OPINION OF ADVOCATE GENERAL

JACOBS

delivered on 20 January 2005 (1)

Case C-434/03

P. Charles and T.S. Charles-Tijmens

v

Staatssecretaris van Financiën

1. In this case, the Netherlands Hoge Raad (Supreme Court) asks the Court to clarify certain aspects of the rules governing the deduction of input VAT and adjustments thereto where capital goods are used partly for taxed (2) output transactions and partly for private purposes.

2. It wishes to know, in essence, whether a national rule which does not allow such goods to be treated as wholly business assets, with their private use being treated as a supply for consideration, is compatible with Community law.

Community VAT provisions

The basic provisions

3. The essence of the VAT system is set out in Article 2 of the First VAT Directive: (3)

‘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.

The common system of value added tax shall be applied up to and including the retail trade stage.’

4. Thus in that system of successive applications and deductions of tax a trader does not remain burdened with the VAT on the goods and services he acquires for business purposes. After the retail stage however – and for all transactions outside the business sphere – no VAT is either charged or deductible.

5. More detailed rules are contained in the Sixth VAT Directive. (4)

6. The scope of VAT is defined in Article 2, under which transactions subject to VAT include 'the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such' and the importation of goods.

7. 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', together with the 'exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis'.

8. 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.

9. Because the right to deduct arises only in respect of supplies used for the purpose of taxed transactions, there is no such right if they are used for the purpose of exempt transactions, that is to say those listed in particular in Article 13 of the directive, or for the purpose of transactions which fall entirely outside the scope of VAT, such as those which are not effected for consideration, or not carried out by a taxable person acting as such, in particular as part of an economic activity within the meaning of Article 4.

The problems of 'mixed' use

10. A number of provisions deal with aspects of the difficulties which could arise from the fact that, for whatever reason, taxed supplies of goods or services made to a taxable person may be used partly for taxed output transactions and partly for other purposes. Clearly, in such situations, it is important to maintain the distinction between taxed and other transactions and the correspondence between deductions of input tax and charging of output tax.

11. Two types of 'mixed' use are dealt with. On the one hand, there are situations in which a taxable person acquires supplies in the course of his business and uses them partly for business and partly for non-business purposes. On the other, there are those in which a business makes both outputs which are taxed and outputs which are not taxed.

12. First, therefore, with regard to private use of business goods and comparable situations, Article 5(6) of the Sixth Directive provides: 'The application by a taxable person of goods forming part of his business assets for his private use or that of his staff, or the disposal thereof free of charge or more generally their application for purposes other than those of his business, where the value added tax on the goods in question or the component parts thereof was wholly or partly deductible, shall be treated as supplies made for consideration.'

13. Similarly, as regards services, Article 6(2) provides: 'The following shall be treated as

supplies of services for consideration:

(a) the use of goods forming part of the assets of a business for the private use of the taxable person or of his staff or more generally for purposes other than those of his business where the value added tax on such goods is wholly or partly deductible;

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

Member States may derogate from the provisions of this paragraph provided that such derogation does not lead to distortion of competition.'

14. Thus, subject to that possibility of a derogation in the case of Article 6(2), those two provisions mean that where a taxable person supplies goods or services to himself from his business but for his non-business use, having deducted the input tax on the supplies he acquired for that purpose, he must in effect charge himself VAT on the transaction.

15. The taxable amount in such cases is determined according to Article 11(A)(1), in accordance with which it is to be:

'…

(b) in respect of supplies referred to in Article 5(6) …, the purchase price of the goods or of similar goods or, in the absence of a purchase price, the cost price, determined [at] the time of supply;

(c) in respect of supplies referred to in Article 6(2), the full cost to the taxable person of providing the services;

…'

16. Second, Article 17(5) of the Sixth Directive deals with situations where goods or services are used by a taxable person both for transactions in respect of which VAT is deductible and for those in respect of which it is not. In such cases, according to the first subparagraph, 'only such proportion of the value added tax shall be deductible as is attributable to the former transactions'.

