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61998C0408

Opinion of Mr Advocate General Jacobs delivered on 13 April 2000. - Abbey National plc v Commissioners of Customs & Excise. - Reference for a preliminary ruling: High Court of Justice (England & Wales), Queen's Bench Division (Divisional Court) - United Kingdom. - VAT - Articles 5(8) and 17(2)(a) and (5) of the Sixth VAT Directive - Transfer of a totality of assets - Deduction of input tax on services used by the transferor for the purposes of the transfer - Goods and services used for the purposes of the taxable person's taxable transactions. - Case C-408/98.

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Opinion of the Advocate-General

1. Under Article 5(8) of the Sixth VAT Directive, Member States may consider that, where a totality of assets or part thereof is transferred, no supply of goods has taken place and the recipient is to be treated as the successor to the transferor. Where a Member State exercises that option, is the result merely that no VAT is payable in respect of the transfer itself, or is it also the case that any VAT payable by the transferor on services received in connection with the transfer is non-deductible because it is not attributable to a taxable supply? In other words, must the transfer be treated in the same way as a supply which is exempt from VAT under Article 13 of the Sixth Directive or does it fall into a different category of non-supply and, if the latter, how should it be treated?

Relevant legislative provisions

Community provisions

2. The principle on which VAT operates is set out as follows in Article 2 of the First VAT Directive:

The principle of the common system of value added tax involves the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged.

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

3. The deduction system is designed to avoid a cumulative effect where VAT has also been levied on goods and/or services used in order to produce those supplied that is to say, to avoid VAT being levied anew on VAT already charged. By its operation, a chain of transactions builds up, in which the net amount payable in respect of each link is a specified proportion of the value added at that stage. When the chain comes to an end, the total amount levied will have been the relevant

proportion of the final price.

4. Under Article 2 of the Sixth Directive, a supply of goods or services effected for consideration by a taxable person acting as such is subject to VAT. According to Article 4(1), a taxable person is a person who carries out an economic activity, whatever the purpose or result of that activity. Economic activities include, under Article 4(2), the exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis.

5. Article 5 defines supplies of goods. Under Article 5(1), a supply of goods means the transfer of the right to dispose of tangible property as owner. The remainder of the paragraphs of that article provide, essentially, positive definitions of what is or may be considered to be a supply and what is or may be considered to be tangible property. The latter may include, under Article 5(3), certain interests in and rights over immovable property. In addition to those positive definitions, however, Article 5(8) provides:

In the event of a transfer, whether for consideration or not or as a contribution to a company, of a totality of assets or part thereof, Member States may consider that no supply of goods has taken place and in that event the recipient shall be treated as the successor to the transferor. Where appropriate, Member States may take the necessary measures to prevent distortion of competition in cases where the recipient is not wholly liable to tax.

6. Under Article 6(5), Article 5(8) applies in like manner to the supply of services.

7. It is important to bear in mind that the provision in Article 5(8) is included in the definition of a supply of goods (and, by virtue of Article 6(5), of a supply of services) and not in the list of exemptions from VAT which are contained, except as regards international trade, in Article 13. Article 13(A) lists exemptions for certain activities in the public interest. Article 13(B) lists a number of other exempt transactions, including (a) insurance transactions and (b) the leasing or letting of immovable property, but Article 13(C) authorises Member States to allow taxpayers to opt for taxation for certain of those transactions, including (a) the leasing or letting of immovable property.

8. Deductions are governed by Articles 17 to 20.

9. Article 17(2)(a) states: 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 ... value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person.

10. Where goods and services are used by a taxable person both for transactions in respect of which VAT is deductible and for transactions in respect of which it is not, Article 17(5) of the Sixth Directive states that only such proportion of the value added tax shall be deductible as is attributable to the former transactions and this proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person. Article 19 provides, basically, for deduction of a fraction equivalent to turnover in VAT-deductible transactions divided by total turnover.

National implementing provisions

11. The United Kingdom legislation pursuant to Article 5(3) of the Sixth Directive treats the transfer of a major interest in land as a supply of goods. In Scotland, where the property in issue in the present case is situated, the definition of a major interest includes the lessee's interest under a lease for a period of not less than 20 years.

