OPINION OF ADVOCATE GENERAL

JACOBS

delivered on 28 October 2004 (1)

Case C-32/03

I/S Fini H

v

Skatteministeriet

1. This reference for a preliminary ruling from the Danish Højesteret (Supreme Court) concerns the circumstances in which a person who holds a lease for premises on which he formerly carried out an economic activity but who has now ceased that activity may or may not continue to be regarded for VAT purposes as a taxable person in respect of the continuing lease, entitled in that capacity to deduct input tax on expenditure relating to the premises.

Legislative background

2. The essence of the VAT system is set out in Article 2 of the First VAT Directive: (2)

‘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. Under Article 2 of the Sixth VAT Directive, (3) a supply of goods or services effected for consideration by a taxable person acting as such is subject to VAT.

4. A taxable person is defined in Article 4(1) as one who carries out an economic activity, whatever its purpose or result. Economic activities are, under Article 4(2), ‘all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions’, together with the ‘exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis’. Article 4(3) provides that ‘Member States may also treat as a taxable person anyone who carries out, on an occasional basis, a

transaction relating to the activities referred to in paragraph 2'.

5. The essentials of the right to deduct are set out in Article 17 of the Sixth Directive. Article 17(2) 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 (a) value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person …' That entitlement arises, in accordance with Article 17(1), at the time when the deductible tax becomes chargeable.

6. Issues relating to the use of taxed input goods and services 'for the purposes of' taxable output transactions, and thus to the circumstances in which a right to deduct arises or does not arise under Article 17(2) of the Sixth Directive, have been considered by the Court on a number of occasions.

7. Of some relevance to the present case is the case-law (4) to the effect that whenever a person has the intention, confirmed by objective evidence, to commence an economic activity and acquires initial taxed supplies for that purpose, he must be regarded as a taxable person acting in that capacity and as having the right immediately to deduct the VAT on supplies acquired for the purposes of his intended taxable transactions, without having to wait for the actual exploitation of the business to begin and even if it does not in fact begin.

8. The Court has not yet ruled specifically on the 'mirror' situation in which a taxable person has ceased an economic activity yet continues to acquire taxed supplies connected with obligations undertaken for the purpose of that activity.

9. It has however held that, at least where a business making taxable transactions is transferred as a going concern, any costs incurred by the transferor for services acquired in order to effect the transfer form part of the overheads of the business prior to the transfer, so that VAT on those services is in principle deductible from his output tax. (5)

10. In Denmark, the relevant version of Paragraph 3 of the Momslov (VAT Law) (6) defines a 'taxable person' as 'any legal or natural person who independently carries on an economic activity'.

11. The practice of the Danish tax authorities was set out in the Momsvejledning (VAT Guidelines) 2001. The cases in which the tax authorities regard legal or natural persons as independently carrying on an economic activity are stated to be those flowing from the case-law of the Court of Justice.

Facts, procedure and submissions

12. I/S Fini H ('Fini H') is a partnership set up in order to operate a restaurant, which it did on leased premises. The 10-year lease was to run until July 1998 with no possibility of termination on either side and could thereafter be terminated on notice by either party. The restaurant closed in July 1993, after which the premises remained unused.

13. It appears that Fini H sought to terminate the lease despite its terms but the landlord would not consent, and that the only other tenants who could be found were unwilling either to pay the same rent or to agree to Fini H's terms for taking over the fixtures. The landlord would have accepted another tenant, provided that Fini H paid the difference between the two rents. Fini H was unwilling to do this and in fact continued as tenant until the lease expired.

14. After the restaurant business ceased, the two partners each pursued their separate business interests but the partnership as such remained registered for VAT and submitted returns setting out deductions of input tax on rent, heating, electricity and the standing telephone charge, all of which continued to be paid in respect of the premises. Since there were no sales and thus no output tax to account for, this resulted in net payments to Fini H.

15. In September 1998, however, the regional tax authority decided that the amounts which it had paid out since October 1993 should be recovered and that no payment would be made in respect of the period from April to September 1998. The decision was taken on the ground that Fini H had not carried on any activity involving the taxable supply of goods and services within the meaning of the Momslov – a condition for deduction of input tax – since the third quarter of 1993. In November 1999, the national tax authority confirmed that decision but in February 2000 Fini H brought a challenge before the Vestre Landsret (Western Regional Court).