17. Under the second subparagraph, that proportion is in principle to be determined in accordance with Article 19 – which defines it essentially as a fraction equivalent to turnover in VAT-deductible transactions divided by total turnover. (5)

18. In addition, Article 20 of the Sixth Directive provides for the amount of deductions of input tax to be adjusted where appropriate:

'1. The initial deduction shall be adjusted according to the procedures laid down by the Member States, in particular:

(a) where that deduction was higher or lower than that to which the taxable person was entitled;

(b) where after the return is made some change occurs in the factors used to determine the amount to be deducted …

2. In the case of capital goods, adjustment shall be spread over five years including that in which the goods were acquired or manufactured. The annual adjustment shall be made only in respect of one fifth of the tax imposed on the goods. The adjustment shall be made on the basis

of the variations in the deduction entitlement in subsequent years in relation to that for the year in which the goods were acquired or manufactured.

...

In the case of immovable property acquired as capital goods, the adjustment period may be extended up to 20 years.

…'

'Transitional' provisions concerning exclusion from deductions

19. Article 17(6) of the Sixth Directive provides for the Council, acting unanimously on a proposal from the Commission, to decide what expenditure is not to be eligible for deduction of VAT, but specifies that the tax is never to be deductible on expenditure which is not strictly business expenditure, such as luxuries, amusements or entertainment.

20. To cover the situation pending the Council's decision, the second subparagraph of Article 17(6) provides: 'Until the above rules come into force, Member States may retain all the exclusions provided for under their national laws when this Directive comes into force.'

21. The rules in question have not in fact been adopted, so that the transitional provision remains applicable.

22. Immediately before the Sixth Directive came into force, the basis for the VAT legislation of the then Member States (including the Netherlands) was the Second VAT Directive. (6) Article 11 of that directive provided, in particular, as follows:

'1. Where goods and services are used for the purposes of his undertaking, the taxable person shall be authorised to deduct from the tax for which he is liable:

(a) the value added tax invoiced to him in respect of goods supplied to him or in respect of services rendered to him;

…

4. Certain goods and services may be excluded from the deduction system, in particular those capable of being exclusively or partially used for the private needs of the taxable person or his staff.'

23. Article 11(1) was thus the precursor of Article 17(2) of the Sixth Directive, (7) and Article 11(4) pursued an aim similar to that of Articles 5(6) and 6(2) of the Sixth Directive, albeit in different terms.

Relevant Netherlands law

24. In the Netherlands, VAT is governed by the Wet op de Omzetbelasting (Turnover Tax Law) 1968 and its implementing regulation, the Uitvoeringsbeschikking Omzetbelasting. The Hoge Raad explains their operation as follows.

25. Under Articles 2 and 15(1) of the 1968 Law, a trader may deduct the VAT charged to him on

goods or services supplied by another trader in so far as those supplies are used within the framework of his business. Thus whenever goods or services are used for both business and non-business (in particular private) purposes, deduction is precluded to the extent of the non-business use.

26. Article 15(4) of the Law provides that the ratio between the business and non-business uses must be established when the supplies are brought into use. Article 12(3) of the Uitvoeringsbeschikking, based on Article 15(6) of the Law, provides that in the declaration for the final tax period of a financial year the tax deducted is to be recalculated on the basis of the data for the overall financial year. No subsequent recalculation or revision of the deduction is possible, nor does the Law provide for subsequent charging of tax on self-supplies, as in Article 6(2)(a) of the Sixth Directive.

27. The rules in the Uitvoeringsbeschikking were laid down in 1969 to implement Article 11(1) of the Second VAT Directive. They thus predate the entry into force of the Sixth Directive for the purposes of Article 17(6) thereof.

Facts, national proceedings and questions referred

28. In March 1997 P. Charles and T.S. Charles-Tijmens ('the appellants') jointly acquired a holiday bungalow in the Netherlands. It was intended both for letting and for private use and was so used during the period at issue – to the extent of 87.5% for letting and 12.5% for private purposes.

29. In accordance with Community and national law, the letting is a taxed transaction and the appellants constitute a single taxable person for that purpose.

30. In their VAT declaration for the second quarter of 1997 the appellants at first deducted 87.5% of the tax charged to them in respect of the bungalow, entailing a refund of NLG 91 which was granted by decision of 1 October 1997. Subsequently, however, they took the view that the input tax charged was 100% deductible, so raised an objection against that decision, requesting an additional refund of NLG 13. The tax inspector declared that objection inadmissible.

31. The appellants then brought the case before the regional court of appeal, the Gerechtshof te's-Hertogenbosch, which confirmed the decision of 1 October 1997. It noted that the appellants use the bungalow for business services subject to VAT but also for private purposes and so cannot deduct all the tax charged to them in respect of the bungalow. It took the view that Articles 6(2) and 17(2) of the Sixth Directive do not preclude restrictions on deduction, while under Article 17(6) Member States may retain all the exclusions provided for under national law when that directive came into force. Since the relevant Netherlands provisions have not been amended since then, there can be no reasonable doubt that a restriction on deduction such as that in issue is permitted.