12. The option in Article 5(8) of the Sixth Directive has been exercised by, inter alia, Regulation 5(1) of the Value Added Tax (Special Provisions) Order (SI 1992/3129) (the VAT Order), under

which, where a person transfers (a) his business or (b) part of his business to another person as a going concern, the supply of the business assets is to be treated as neither a supply of goods nor a supply of services. In both cases, such treatment is subject to the condition that the transferee must use the assets for carrying on the same kind of business as the transferor and must be, or must immediately become, a taxable person. In the case of a transfer of part of a business, there is the further condition that the part must be capable of separate operation.

13. Finally, the United Kingdom has applied Article 13(B)(b) and (C)(a) of the Sixth Directive by making the grant of any interest in or right over land an exempt supply, but by allowing owners of commercial property or of interests in commercial property to waive the exemption in respect of particular buildings.

Factual and procedural background

14. The essential facts of the case in the main proceedings, as they appear from the national court's order for reference and accompanying file and from the observations to the Court, are as follows.

15. Scottish Mutual Assurance plc (Scottish Mutual) is a wholly-owned subsidiary of Abbey National plc (Abbey National), which represents it for VAT purposes. It is partly exempt from VAT; in addition to its insurance business (which is exempt pursuant to Article 13(B)(a)), it operates a commercial property-letting business, in respect of which it has opted for taxation in accordance with the United Kingdom rules implementing Article 13(C)(a). It thus charges VAT on rents, and deducts from that VAT input tax incurred in running the business. With regard to residual input tax which cannot be attributed directly either to taxable or to exempt transactions, the Abbey National group has agreed with the Commissioners of Customs and Excise (the Commissioners) on an apportionment method in accordance with the United Kingdom provisions implementing Articles 17(5) and 19.

16. In the course of its property-letting business, Scottish Mutual acquires and disposes of property from time to time. One such property was Atholl House, in Aberdeen, which it held on a 125-year lease running from 1976 and which was sublet on a 40-year lease. In 1993, it sold its interest in the 125-year lease, with the sub-tenancy, to an unconnected company, as an ongoing business in respect of which the latter, too, had opted for taxation. Pursuant to Regulation 5(1) of the VAT Order, no VAT was payable on the transfer price of £5 400 000.

17. In connection with the transfer, however, Scottish Mutual incurred professional fees on which VAT of £4 365.04 was charged. Considering that sum to be input tax attributable to a transaction in the course of its taxable business, the company deducted it from its output tax. Following an assessment in 1994, the Commissioners took the view that the sale of Atholl House was a transfer of a going concern by Scottish Mutual and as such not a taxable supply to which input tax could be attributed. A proportion of the VAT determined by the agreed method of apportionment of residual, non-attributable, input tax could none the less be deducted.

18. Abbey National challenged the assessment before the VAT and Duties Tribunal, London, which dismissed its appeal in 1997. The Tribunal decided, essentially, that the right to deduct arises where goods or services are used for the purposes of, and are directly and immediately linked to, a taxable transaction; the transfer of Atholl House was not a taxable transaction and could thus not itself form the basis for a right to deduct; indeed, the Tribunal proceeded on the basis that the transfer was not a transfer of a going concern but fell within the management of Scottish Mutual's property investment portfolio; however, Scottish Mutual's property-letting business was intended to provide funds to meet claims in the course of its insurance business; expenses incurred in connection with the transfer were thus overheads directly and immediately linked to the company's supplies, both taxable and exempt; the assessment was consequently made on the correct basis.

19. Abbey National then appealed to the English High Court which, on 2 November 1998, noting that the transfer was agreed between the parties to be (contrary to the finding of the VAT Tribunal) a transfer of a going concern, and that the case involved a matter of VAT law which was of widespread concern to the commercial property industry but on which the Court of Justice had not yet ruled, sought a preliminary ruling from the Court on the following questions:

1. Having regard to the terms of Article 17(2) of the Sixth VAT Directive, do the words in Article 5(8) thereof "the recipient shall be treated as the successor to the transferor" require that the recipient's supplies should be treated as if they had been made by the transferor, for the purpose of determining the transferor's input tax deduction?