16. In August 2001 that court upheld the decision, considering that expenditure on rent after the business had been wound up, not attributable to normal winding-up operations but based solely on a non-termination clause, could not be regarded as operational expenditure connected with an independent activity for the purposes of Paragraph 3 of the Momslov and that Fini H could not be regarded as having acted in good faith in remaining registered for VAT purposes.

17. That judgment has now been appealed to the Højesteret, which seeks a preliminary ruling on the following questions:

'1. Can a person be regarded as independently carrying on an economic activity within the meaning of Article 4(1) to (3) of the Sixth VAT Directive in a situation in which the person concerned originally entered into a lease agreement as part of an independent economic activity but has now ceased that actual activity, even though the lease continues to exist for a particular period as a result of a non-termination clause, and in which, after the actual activity ceases, no transactions subject to VAT are conducted by application of the lease for the purpose of obtaining income therefrom on a continuing basis?

2. Does the question whether or not the person concerned actively seeks, during the remaining part of the period of non-terminability, either to utilise the commercial lease to conduct transactions subject to VAT for the purpose of obtaining income therefrom on a continuing basis or to dispose thereof have any bearing on the answer to Question 1 and does the length of the period of non-terminability or the remaining part thereof likewise have any bearing?'

18. Written observations have been submitted by Fini H, the Danish Government and the Commission, all of whom presented oral argument at the hearing on 15 September 2004. Fini H considers that it is entitled to deduct, while the Danish Government and the Commission consider that it is not.

19. Fini H argues essentially that it derives a right to deduct from the fact that the lease was entered into for the purposes of the commencement or operation of an economic activity. It cites the judgments in *Rompelman*, *INZO* and *Breitsohl*, (7) placing particular reliance on the Court's references to the principles of fiscal neutrality and legal certainty. If it were not entitled to deduct, it

would be burdened with input VAT on supplies acquired for the purposes of a business making taxable output supplies, and obligations which it had undertaken in the course of business would change their nature as a result of a later change in circumstances. At the hearing, Fini H stressed that the length of the non-termination period was usual practice in the commercial context.

20. The Danish Government draws attention to the phrase 'for the purpose of obtaining income therefrom on a continuing basis' in Article 4(2) of the Sixth Directive. When a taxable person no longer exploits property for such a purpose, the right to deduct ceases at the same time as the economic activity or within a reasonably brief period thereafter; he cannot enjoy an indefinite right on the basis that he formerly carried on such an activity. On cessation of that activity, the taxable person must dispose of the property or otherwise use it for the purpose of obtaining income. In the present case no effort was made to use the premises or the lease for that purpose. The continuing expenditure was not related to the commencement, operation or cessation of the business. To allow a right to deduct in those circumstances would run counter to the principle of fiscal neutrality, since no VAT is passed on to any final consumer. To refuse the right is however consistent with legal certainty in that it is based on objective, ascertainable criteria. The case-law cited by Fini H concerns a different situation and is not transposable. Other judgments (8) however make it clear that the mere possession of a lease cannot constitute an economic activity.

21. The Commission notes first that the Court's case-law, from *Rompelman* to *Breitsohl*, (9) acknowledges that tax authorities may require objective evidence in support of a person's declared intention to pursue an economic activity which will give rise to taxable transactions, and in the absence of such evidence may refuse the right to deduct. Second, certain transactions relating for example to closing down a business will continue to be 'for the purposes of' taxed outputs even after the cessation of economic activity. In the present case, it is for the national court to assess whether the transactions showed an intention to pursue the activity or are directly and necessarily linked to the closing down of the business. The mere continuation of a contractual obligation in the form of a lease cannot however demonstrate an intention to pursue an economic activity. If Fini H in fact sought to exploit the lease for the purpose of obtaining income – again a matter to be determined by the national court – the supplies acquired might be attributable to that new or future economic activity, but not to the previous restaurant business.

Assessment

General considerations

22. In the normal course of a business acquiring input supplies and making output supplies both subject to VAT, the taxable person seeks to make a regular profit, so that the value of the output tax will regularly be greater than that of the input tax. He will therefore periodically pay to the tax authorities the difference between the two, that is to say the amount of the output tax which he has received from his customers after deduction of the input tax charged on the supplies which he uses for the purpose of his output transactions. (10)

23. That is however a simplified scenario, from which detailed operation may differ in practice.

24. First, although input tax may be deducted only if the supplies bearing it are used for the purposes of taxable output supplies, and although the metaphor of a chain of transactions is often used in that context, deduction is not dependent on completion of a chronological sequence of specifically related input and output transactions.