32. The case is now on further appeal before the Hoge Raad, which considers that two of the grounds of appeal raise questions of Community law.

33. First, the appellants argue that the partial exclusion from deduction is contrary to the Sixth Directive. It follows from Article 6(2) that the private use of the bungalow should be a taxed service because they have chosen to include the entire dwelling in their business assets. In accordance with Article 17(2), there is therefore a right to deduct the full amount of input VAT.

34. Secondly, they challenge the Gerechtshof's assessment of Article 17(6) of the Sixth Directive. When that directive came into force, Netherlands law did not provide for an exclusion from deduction as referred to in that provision, other than in respect of motor vehicles. Article 17(6) relates only to exclusions of the kind referred to in Article 11(4) of the Second VAT Directive, in respect of 'certain goods and services'. The partial exclusion from deduction in Article 15(1) of the 1968 Law was not based on that provision and is not of that kind. In respect of items such as the bungalow at issue there was no exclusion in law from the right to deduct as referred to in Article 11(4) of the Second Directive, so that Article 17(6) of the Sixth Directive does not legitimate partial exclusion from deduction.

35. Having compared the relevant Community and national legislation, the Hoge Raad notes that the two pursue the same aim and may have the same effect and that, to the extent that there is no distortion of competition, any differences might be seen as derogations authorised under Article 6(2) of the Sixth Directive.

36. However, it points out, the effect is not always the same. Under the Sixth Directive the taxable person has an immediate right to full deduction, and there is no adjustment in respect of private use until such use takes place. Under the Netherlands Law, the extent of future private use must be established in the first year, deduction is precluded to that extent and there is no provision for adjustment where the extent of use differs in subsequent years. The taxable person will derive an unjustified advantage if he subsequently increases the extent of his private use, yet there is no mechanism to prevent manipulation to that end, with possible distortion of competition. Conversely, a reduction in private use imposes an unjustified VAT burden on the taxable person.

37. The Hoge Raad therefore requests a preliminary ruling by the Court on whether a statutory scheme such as that described, which was already in existence before the Sixth Directive was adopted and under which:

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

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

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

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

38. Written observations have been submitted by the Netherlands Government and the Commission, both of which have also, together with the appellants in the main proceedings and the German Government, replied to two written questions put by the Court. At the hearing, oral argument was presented by the appellants, by the German and Netherlands Governments and by the Commission.

Assessment

39. The Hoge Raad's questions and the submissions to the Court raise a number of issues whose interrelationships are not simple, and a brief outline of the way in which I intend to address

them may be helpful at this stage.

40. After first identifying the relevant features of Netherlands law, (8) I shall examine the requirement in the Court's case-law that a taxable person must be allowed to integrate into his business an asset which is partly used for private purposes. (9) That will entail an analysis of the various relevant mechanisms of the Sixth Directive (10) and the scope of the derogation in the last sentence of Article 6(2), (11) together with a consideration of the effects which those mechanisms entail depending on whether goods are included in business or private assets. (12) I shall also consider in particular the comparative effects of, on the one hand, excluding goods from business assets and, on the other, including them but treating their private use as not being a supply for consideration. (13) Finally, I shall consider the scope of the authorisation under Article 17(6) to maintain pre-existing legislation in force. (14)

Availability of choice under Netherlands law

41. As a preliminary point, the Netherlands Government denies that under Netherlands law a taxable person acquiring capital goods used for both business and private purposes cannot choose to include them wholly in his business assets. It has produced a copy of a circular reproducing a decision of the State Secretary for Finance of 27 November 2002, in which the availability of the choice is confirmed. At the hearing, counsel for the appellants challenged that assertion, and the Netherlands Government reiterated that the choice was available under an administrative rule.

42. This Court is not competent to interpret Netherlands law. It must proceed on the basis of the referring court's statement of national law. The Hoge Raad's question explicitly concerns a legal situation in which 'there is no possibility of choosing to include capital goods … wholly in the assets of an undertaking where the acquirer uses those goods … both within the undertaking and outside it (in particular for private purposes)'.

