiday village in order to construct buildings containing approximately 300 apartments for seasonal use. The building permits were also issued for public service spaces, parking spaces and open-air equipment.

11 Iberdrola entered into a contract with the municipality of Tsarevo for the reconstruction of the pump station by means of construction or improvement works on that pump station and commissioned those works from a third party company.

12 Following completion of the works, the buildings which Iberdrola planned to construct in the holiday village could be connected to the pump station. The Varhoven administrativen sad (Supreme Administrative Court, Bulgaria) refers to an expert opinion which states that, without that reconstruction, the connection would be impossible since the existing sewer system is insufficient.

13 The costs indicated on the invoice for the reconstruction of the pump station were listed in

Iberdrola's accounts as 'deferred expenditure', as expenditure for the acquisition of tangible fixed assets, and in its profit and loss account as stocks for 2009 and 2010. According to the expert, there is a link between the supplies indicated on the invoice and the goods and services which Iberdrola must supply after the construction of the authorised buildings on its parcels of land.

14 The Bulgarian tax authority took the view that Iberdrola could not deduct input VAT of BGN 147 635 (Bulgarian leva) (approximately EUR 74 284) and sent Iberdrola an adjusted tax notice and an amended adjusted tax notice.

15 The Administrativen sad Sofia (Administrative Court, Sofia) however annulled those notices. It took the view that the municipality of Tsarevo benefited from the supply of services free of charge consisting of the completion of the works to reconstruct the pump station. However, the fact that the supply of services was free of charge did not justify, according to that court, the application of Article 70(1)(2) of the ZDDS, given that those services were used in the context of Iberdrola's economic activity, namely the connection of the buildings for which a building permit had been granted to the pump station. According to the Administrativen sad Sofia (Administrative Court, Sofia), if the right to deduct input VAT in respect of a supply of services were to be recognised, the expenditure incurred for that purpose must form part of the general costs of the taxable person and constitute a component of the price of those services. It is irrelevant whether the works carried out relate to a property belonging to the municipality.

16 The referring court makes references to two judgments of the Court, delivered in cases also centring on Article 70(2) of the ZDDS, namely the judgment of 16 February 2002, *Eon Aset Menidjmunt* (C?118/11, EU:C:2012:97), and the judgment of 22 March 2012 *Klub* (C?153/11, EU:C:2012:163). The referring court indicates however that those judgments led to conflicting interpretations by the national courts.

17 According to certain courts, despite the fact that the works were carried out free of charge, the fact that the work relates to the property of the municipality and does not constitute therefore an asset of the undertaking prevents the deduction of input VAT. According to other courts, on the other hand, the listing of the costs incurred for the works in the general costs of the undertaking and the use of the pump station in the context of the activity of the undertaking gives rise to a right to deduct.

18 Moreover, the referring court indicates that, according to the national provision at issue in the main proceedings, the fact that a supply of services is provided free of charge is sufficient by itself to refuse to recognise the right to deduct input VAT, and, consequently, is independent of whether the services in question are used in the context of the economic activity of the recipient of the services or for purposes other than those relating to the recipient's undertaking. The referring court points out however the difference between that provision and Article 26(1)(b) of Directive 2006/112, which subjects the refusal of the right to deduct to the dual condition that the supply of those services is free of charge and that they are used for purposes other than the activity of the undertaking.

19 In those circumstances, the Varhoven administrativen sad (Administrative Supreme Court, Bulgaria) decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

'(1) Do Article 26(1)(b), Article 168(a), and Article 176 of Council Directive 2006/112 … preclude a provision of national law such as Article 70(1)(2) of the [ZDDS], which restricts the right to deduct input VAT in respect of the supply of services relating to construction or improvement of a property owned by a third party, which are used both by the recipient of the supply and by the third party, for the sole reason that the third party enjoys the result of those services free of

charge, without taking into account the fact that the services are to be used in the context of the economic activity of the taxable recipient?

(2) Do Article 26(1)(b), Article 168(a), and Article 176 of Directive 2006/112 … preclude a tax practice consisting of refusing to recognise the right to deduct the input VAT in respect of the supply of services, where the expenditure corresponding to those services is counted among the taxable person's general costs, on the ground that it was incurred in order to construct or improve a property owned by another person, without taking into account the fact that that property is also to be used by the recipient of the supply of building services in the context of its economic activity?'