25. Thus input tax is deductible as soon as it becomes chargeable; it is not necessary to wait

until an output transaction making use of the input supply has been made. (11) What matters is whether that input is a cost component of a taxable output transaction and thus whether it has a direct and immediate link with such a transaction. (12)

26. Secondly, although they cannot be attributed to specific outputs, the general running costs of a business making taxable supplies are in principle to be regarded as such cost components inasmuch as they have a direct and immediate link to the business as a whole. (13)

27. Thirdly, not only is input VAT deductible, both on specific supplies and on general running costs, before any taxable output transactions are made – for example, when a business is starting up – but the right to deduct is not lost even if the economic activity envisaged does not give rise to taxed transactions or the taxable person has been unable to use the goods or services acquired by reason of circumstances beyond his control. There is however in such cases a proviso that there must have been a genuine intention – borne out by objective evidence, which tax authorities are fully entitled to require – to make such transactions and that the costs were incurred to that end. (14)

28. Fourthly, the right to deduct may remain even where the taxable person no longer effects output transactions after acquiring the input supplies, as for example in the case of expenditure incurred in order to terminate the operation of the business.

29. The Court has held that to be the case in principle with regard to expenditure incurred in order to transfer all or part of the assets of a business to another taxable person. (15) Even though that ruling was given in the specific context of Article 5(8) of the Sixth Directive, under which it is possible to deem that no supply has taken place in those circumstances, the same interpretation must apply when the taxable person ceases to operate the business in other circumstances also. As the Court stated in *Abbey National*: (16)

‘Any other interpretation of Article 17 of the Sixth Directive would be contrary to the principle that the VAT system must be completely neutral as regards the tax burden on all the economic activities of a business provided that they are themselves subject to VAT, and would make the economic operator liable to pay VAT in the context of his economic activity without giving him the possibility of deducting it (see, to that effect, *Gabalfrisa*, paragraph 45). An arbitrary distinction would thus be drawn between expenditure incurred for the purposes of a business before it is actually operated and that incurred during its operation, on the one hand, and, on the other hand, the expenditure incurred in order to terminate its operation.’

30. Finally, in some circumstances the amount of input VAT may exceed the amount of output tax, resulting in a payment by the tax authorities to the taxable person. Such an outcome is possible if a business fails to make a profit or even simply fails to make any taxed output transactions. That, in turn, is likely during tax periods when a business is commencing or being wound up and output transactions are not yet, or no longer, made.

31. Such a situation is not in itself in any way inconsistent with the Community VAT regime, even though it entails a net payment to the taxable person in respect of part or all of the period of that person’s economic activity – which remains an economic activity whatever its results. (17)

32. VAT is designed as a general tax on (final, private) consumption, (18) not as a burden on businesses which operate at the stages leading up to that consumption. The Court has consistently stressed 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. (19) Situations in which a taxable person may recover input VAT without actually making any taxable output supplies simply involve the restitution of amounts previously advanced to the tax authorities in the expectation that

the transactions on which they were levied would lead to an ultimate taxable supply for final consumption. If that expectation is not fulfilled and no such final consumption takes place, there is no basis for levying the tax at earlier stages. Consequently, the amounts advanced fall to be refunded to the taxable person who currently bears the burden.

The present case

33. Although the national court's questions are framed in terms of what may constitute an economic activity within the meaning of Article 4 of the Sixth Directive, the issue is whether Fini H is entitled to deduct its input tax in the factual circumstances described.

34. That entitlement is dependent not only on Fini H's status as a taxable person (one carrying out such an economic activity) but also on the existence of a direct and immediate link between the input supplies in question and the actual or intended output transactions of the activity in question, as required by Article 17 of the Directive and the case-law cited in notes 1213.

35. Fini H ceased operating its restaurant on the premises in question in July 1993, but continued to pay rent in pursuance of the obligation which it had contracted in order to carry on that business.

36. When a taxable person terminates an economic activity, it seems clear that his status as such cannot come to an end immediately on making the final output transaction. There will inevitably be subsequent costs – including such as may arise out of obligations which cannot be terminated forthwith – to be counted against the final and overall profits of the business. VAT on those costs must be deductible since they will affect the overall value added during the course of the operation of the business as a whole, which in turn determines the overall amount of VAT to be accounted for.

37. It follows moreover from *Abbey National* (20) that VAT on costs incurred in relation to closing down the business must remain deductible even though no further taxable outputs were made. Such costs form part of the general overheads of the complete restaurant business from inception to termination and thus have a direct and immediate link with the output transactions of that business.