43. However, it may be noted that:

– the Netherlands Government refers to an administrative decision, and the Court has repeatedly stated that any incompatibility of national legislation with Community law must be remedied by means of binding national provisions having the same legal force as the legislation in question; (15)

– the administrative decision in question was taken in 2002 whereas the material time in the case in the national proceedings is the 1997 tax year;

– the decision explicitly states that when the taxpayer chooses to include capital goods wholly in his business assets deduction is precluded to the extent that the goods are not used for business purposes and that this exclusion is based on Article 17(6) of the Sixth Directive; and

– the availability of an initial choice in this regard does not appear to entail the possibility of subsequent adjustment to take account of changing use.

Disputed features of the Netherlands system

44. It is clear that the system described differs from the mechanism envisaged in Article 6(2) of the Sixth Directive. The two may pursue largely the same aim but, as the Hoge Raad has

explained, their effects are likely to diverge in practice, in particular if the extent of private use of capital goods acquired for both business and private purposes changes over time.

45. It has to be decided whether the features of the Netherlands system may none the less be compatible with the provisions of the Sixth Directive.

46. The features identified by the Hoge Raad in its question are that (i) capital goods used both for business and non-business purposes cannot be included wholly in business assets; therefore (ii) input tax on such goods cannot be deducted in full and (iii) there is no provision for VAT to be charged on their private use. The second and third of those features are clearly direct and automatic consequences of the first, but I would add another significant feature which is less obviously so, to which the Hoge Raad draws attention in its reasoning: (iv) once the goods have been allocated between business and private assets, that allocation can no longer be adjusted after the end of the first year.

Requirement as to the availability of choice

47. The Court has repeatedly affirmed that 'a taxable person may choose whether or not to integrate into his business, for the purposes of applying the Sixth Directive, part of an asset which is given over to his private use'. (16)

48. Consequently, in so far as that is not possible under the Netherlands rules, those rules would appear to be incompatible with the directive.

49. However, the Netherlands Government argues that the rules fulfil, on the one hand, the requirement in Article 17(2) of the Sixth Directive that there may be no deduction in respect of supplies used by a taxpayer for transactions which do not bear tax and, on the other, the purpose of Article 6(2) of ensuring equal treatment as between taxable persons and final consumers. (17) Like the Commission, it believes that any divergence between the Netherlands rules and Article 6(2) is permitted by the possibility of derogation in the last sentence of that paragraph. (18) And at the hearing the German Government specifically asked the Court to reconsider its case-law requiring that the taxable person be allowed the choice of inclusion in business assets in all cases.

50. It is therefore desirable to consider the matter more closely.

Relevant problems and solutions in the scheme of the VAT directives

51. It is axiomatic in the system set up by the VAT directives that, on the one hand, input tax on supplies used by a taxable person for the purposes of his taxed business transactions should be deductible while, on the other, final consumption for private purposes should bear tax in full.

52. Deduction of input tax is linked to charging of output tax, so that where supplies acquired by a taxable person are used for the purposes of transactions which are exempt or which fall outside the scope of VAT, there can be no output tax and no deduction of input tax.

53. Difficulties may arise where there is overlap or interference between the types of use to which supplies are put.

54. The Sixth Directive offers two routes by which to avoid such difficulties, though the circumstances of their application differ and they are not simply interchangeable.

55. The first route concerns the situation in which a taxable person consumes, in his private capacity, goods or services which were initially treated as intended for taxable business purposes and on which the input VAT was thus initially deducted. Under the broadly parallel provisions of, on the one hand, Article 5(6) where the final consumption is of goods or, on the other, Article 6(2) in a case such as the present which involves services, he is in effect deemed to act in a dual capacity as business supplier and private purchaser, so that he must account for output VAT on the 'transaction'.

56. The second route is the pro rata deduction system governed by Articles 17(5) and 19, where a business makes both taxed and untaxed output transactions. The basic rule is that, calculated on a yearly basis, a fraction of input tax corresponding to the net value of taxed output transactions divided by the net value of all output transactions of the business is deductible.