Consideration of the questions referred

20 It should be noted, first of all, that the dispute in the main proceedings and the questions referred by the referring court relate to the scope of the right to deduct laid down by Directive 2006/112 and, more specifically, by Article 168(a) thereof.

21 To the extent that the questions referred relate to Article 176 of Directive 2006/112, it should be recalled that the Court has already assessed that article in the context of cases relating to Article 70 of the ZDDS (judgments of 16 February 2012, *Eon Aset Menidjmunt*, C?118/11, EU:C:2012:97, paragraphs 71 to 74, and of 18 July 2013, *AES-3C Maritza East 1*, C?124/12, EU:C:2013:488, paragraphs 45 to 54). It is important to point out that, even if Article 70 of the ZDDS were to provide for an exception from the right to deduct in place at the date of accession of the Republic of Bulgaria to the European Union, Article 176 of Directive 2006/112 allows for such exclusions to be maintained only in so far as they do not provide for general exclusions from the right to a deduct established by that directive and in particular by Article 168 thereof (see, to that effect, judgment of 23 April 2009, *PARAT Automotive Cabrio*, C?74/08, EU:C:2009:261, paragraph 29 and the case-law cited).

22 As regards Article 26 of Directive 2006/112, that provision relates to the taxability of certain transactions. In the case in the main proceedings, the dispute does not concern the possible taxability of the supply of services carried out by the taxable person for the third party and the corresponding requirement to pay the VAT which would relate thereto, but rather concerns the right to deduct input VAT levied on the expenses incurred by the taxable person in order to carry out that supply of services.

23 It is therefore unnecessary to examine the present dispute from the perspective of Article 26 of Directive 2006/112.

24 Consequently, it is necessary to find that, by its questions, which it is appropriate to examine together, the referring court asks, in essence, whether Article 168(a) of Directive 2006/112 must be interpreted as meaning that a taxable person has the right to deduct input VAT in respect of a supply of services consisting of the construction or improvement of a property owned by a third party when that third party enjoys the results of those services free of charge and when those services are used both by the taxable person and by the third party in the context of their economic activity.

25 With regard to whether the right to deduct laid down by Article 168(a) of Directive 2006/112 precludes a provision such as Article 70 of the ZDDS, it should be recalled that that right is an integral part of the VAT scheme and in principle may not be limited. It is exercisable immediately in respect of all the taxes charged on input transactions (see to that effect, in particular, judgments of 29 October 2009, *SKF*, C?29/08, EU:C:2009:665, paragraph 55, and of 18 July 2013, *AES-3C Maritza East 1*, C?124/12, EU:C:2013:488, paragraph 25).

26 The deduction system is intended to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT (see, in particular, judgments of 29 October 2009, *SKF*, C?29/08, EU:C:2009:665, paragraph 56, and of 18 July 2013, *AES-3C Maritza East 1*, C?124/12, EU:C:2013:488, paragraph 26).

27 It follows from Article 168 of Directive 2006/112 that, in so far as the taxable person, acting as such at the time when he acquires goods or receives services, uses those goods or services for the purposes of his taxed transactions, he is entitled to deduct the VAT paid or payable in respect of those goods or services (see, to that effect, judgment of 22 October 2015, *Sveda*, C?126/14, EU:C:2015:712, paragraph 18).

28 In accordance with settled case-law, the existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to the right to deduct is necessary, in principle, before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement. The right to deduct VAT charged on the acquisition of input goods or services presupposes that the expenditure incurred in acquiring them was a component of the cost of the output transactions that gave rise to the right to deduct (judgments of 29 October 2009, *SKF*, C?29/08, EU:C:2009:665, paragraph 57, and of 18 July 2013, *AES-3C Maritza East 1*, C?124/12, EU:C:2013:488, paragraph 27).

29 A taxable person also has a right to deduct even where there is no direct and immediate link between a particular input transaction and an output transaction or transactions giving rise to the right to deduct, where the costs of the services in question are part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such costs do have a direct and immediate link with the taxable person’s economic activity as a whole (see, in particular, judgments of 29 October 2009, *SKF*, C?29/08, EU:C:2009:665, paragraph 58, and of 18 July 2013, *AES-3C Maritza East 1*, C?124/12, EU:C:2013:488, paragraph 28).