38. Costs incurred in disposing of the lease of the business premises must fall within that category, in the same way as those involved in disposing of the restaurant's other assets. And since a business which is closing down cannot reasonably be expected to dispose of its assets overnight, necessary interim costs such as rent pending final disposal must also be included.

39. In principle, therefore, the national court's first question must be answered in the affirmative: in the circumstances stated the taxable person may be regarded as continuing to act as such, in other words as continuing to carry on an economic activity for the purposes of Article 4 of the Directive.

Duration of the lease

40. However, the difficulty in the present case, to which the national court refers in its second question, stems from the unusual length of time – some five years – during which the lease was kept on after the business closed, without being in any way disposed of or used for any other economic activity.

41. The reason for that length of time appears to be twofold: on the one hand the lease could not be terminated without the landlord's consent, which was not given; on the other hand such opportunities as arose for finding another tenant were all on terms which were not accepted by Fini H.

42. As regards the first point, it appears from the order for reference that Fini H had no legal entitlement to terminate the lease before 1998. The lease was entered into for the purposes of the restaurant business, an economic activity making taxable output transactions. To the extent that Fini H could not escape paying the rent after the closure of the business (and the premises were not used for any other purpose) then that rent must be regarded as forming part of the overheads of the business as a whole. The VAT charged on it must therefore be deductible.

43. However, it also appears that payment of the full rent was not inescapable, since at least some of the cost could have been saved by accepting another tenant, albeit on terms not wholly satisfactory to Fini H. Can the latter's refusal to accept those terms affect its entitlement to deduct?

44. As a rule, a person carrying on an economic activity will seek to do so – whether in starting up, in operating, or in closing down the enterprise – in as profitable a manner as possible. Indeed, the assumption that this is so underlies the whole system of value added tax.

45. It is moreover an entirely reasonable assumption in the normal course of business, and one which tends to belie the Danish Government's fears that a trader might somehow contrive to obtain 98 years' refunds of input VAT on a 99-year lease used for just one year for the purposes of an active business. In the absence of fraud, the amount of input tax deducted can never exceed actual expenditure on inputs.

46. Sometimes however one or more parts of the operation will not be profitable.

47. In its judgments from *Rompelman* to *Breitsohl*, the Court has recognised that such circumstances do not in principle affect the right to deduct input tax when the initial phase of a business comes to naught for reasons beyond the economic operator's control. The same must be true when the final phase or even the whole enterprise is loss-making in that the value of taxed inputs exceeds that of taxable outputs.

48. In my view, it should make no difference if the reasons for that situation are not – or not entirely – beyond the taxable person's control, provided that there is no fraud, abuse or other extraneous use of the inputs in question.

49. The application of value added tax is an objective matter. Tax is levied on the value actually added, even if greater value could have been added by a more astute operator, generating greater tax revenue. Nor can the result be affected if a taxable person failed to minimise his losses, and thus the amount of input tax to be refunded by the tax authority, either during a particular tax period or over the whole operation of his business. The desired level of profit depends on many considerations, (21) and a taxable person cannot be required to run his business with a view to maximising VAT revenue or be penalised for failing to do so.

50. It should moreover be borne in mind that, unless there is some intention to abuse the tax system, taxable persons will generally seek to keep their own losses to a minimum, so that 'shortfalls' in VAT revenue in circumstances such as those of the present case are likely in practice to be rather rare.

51. The view which I advocate is however based on the assumption that the input supplies in issue do not lose their direct and immediate link with the taxable output transactions of the business as a whole, from its inception to its demise.

52. That link might be lost in a number of ways, whenever the input supplies – in this case the leased premises and related services – are used for a purpose separate from those of the business. That would be the case if they were used for private purposes (which would constitute final consumption and would not give rise to any right to deduct) or for the purposes of some other business (in which case the right to deduct would be determined by the circumstances of that business; see paragraphs 54 to 57 below). It would also of course be the case if there were any fraud or abuse, in relation either to the VAT system itself or to any other system.

53. In that regard, it would seem reasonable to consider, by analogy with the case-law on costs incurred in the course of setting up a business, that the tax authority may require objective evidence that the input supplies were not employed for any purpose separate from those of the original business.

Possible intention to commence a new economic activity

54. A final aspect of the national court's second question is whether it would be relevant if Fini H intended to use the premises for some other business subject to VAT.