57. Article 20 further provides for deductions to be adjusted if inter alia a change occurs in the factors used to determine the deductible amount. The likelihood of such a change is significant in the case of capital goods, often used over a number of years during which the purposes to which they are put may change. There is therefore an adjustment period of five years, extendable to 20 years in the case of immovable property, with varying deductions staggered over the whole period. (19)

58. It is helpful to compare the salient points of the two systems.

59. First, both systems apply only where taxed supplies are acquired within the business sphere. Articles 5(6) and 6(2) concern goods forming part of business assets or services supplied by a business. Article 17(5) concerns goods or services used by a taxable person for both taxed and untaxed – that is to say, exempt – transactions. Neither set of provisions can apply where a taxable person acquires goods in a private capacity or uses them for transactions outside the scope of VAT. In such cases input tax can never be deductible, and the transactions are excluded from the calculation of the deductible portion. (20) Moreover, even if a taxable person were to transfer to his business assets goods acquired in a private capacity, that would also fall outside the scope of VAT, since he would be acting not 'as such' but in his private capacity.

60. Second, both systems are designed to ensure a correspondence between deduction of input tax and charging of output tax, but operate in effect as mirror images of one another. Articles 5(6) and 6(2) stipulate that, where there has been deduction of input tax, output tax must be levied on transactions which would otherwise – since they are not effected for consideration – fall outside the scope of VAT. Article 17(5) provides that, to the extent that no output tax can be charged because a transaction is exempt, there is to be no corresponding deduction of input tax. Thus, if there is to be any overlap between the two systems, the first step must be to apply Articles 5(6) and 6(2), so that private use becomes a taxed output; then all the taxed outputs, including private use, must be aggregated and distinguished, for the application of Article 17(5), from exempt outputs.

61. Finally, both systems allow for adjustment to changing circumstances, though the mechanism is different in each case. In the case of Articles 5(6) and 6(2) the adjustment is in effect self-executing, since tax is charged as and when consumption occurs. In the case of Article 17(5) the entitlement to deduction is calculated on an annual basis and may thus vary from year to year, and Article 20 provides in addition for an adjustment period of several years for capital goods.

Scope of the possibility of derogation in Article 6(2)

62. Article 6(2) defines certain categories of 'transaction' which are to be treated as supplies of services for consideration, although they are not normally made for consideration and would thus otherwise fall outside the scope of VAT.

63. The final sentence of Article 6(2) allows Member States to 'derogate from the provisions of this paragraph', provided that there is no distortion of competition.

64. In my view, the scope of that authorisation can extend only to treating the categories of transaction in question, in whole or in part, as not being supplies of services for consideration, and thus as falling outside the scope of VAT. It does not allow Member States to add or substitute other rules not provided for in the Sixth Directive.

65. That view follows from the wording of the provision and is confirmed by the Court's judgment in *Cookie's World*. (21)

66. Consequently, the last sentence of Article 6(2) does not seem capable of authorising the Member States to refuse taxable persons the choice of including in their business assets goods used for both business and private purposes.

67. It does on the other hand authorise them to treat the gratuitous private use of those goods as a supply not made for consideration and therefore not to be taxed, giving rise to no right to deduct input tax on supplies attributable to that use.

68. However, three further remarks must be made at this point.

69. First, while the last sentence of Article 6(2) may not authorise Member States to refuse taxable persons the choice of including in their business assets goods used for both business and private purposes, nor does it – or anything else in that paragraph – specifically preclude them from doing so. Article 6(2) simply deals with situations where goods have been included in business assets and are then used for private purposes.

70. Second, where goods are not included in a taxable person's business assets, they are excluded from the sphere of VAT in general; they are thus beyond the reach both of Articles 5(6) and 6(2) and of Article 17(5).

71. Third, if a Member State derogates from Article 6(2) by treating some or all of the supplies in question as not made for consideration, and thus outside the scope of VAT, the effect is in some ways comparable to that of excluding the inputs concerned from business assets: there is no right to deduction of input tax, but the transactions in question are also excluded from the calculation of the deductible portion for the purposes of Article 17(5).

72. It is therefore desirable to consider more closely the effects of including goods which are used for both business and private purposes in, on the one hand, business assets and, on the other, private assets.

Consequences of including goods in business or private assets

73. When goods are acquired as part of a taxable person's business assets, the VAT paid on their acquisition is immediately deductible, unless they are to be used wholly or partly for the purposes of transactions which do not bear tax. Where they are to be wholly so used, no deduction at all is possible. Where they are to be partly so used, Article 17(5) determines the deductible proportion. In that calculation, input VAT remains deductible when the subsequent use involves private consumption, provided that the consumption is taxed in accordance with Article 5(6) or 6(2).