2. In the event of "a transfer ... of a totality of assets or part thereof" within Article 5(8) of the Sixth VAT Directive, where the Member State, by virtue of national measures adopted pursuant to that article, considers that no supply of goods or services has taken place, may the taxpayer, upon the proper interpretation of Articles 5(8) and 17(2), deduct the whole of the input tax in respect of costs attributable to the transfer, if the taxpayer would, apart from the application of Article 5(8), be obliged to account for output tax on the transfer?

3. Where the economic activity of the transferor prior to the transaction falling within Article 5(8) has been fully taxable, is input tax deductible in respect of a payment made in connection with the termination of that activity?

20. Written observations have been submitted by Abbey National, the United Kingdom and Netherlands Governments and the Commission. Abbey National, the United Kingdom Government and the Commission also presented oral argument at the hearing.

Analysis

The issue

21. The three questions as formulated suggest three routes (favoured, it would seem, by Abbey National) by which a solution to the dispute might be reached. However, they are not the only possible routes. A different analysis has been suggested by the Netherlands Government and by the Commission. Therefore, whilst recognising that the considerations engendered by the three questions specifically raised may play a role, I shall address more generally the question: Where a Member State has made use of the option in Articles 5(8) and 6(5), so that a transfer of a totality of assets or part thereof is treated as not being a supply of goods or services, is VAT on supplies received in order to make that transfer deductible by the transferor?

Purpose of Article 5(8)

22. When interpreting Article 5(8) and applying it to circumstances such as those of Scottish Mutual, it is helpful to bear in mind the purpose for which it was enacted.

23. No specific enlightenment is to be gained from the preamble to the Sixth Directive or to its predecessor, the Second VAT Directive. However, in the Commission's explanatory memorandum to its Proposal for a Sixth Directive, the option was described as being available in the interests of simplicity and so as not to overburden the resources of the undertaking.

24. Although the draft provision was narrower than that finally adopted, the purpose is clearly one of convenience. If VAT were charged on the transfer of the assets of a business, considerable sums of money might be immobilised only to be deducted later. The net effect would be nil, but the business might find itself in financially straitened circumstances at the possibly delicate juncture of a change of ownership. A Member State can easily avoid creating such difficulties by implementing Article 5(8), since the overall VAT burden on the business, and the overall amount levied by the revenue authorities, will not be affected.

Transfer of a totality of assets or part thereof

25. The question of what constitutes a transfer of a totality of assets or part thereof has not been debated before the Court, although the Netherlands Government has questioned whether the transfer in the present case fell within that definition, and it appears that the VAT and Duties Tribunal considered that there was no evidence that Atholl House was a separate identifiable business activity for the purpose of classifying the sale of the lessee's interest as a transfer of a business as a going concern.

26. The transfer of a totality of assets, viewed in the context of a supply effected by a taxable person one who carries on an economic activity may be seen clearly to refer to the transfer of a business, in its entirety, by means of a transfer of its assets rather than of the shares in the business.

27. The concept of part of a totality of assets, however, is not as clear. In particular, the question arises as to how a distinction is to be drawn between the transfer of such a part and an ordinary transfer of one or more of the assets of a business, which would normally be a taxable transaction. Community law is silent on the point; no elucidation is to be found in any of the VAT directives, nor has the question hitherto been considered by the Court.

28. The solution adopted in the United Kingdom would appear to be a reasonable one: when assets representing a part of a business which is capable of separate operation are transferred in such a way that the transferred business continues as a going concern, the option exercised under Article 5(8) of the Sixth Directive applies and no supply is deemed to have taken place. Those criteria do not appear to place any strain on the broad wording of the Community provision, and whether they are met in a particular case must thus remain a matter for the competent national court.

29. The circumstances of the present case involve a transaction which is said to qualify, within the definition applied in the United Kingdom, as a transfer of part of a totality of assets in other words, of a self-standing part of a business. The fact that the transfer was not of the totality of Scottish Mutual's assets has given rise to some debate in these proceedings as to whether the VAT incurred in effecting the transfer may be in any way attributable to and deductible in respect of its retained and continuing property-letting business, or the generality of its business in both the insurance and property-letting sectors. Rather than addressing those questions immediately, however, I find it more helpful to consider first the straightforward situation of a transfer of a totality of assets. It will then be seen to what extent further consideration of the specific circumstances of a transfer of part of the assets of a larger overall business may be required.