30 On the other hand, where goods or services acquired by a taxable person are used for purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected or input tax deducted (see, to that effect, judgment of 29 October 2009, *SKF*, C?29/08, EU:C:2009:665, paragraph 59).

31 It is apparent from the case-law of the Court that, in the context of the direct-link test that is to be applied by the tax authorities and national courts, they should consider all the circumstances surrounding the transactions concerned and take account only of the transactions which are objectively linked to the taxable person’s taxable activity. The existence of such a link must thus be assessed in the light of the objective content of the transaction in question (see, to that effect, judgment of 22 October 2015, *Sveda*, C?126/14, EU:C:2015:712, paragraph 29).

32 In the appraisal of the question as to whether, in circumstances such as those at issue in the main proceedings, Iberdrola has the right to deduct input VAT for the reconstruction of the waste-water pump station, it is therefore necessary to determine whether there is a direct and immediate link between, on the one hand, that reconstruction service and, on the other hand, a taxed output transaction by Iberdrola or that undertaking’s economic activity.

33 It is clear from the order for reference that, without the reconstruction of that pump station, it would have been impossible to connect the buildings which Iberdrola planned to build to that pump station, with the result that that reconstruction was essential for completing that project and that, consequently, in the absence of such reconstruction, Iberdrola would not have been able to carry

out its economic activity.

34 Those circumstances are likely to demonstrate the existence of a direct and immediate link between the reconstruction service in respect of the pump station belonging to the municipality of Tsarevo and a taxed output transaction by Iberdrola, since it appears that the service was supplied in order to allow the latter to carry out the construction project at issue in the main proceedings.

35 The fact that the municipality of Tsarevo also benefits from that service cannot justify the right to deduct corresponding to that service being denied to Iberdrola if the existence of such a direct and immediate link is established, which is a matter for the referring court to determine.

36 In that regard, it will be necessary to take into account the fact that the input reconstruction service at issue in the main proceedings is a component of the cost of a taxed output transaction by Iberdrola.

37 That being said, it is also for the referring court to examine whether that service was limited to that which was necessary to ensure the connection of those buildings to the pump station at issue in the main proceedings or whether that service went beyond that which was necessary for that purpose.

38 In the first situation, it would be necessary to recognise a right to deduct the input VAT levied on all the costs incurred for the reconstruction of the pump station since those costs can be regarded as having a direct and immediate link with the general costs connected with all the economic activities of the taxable person (see, to that effect, judgment of 18 July 2013, *AES-3C Maritza East 1*, C?124/12, EU:C:2013:488, paragraph 52).

39 By contrast, if the reconstruction works relating to that pump station exceeded the needs created solely by the buildings constructed by Iberdrola, the existence of a direct and immediate link between that service and the taxed output transaction by Iberdrola, consisting of the construction of those buildings, would be partially broken and a right to deduct would thus have to be recognised in respect of Iberdrola only for the input VAT levied on the part of the costs incurred for the reconstruction of the pump station which was objectively necessary to allow Iberdrola to carry out its taxed transactions.

40 In those circumstances, the answer to the questions referred is that Article 168(a) of Directive 2006/112 must be interpreted as meaning that a taxable person has the right to deduct input VAT in respect of a supply of services consisting of the construction or improvement of a property owned by a third party when that third party enjoys the results of those services free of charge and when those services are used both by the taxable person and by the third party in the context of their economic activity, in so far as those services do not exceed that which is necessary to allow that taxable person to carry out the taxable output transactions and where their cost is included in the price of those transactions.

Costs

41 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 (First Chamber) hereby rules:

Article 168(a) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as meaning that a taxable person has the right to deduct input value added tax in respect of a supply of services consisting of the construction or improvement of a property owned by a third party when that third party

enjoys the results of those services free of charge and when those services are used both by the taxable person and by the third party in the context of their economic activity, in so far as those services do not exceed that which is necessary to allow that taxable person to carry out the taxable output transactions and where their cost is included in the price of those transactions.

[Signatures]

* Language of the case: Bulgarian.