74. In the latter situation, even though his private consumption is subject to VAT, as is that of any other private consumer, the taxable person may in some cases derive certain tax advantages from the application of Articles 5(6) and 6(2) because, inter alia:

– deduction is immediate, whereas taxation is deferred and staggered over the period of private use, providing a possible cash-flow benefit;

– VAT is charged on the cost of goods or services used, which is likely to be lower than the price at which they could have been acquired as a private individual from another trader;

– in the case of capital goods, including immovable property, the cost to the taxable person of providing the 'service' of use of the goods or property (and thus the output tax) may be particularly low in relation to the cost of acquisition (and thus to the deductible input tax), so that private use will in effect bear a reduced tax burden – a benefit likely to increase with the proportion of private use.

75. Where goods are acquired as part of a taxable person's private assets, they are outside the scope of VAT and no deduction is possible. If they are then used for business purposes, there is still no right to deduction because it is the capacity in which a person acquires goods which determines the existence of the initial right to deduct (22) and because a person who transfers goods from his private assets to his business, or makes them available for use by his business, does not make a supply for consideration in his capacity as a taxable person. Any input tax on supplies acquired in a private capacity and then used for business purposes thus becomes locked into the cost of those supplies, imposing a burden on the taxable person which may be seen as inappropriate in the light of the principle of the neutrality of VAT.

76. Thus, if goods used for both private and business purposes are included in private assets, the taxable person will suffer a disadvantage. If they are included in business assets he may gain an advantage where the private use is treated as supply for consideration pursuant to Articles 5(6) and 6(2).

77. The advantage or disadvantage experienced by the taxable person has of course an exact counterpart in a corresponding loss or gain of tax revenue for the fiscal authority.

78. In those circumstances, it is clear that the availability of a choice as to whether to include mixed-use goods in business or private assets favours the taxable person, who may be expected to opt always for inclusion in business assets. Conversely, fiscal authorities will prefer a compulsory allocation to private assets of a proportion equivalent to that of private use.

79. However, whilst it may legitimately be contended that goods put to private use, or the proportion put to that use, should be placed outside the VAT system from the moment of acquisition, so that there is never any deduction of input tax, that does not take account of the fact that where goods are included in private assets there is no adjustment mechanism to deal with situations where they are subsequently put to business use.

80. In concrete terms, the appellants in the present case might have acquired the bungalow with a view to spending most of the year there, letting it for, say, only a month and a half. Under the Netherlands rules as described, they would have had to allocate 12.5% to business assets and 87.5% to private assets, with consequent deduction of only 12.5% of the VAT on the acquisition. The following year, they might have decided that they preferred to live elsewhere, or that the income from letting was insufficient, and might have given the bungalow over entirely to letting thereafter. There is no mechanism under either the Netherlands rules as described or the Sixth Directive whereby the transfer to business assets could give rise to deduction of the outstanding portion of input tax. Yet if they were subsequently to sell the bungalow as a letting business, they would have to charge VAT on the sale.

81. By contrast, where goods are allocated to business assets and subsequently put to private use, the Sixth Directive offers an adjustment mechanism, albeit an imperfect one, in the provisions of Articles 5(6) and 6(2).

82. I conclude therefore that the Court's case-law to the effect that a taxable person must be able to choose whether to include capital goods used for both business and private purposes in either his business or his private assets is justified by the fact that, although it may provide him with a possible tax advantage, the alternative would impose on him a disadvantage which is incompatible with the principles of VAT and which cannot be remedied. Nor does any other solution consistent with the principle of fiscal neutrality appear to be available under the existing legislation – or indeed perhaps at all.

Consequences of a derogation from Article 6(2)

83. I have noted that the extent of the derogation authorised by the last sentence of Article 6(2) can only be to treat the private use in question as not being a supply made for consideration, and thus as falling outside the scope of VAT. I have also noted that such treatment may have consequences similar to those of excluding the goods used from the taxable person's business assets.

84. However, there are distinctions to be drawn between the two situations.

85. Where goods are excluded from business assets, there is never any question of deduction of input tax. Where they are included in business assets, input tax is in principle immediately deductible, either in full or in a proportion determined by Articles 17(5) and 19 – a proportion which cannot take account of supplies falling outside the scope of VAT.

86. If a MemberState regards private use of business assets as falling outside the scope of VAT, difficulties arise because a subsequent event – the private use – appears to have a retroactive effect on the classification, and thus the deductibility, of the relevant input tax, even though that tax was in principle immediately deductible. It is not, as we have seen, possible to determine in advance the true future extent of private use in order to exclude the correct proportion of input tax from immediate deduction.