Transfer of a totality of assets

30. The simplest situation to consider, and that from which the treatment of other situations may be deduced, is that of the transfer of all the assets of a business which is engaged exclusively in making taxable supplies.

31. In order to be deductible, VAT must be borne by supplies (inputs) which are used for the purposes of the taxpayer's taxable transactions (outputs). This is clear from the wording of Article 17(2), particularly when viewed in the context of the provision which it replaced Article 11(1) of the Second Directive, which referred to supplies used for the purposes of his undertaking and of the proposal for a Sixth Directive, which spoke of supplies used for the purposes of his taxable business. It thus appears that the legislature deliberately chose wording intended to limit the scope of the right to deduct to the situation where inputs are used for the purposes of identifiable taxable transactions. The principle that deductibility is dependent upon attributability is also inherent in the apportionment rules governed by Articles 17(5) and 19.

32. Seen in that light, the position of exempt supplies is anomalous in the scheme of VAT, particularly where they are cost components of subsequent taxable supplies. Their full cost, including the VAT levied on inputs, will presumably be reflected in the price charged. In that situation, there will be double or cumulative taxation, since VAT will be charged in full on an output one of whose cost components already includes VAT. There is a potentially serious departure from the principle on which VAT is levied in that a chain of supplies may be broken in this manner at more than one point, with a concomitant repetition of cumulative taxation. Such factors suggest that the treatment accorded to exemptions should be applied restrictively; to the extent possible, the VAT treatment of each transaction should conform to the basic principle, in order to avoid distortions.

33. That effect of exempt supplies was the basis of the approach followed by the Court in BLP. A management and holding company had sold 95% of the shares in a company which it owned, by an exempt transaction (transactions in shares are compulsorily exempt under Article 13(B)(5)). The purpose of the sale was to raise funds to pay debts deriving from taxable transactions. As in the present case, professional fees were incurred in relation to the sale, and the question arose whether the VAT charged on those fees was deductible. The Court held that, to give rise to a right to deduct, the goods or services in question must have a direct and immediate link with the taxable transactions and thus that where a taxable person supplies services to another taxable person who uses them for an exempt transaction, the latter person is not entitled to deduct the input VAT paid, even if the ultimate purpose of the transaction is the carrying out of a taxable transaction. That ruling was based not only on the wording of the First and Sixth Directives but also on the consideration that it would be contrary to the need for legal certainty and facility of application of the tax to require the revenue authorities to determine the intention of the taxable person when supplies are not objectively linked to taxable transactions.

34. However, in other cases the Court has taken what appears to be a broader approach. In Intiem, for example, it held that the right to deduct input tax applies to goods and services connected with the pursuit of the taxable person's business; in Sofitam, it stated that the right to deduct must be applied in such a way that its scope corresponds as far as possible to the sphere of the taxable person's business; and in Ghent Coal it ruled that a taxable person acting as such is entitled to deduct VAT payable on supplies acquired for the purpose of investment work intended to be used in connection with taxable transactions, even where, for reasons beyond the taxable person's control, those taxable transactions were never in fact carried out. Indeed, in BLP itself the Court also stated that if the company had raised the money by way of a bank loan rather than by making an exempt transaction, it could have deducted VAT on professional fees incurred for that purpose since such fees would have constituted overheads which would have formed cost components of its taxable transactions.