55. Any such situation would be covered by the Court's existing case-law from *Rompelman* to *Breitsohl*. If, during the disputed period, Fini H genuinely intended to use the premises in order to derive income through transactions subject to VAT, which might include subletting, then the input tax is in principle deductible, even if no such income was ultimately forthcoming.

56. However, it is clear from the case-law that the tax authority may require objective evidence that Fini H intended in good faith to use the leased premises for that purpose. In the absence of such evidence, it may refuse to allow deduction. (22) That in turn presupposes that the intention must be definite and reasonably specific. Mere willingness to use premises in that way as and when the opportunity might arise would not in my view be sufficient.

57. Where such an approach is relevant, the assessment would be one of fact for the national court to carry out. Since however in the present case Fini H itself does not appear to rely on such an approach, the determination is likely to turn solely on the factors I have outlined above in relation to the link between the closed restaurant business and the continuing lease.

Conclusion

58. I am therefore of the opinion that the Court should give the following answer to the questions raised by the Højesteret:

(1) Articles 4 and 17 of the Sixth VAT Directive 77/388/EC are to be interpreted as meaning

that where for the purposes of his taxable output transactions a taxable person enters into an obligation – such as a lease of business premises – to acquire taxable supplies of goods or services, but ceases to make taxable output transactions before the expiry of the obligation, continuing none the less to acquire the goods or services in question in pursuance of that obligation, he is in principle to be considered in that regard as retaining the status of taxable person acting as such and thus entitled to deduct the VAT on those goods or services for the duration of the initial obligation, provided that:

– the direct and immediate link between the supplies and the transactions for the purposes of which the original obligation to acquire them was entered into is not lost by their use for private purposes or for the purposes of a different economic activity; and

– the continued existence of that direct and immediate link can be established by objective evidence, if the tax authority so requires.

(2) The length of the period which elapses until the expiry of the obligation is in principle not relevant in that regard. The fact that the person concerned may actively seek to utilise the goods or services acquired for a purpose other than the original taxable output transactions is relevant only in so far as it may break the direct and immediate link with those transactions.

1 – Original language: English.

2 – First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes, OJ, English Special Edition 1967, p. 14.

3 – 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 (‘the Sixth Directive’).

4 – Case 268/83 *Rompelman* [1985] ECR 655; Case C-110/94 *INZO* [1996] ECR I-857; Case C-37/95 *Ghent Coal Terminal* [1998] ECR I-1; Joined Cases C-110/98 to C-147/98 *Gabalfrisa* [2000] ECR I-1577; Case C-396/98 *Schloßstraße* [2000] ECR I-4279; Case C-400/98 *Breitsohl* [2000] ECR I-4321.

5 – See Case C-408/98 *Abbey National* [2001] ECR I-1361, especially at paragraph 35 et seq. of the judgment; Case C-137/02 *Faxworld*, judgment of 29 April 2004, paragraph 39.

6 – In Consolidating Regulation No 804 of 16 August 2000.

7 – Cited in note 4.

8 – Case C-60/90 *Polysar Investments* [1991] ECR I-3111; C-80/95 *Harnas & Helm* [1997] ECR I-745; C-102/00 *Welthgrove* [2001] ECR I-5679.

9 – Cited in note 4. The Commission cites in particular *Breitsohl*, paragraph 39 of the judgment.

10 – The situation is more complex where some transactions are taxable and others are exempt, giving rise to deduction *pro rata*. In the present case, however, there is no suggestion that Fini H was engaged in anything other than a business fully subject to VAT.

11 – Article 17(1) of the Sixth Directive.

12 – See for example Case C-4/94 *BLP Group* [1995] ECR I-983, at paragraph 19 of the judgment; Case C-98/98 *Midland Bank* [2000] ECR I-4177, at paragraph 20 et seq.

13 – See for example Case C-16/00 *CIBO Participations* [2001] ECR I-6663, at paragraph 35 of the judgment.

14 – See for example the cases cited in note 412, paragraph 22 of the judgment.

15 – See *Abbey National* and *Faxworld*, both cited in note 5.

16 – At paragraph 35 of the judgment.

17 – Article 4(1) of the Sixth VAT Directive.

18 – Article 2 of the First VAT Directive, cited in paragraph 2.

19 – See for example *Ghent Coal Terminal*, cited in note 4, at paragraph 15 of the judgment.

20 – See paragraphs 28 and 29 above.

21 – Compare *BLP Group*, cited in note 12, at paragraph 26 of the judgment.

22 – See for example *Gabalfrisa*, cited in note 4, paragraph 46 of the judgment.