87. In that regard it may be significant that there is no possibility of derogation from the provisions of Article 5(6), which concerns private consumption rather than use of goods forming part of business assets. VAT is thus always levied on private consumption, and the problem I have just outlined is avoided.

88. With regard to services consisting in the use of business assets under Article 6(2), it may be presumed that the use in question will always be of capital goods. Use of other goods will either involve consumption or will be such as to escape any realistic accounting mechanism for tax purposes.

89. While use of a business asset treated by a Member State as falling outside the scope of VAT cannot be taken into account for calculating the deductible proportion in accordance with Articles 17(5) and 19, it can still be taken into account in the context of Article 20, which concerns adjustments to be made to the initial deduction when some subsequent change occurs in the factors used to determine the amount of that initial deduction.

90. Where capital goods, and in particular immovable property, are concerned the adjustment period under Article 20 thus allows a more flexible approach to be taken if private use is treated as not being a supply for consideration than if the assets used are excluded from the business, avoiding to a significant extent both the disadvantage to the taxpayer entailed in the latter case and the advantage which he might in some cases derive from the simple application of Article 6(2).

Conclusion on Article 6(2)

91. I therefore reach the view that national legislation which does not allow a taxable person to choose to include capital goods wholly in the assets of his business where he uses those goods both within the business and outside it, in particular for private purposes, is neither compatible with Article 6(2) of the Sixth Directive nor authorised under the last sentence of that provision.

92. Legislation which treats the use of such goods as not being a supply for consideration, and thus as falling outside the scope of VAT, is however capable of being authorised under that sentence, provided that it does not give rise to any distortion of competition and that it is used in conjunction with the adjustment mechanism provided for in Article 20 of the Sixth Directive.

Article 17(6)

93. It remains to be considered whether the Netherlands rules in issue may be authorised under the second subparagraph of Article 17(6) of the Sixth Directive on the ground that they embody an exclusion from the right to deduction provided for under national law before the directive came into force.

94. Since the Kingdom of the Netherlands was bound by the harmonised VAT rules laid down in

the Second Directive before the Sixth Directive came into force, it is clear that only exclusions compatible with the Second Directive can be authorised in that way.

95. In that directive, Article 11(1) set up a general right of deduction where goods and services are used for the purposes of the taxable person's undertaking, but Article 11(4) authorised exclusions from the deduction system, for '[c]ertain goods and services …, in particular those capable of being exclusively or partially used for the private needs of the taxable person or his staff'.

96. Both the referring court and the Netherlands Government state that the disputed national rules were enacted in implementation of Article 11(1) of the Second Directive. Even without those statements, such a conclusion seems justified by the fact that the rules in question seek to confine deduction to cases where supplies are used for business purposes.

97. The Commission submits that only exclusions authorised under Article 11(4) of the Second Directive may be retained under the second subparagraph of Article 17(6) of the Sixth Directive. The Netherlands Government however argues that rules adopted under Article 11(1) may also benefit from the provision.

98. I agree with the Commission. Article 11(1) of the Second Directive was superseded by Article 17(2) of the Sixth Directive. National legislation must now conform with the latter – read in conjunction with, inter alia, Articles 5(6) and 6(2) – within the field of application which it has inherited unchanged from its predecessor. Article 17(6) of the Sixth Directive however is the successor to Article 11(4) of the Second Directive, but allows the retention of exclusions which were valid under that provision.

99. The wording of Article 11(4) of the Second Directive envisages the exclusion of certain types of goods and services – for example, motor cars – rather than a blanket exclusion in respect of all private use, as is confirmed by the Court's case-law on the second subparagraph of Article 17(6) of the Sixth Directive and the legislative context of that provision.

100. In my Opinion in *Lennartz*, (23) I considered that Article 17(6) could not justify the retention of a general measure applicable to all categories of expenditure involving both business and private use, and the Court took the same view, (24) though without specifically referring to Article 17(6).

101. In *Commission* v *France*, (25) I examined the provision and its legislative context in rather more detail, and from the sources which I quoted it may be seen that the types of exclusion contemplated by the legislator concern categories of expenditure defined by reference to the nature of the supply acquired rather than the purpose to which it is put. It is noteworthy that in the cases where the Court has considered a MemberState's reliance on the second subparagraph of Article 17(6), (26) that appears always to have been the type of exclusion concerned.