35. The contrast between those two approaches may be more apparent than real. The reference to cost components in the BLP judgment is a reminder of the basic principle set out in Article 2 of the First Directive: On each transaction, value added tax ... shall be chargeable after deduction of the amount of value added tax borne directly by the various cost components. Thus, what matters is whether the taxed input is a cost component of a taxable output, not whether the most closely-linked transaction is itself taxable. As the Commission submitted at the hearing, the conclusion to be drawn from the BLP judgment is that the question to be asked is not what is the transaction with which the cost component has the most direct and immediate link but whether there is a sufficiently direct and immediate link with a taxable economic activity. Indeed, it may be stressed that in that case the Court was concerned with supplies which were not objectively linked to taxable transactions. Nevertheless, it remains clear from BLP that the chain-breaking effect which is an inherent feature of an exempt transaction will always prevent VAT incurred on supplies used for such a transaction from being deductible from VAT to be paid on a subsequent output supply of which the exempt transaction forms a cost component. The need for a direct and immediate link thus does not refer exclusively to the very next link in the chain but serves to exclude situations where the chain has been broken by an exempt supply.

36. The next point to be made is that the transfer of a totality of assets in a Member State which has exercised the option in Article 5(8) is not a taxable transaction. I agree in this regard with the view put forward by both the United Kingdom Government and the Commission at the hearing, that no purpose is to be served by looking at the transfer as a transaction which would normally be taxable. Since it must be deemed not to be a supply at all, it is irrelevant that it would have been a taxable supply had the option not been exercised. Thus, I agree with the Commission that the High Court's second question is not germane to the solution required in the present case.

37. Since the transfer is not a taxable supply, it follows inescapably from Article 17(2) of the Sixth Directive that it cannot itself form the basis for deduction of input tax incurred in connection with it.

38. However, it is not an exempt supply either. An exempt supply has the effect of breaking the VAT chain. There is no reason to consider that the chain is broken by a transaction in which no supply of goods [or services] has taken place. On the contrary, the stipulation that the recipient shall be treated as the successor to the transferor stresses the continuity of the situation from a VAT point of view. Although to pursue the metaphor one link in the chain is deemed not to exist, the fact of that missing link does not imply a break and a recommencement of the chain but rather a sequential relationship between the links on either side of it. In addition, as I have reasoned, the treatment accorded to exemptions should be applied restrictively. Thus it is appropriate to look further in order to see whether the VAT which it is sought to deduct was borne by a supply forming a cost component of some other taxable transaction.

39. As a general rule, where the assets of a business are sold, the seller (transferor) will calculate the price so as to pass on any costs incurred in the sale. Those costs will thus, together with any

incurred by the buyer (recipient), form part of the cost components of taxable supplies subsequently made. However, VAT borne by supplies in connection with the sale can be deducted by the buyer the maker of the subsequent taxable supplies only if it has been paid by him. And if it cannot be deducted, it will give rise contrary to the basic principle of neutrality which governs the VAT system to double taxation. To avoid that difficulty the obvious solution is for the VAT to be deductible by the transferor. In that way, moreover, the recipient is placed in the same position as if he had paid all the costs himself and been able to recover the VAT thereon.

40. It would in that event be necessary to consider that the transferor's input supplies were acquired for the purposes of the recipient's subsequent taxable outputs, an approach favoured by Abbey National and alluded to in the High Court's first question. The United Kingdom Government has objected that this would involve an unacceptable reversal of the order of succession laid down in Article 5(8), making the transferor the successor to the recipient. That objection does not appear to me to be justified. The approach in question merely postulates that the purpose for which the input is used may be that of the person deemed in these particular circumstances to be the successor to the person acquiring the input, and in no way requires any reversal of the chain.

41. However, the reasoning in the last two paragraphs has been predicated to some extent on the assumption of a chronological sequence when determining the relationship between inputs and outputs. In that reasoning, moreover, it makes a difference whether the costs incurred by the transferor in relation to the transfer are passed on to the recipient in the price. But the economic reality of business does not necessarily conform to that chronological assumption nor indeed is it inherent in the VAT system, since the tax deductible is that due or paid in respect of goods or services supplied or to be supplied.

42. According to a broader approach, where a taxable person pursues an economic activity in which he makes wholly taxable supplies, all the goods and services supplied to him for the purposes of that activity are cost components of his outputs and all the VAT borne by them should be deductible. The fact that, from a strict bookkeeping point of view, inputs are not attributed to or even apportioned among particular outputs is of no import here. Clearly not all goods and services consumed by a taxable person will be incorporated directly into an identifiable output. Some will be of the nature of general overheads and, to the extent that those overheads are cost components of taxable supplies, VAT levied on them may be deducted. Many types of overhead may be absorbed by the business as a whole, simply influencing indirectly the range of profit margins sought.