102. As both the Hoge Raad in its referring judgment and the Commission in its observations have pointed out, that view is confirmed in particular by the Court's judgment in *Royscot Leasing*. (27)

103. It thus does not seem possible for the disputed rules to come within the second subparagraph of Article 17(6) of the Sixth Directive.

Conclusion

104. In the light of all the foregoing considerations, I am of the opinion that the Court should answer the Hoge Raad's question as follows:

National legislation which does not allow a taxable person to choose to include capital goods wholly in the assets of his business where he uses those goods both within the business and outside it, in particular for private purposes, is neither compatible with Article 6(2) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment – nor capable of falling within the scope of the derogation provided for in the last sentence of that provision.

National legislation which treats the use of such goods as not being a supply for consideration, and thus as falling outside the scope of VAT, may however fall within the scope of that derogation, provided that it does not give rise to any distortion of competition and that it is used in conjunction with the adjustment mechanism provided for in Article 20 of the Sixth Directive.

National legislation, in existence when the Sixth Directive came into force, which provides for a general exclusion from the right of deduction in respect of all goods and services used for non-business purposes does not come within the scope of the second subparagraph of Article 17(6) of that directive.

1 – Original language: English.

2 – Although the word 'taxable' is used in the English version of the legislation (where the French speaks of 'opérations taxées' – see point 8 below), I prefer in the present context to use the word 'taxed' rather than 'taxable' when referring to transactions on which VAT is levied. They are thus distinguished from, on the one hand, transactions which fall within the scope of the tax but are exempted and, on the other hand, those which fall outside the scope of the tax.

3 – 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).

4 – 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').

5 – However, Article 17(5) also allows Member States to vary that rule within certain limits. In particular, there is an option of separate accounting for the taxable and non-taxable parts of the business, and an option of determining the deductible proportion of the input tax according to the use to which the supplies are put – for example, half of the input tax would be deductible in respect of goods half of which were used for taxable outputs and half for non-taxable outputs, regardless of the relative value of the two sets of outputs.

6 – Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes – Structure and procedures for the application of the common system of value added tax (OJ, English Special Edition 1967, p. 16).

7 – Cited in point 8 above.

8 – Points 41 to 46.

9 – Point 47 et seq.

10 – Points 51 to 61.

11 – Points 62 to 71.

12 – Points 73 to 82.

13 – Points 83 to 90.

14 – Points 93 to 103.

15 – See, for example, Case C-160/99 *Commission* v *France* [2000] ECR I-6137, paragraph 23.

16 – Case C-269/00 *Seeling* [2003] ECR I-4101, paragraph 40; see also Case C-291/92 *Armbrecht* [1995] ECR I-2775, paragraph 20, and Case C-415/98 *Bakcsi* [2001] ECR I-1831, paragraph 25.

17 – Case C-230/94 *Enkler* [1996] ECR I-4517, paragraph 35. For a fuller explanation of the way in which equal treatment is ensured, see the Opinion of Advocate General Ruiz-Jarabo Colomer in Case C-412/03 *Hotel Scandic Gåsabäck*, delivered on 23 November 2004, points 24 to 32.

18 – See point 13 above.

19 – For practical examples of how the system operates where the use of capital goods varies from year to year, see P. Farmer and R. Lyal, *EC Tax Law*, 1994, p. 196, and B.J.M. Terra, *Europees indirect belastingrecht*, 2002, p. 459.

20 – See, most recently, Case C-77/01 *EDM*, paragraphs 53 and 54 of the judgment delivered on 29 April 2004, not yet reported.

21 – Case C-155/01 [2003] ECR I-8785, paragraphs 58 and 59; see also Case 50/88 *Kühne* [1989] ECR 1925, paragraphs 16 to 19.

22 – Case C-97/90 *Lennartz* [1991] ECR I-3795.

23 – Cited in footnote 22, points 76 to 79.

24 – Paragraph 35 of the judgment.

25 – Case C-43/96 [1998] ECR I-3903, point 12 et seq. of the Opinion.

26 – I refer to Case C-305/97 *Royscot Leasing* [1999] ECR I-6671, Case C-177/99 *Ampafrance* [2000] ECR I-7013, Case C-345/99 *Commission* v *France* [2001] ECR I-4493, Case C-409/99 *Metropol* [2002] ECR I-81, Case C-40/00 *Commission* v *France* [2001] ECR I-4539 and *Cookie's World*, cited in footnote 21.

27 – Cited in footnote 26, paragraph 20 et seq.