43. One such type of overhead includes costs incurred on starting up a business. It is clear from the case-law of the Court that the VAT on such costs may be deducted by the taxable person, even in certain circumstances where there is no output tax for it to be deducted from, with the result that the deduction in fact amounts to a payment by the revenue authority to the taxable person. Under United Kingdom legislation, the same applies to VAT on costs incurred in connection with the termination of a business, and the Commission appeared to accept at the hearing that such an approach is consistent with Community law.

44. I agree. The Court stated in Rompelman that the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. That intention would clearly not be achieved if he were left with a non-deductible VAT bill on winding up his business. In addition, it may be reasoned that from an economic point of view the costs of winding up a business are costs of the business as a whole and thus cost components of the supplies which it makes, even if they are not specifically entered as such in the accounts.

45. The transfer of a totality of business assets particularly where, pursuant to Article 5(8), no supply is deemed to have taken place and the recipient is treated as the successor to the transferor is not the same as the liquidation of the business and again I must agree with the Commission that the approach adumbrated in the High Court's third question is perhaps not the most apposite. However, as the Commission suggested at the hearing, it may provide a useful

analogy. If it is possible to deduct VAT incurred, after the making of the last taxable supplies, in connection with the termination of a business, then the same must equally apply where the business is not wound up but passed on, so that it continues operating and making taxable supplies in other words, where the step taken is an event in the course of pursuing the business rather than the event which brings it to an end.

46. Thus, both approaches lead to the same conclusion: where, in the context of Article 5(8), there is a transfer of the totality of the assets of a business engaged solely in making taxable supplies, the transferor may deduct VAT incurred on inputs received in connection with the transfer because those inputs are attributable to taxable outputs and the chain linking the inputs to the outputs is not broken by an intervening exempt transaction.

47. On that basis, it clearly follows from Articles 17(5) and 19 that where the transfer of the totality of assets relates to a business engaged in making both taxable and exempt supplies, any input VAT must be apportioned between them, so that only part of it will be deductible.

Transfer of part of a totality of assets

48. The question of apportionment does not present itself in quite as simple a manner where the transfer is of only part of the transferor's assets and where, as in the present case, the transferor is engaged in making both taxable and exempt supplies. Indeed, a further complication appears to arise here, in that the assets transferred represent only a part of the transferor's taxable business which itself is only a part of the whole business.

49. However, in the light of the conclusion which I have reached with regard to the transfer of a totality of assets, I think those apparent complexities may be seen to dissipate. To the extent that the VAT on services related to the transfer is deductible, it is because it is attributable to because there is a direct and immediate link with supplies made by the part of the business whose assets are transferred. Thus, if those supplies are all taxable, it will be deductible in full, and there will be no need to look any further. Apportionment will come into play if the supplies are partly taxable and partly exempt.

50. The only circumstances in which it would be necessary to look to other aspects of the taxable person's business in order to determine apportionment would be if it were considered that, contrary to my view, the VAT in question could not be attributed to the taxable supplies of the part of the business transferred.

51. If that were the case, I consider that it would be necessary, before discounting any possibility of deduction, to examine whether as envisaged for example in paragraph 25 of the judgment in BLP the costs of the transfer were cost components, in the form of overheads, of the supplies made by the business as a whole (here, the insurance business), or by that part of it (here, the property-letting business) of which the part transferred formed a smaller part. Such matters would, however, be for the competent national court to examine as issues of fact.

Conclusion

52. Accordingly, in my opinion the Court should give the following answer to the High Court in this case:

Where a Member State has made use of the option in Articles 5(8) and 6(5) of the Sixth VAT Directive, so that a transfer of a totality of assets or part thereof is treated as not being a supply of goods or services, VAT on supplies received in order to make that transfer is deductible by the transferor:

in full where the assets are those of a business making only taxable supplies;

in accordance with Articles 17(5) and 19 of the directive where the assets are those of a business making both taxable and exempt supplies.