OPINION OF ADVOCATE GENERAL

CRUZ VILLALÓN

delivered on 26 April 2012 (1)

Case C?511/10

Finanzamt Hildesheim

v

BLC Baumarkt GmbH & Co. KG

(Reference for a preliminary ruling from the Bundesfinanzhof (Germany))

(Value added tax – Sixth Directive – Deduction of input tax – Goods and services used both for taxable transactions and for exempt transactions – Letting of a property for commercial and residential purposes – Calculation of the deductible proportion – National legislation which provides for calculation of the deductible proportion based on the surface area of the property used for each type of letting)

1. By means of a single question, which the Bundesfinanzhof (Federal Finance Court) formulates in terms which are prima facie very precise, the present reference for a preliminary ruling provides the Court of Justice with an opportunity to move forward with the complex interpretation of the design and the scope of the system laid down in Article 17(5) of the Sixth Directive, (2) in particular the third subparagraph, point (c), thereof. It will be seen that the question concerns the scope of point (c) to the extent that, as is well-known, it provides that in relation to goods and services used both for transactions in respect of which VAT is deductible and for transactions in respect of which VAT is not deductible ('mixed use'), Member States may authorise or compel taxable persons to calculate the VAT deductible on the basis of the use (3) of those goods and services.

I – **Legislative framework**

A – *European Union law. The Sixth Directive*

2. According to the twelfth recital in the preamble to the Sixth Directive, 'the rules governing deductions should be harmonised to the extent that they affect the actual amounts collected ... the deductible proportion should be calculated in a similar manner in all the Member States'.

3. Article 17(5) of the Sixth Directive provides as follows:

'As regards goods and services to be used by a taxable person both for transactions covered by paragraphs 2 and 3, in respect of which [VAT] is deductible, and for transactions in respect of which [VAT] is not deductible, only such proportion of the [VAT] shall be deductible as is

attributable to the former transactions.

This proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person.

However, Member States may:

(a) authorise the taxable person to determine a proportion for each sector of his business, provided that separate accounts are kept for each sector;

(b) compel the taxable person to determine a proportion for each sector of his business and to keep separate accounts for each sector;

(c) authorise or compel the taxable person to make the deduction on the basis of the use made of all or part of the goods and services;

(d) authorise or compel the taxable person to make the deduction in accordance with the rule laid down in the first subparagraph, in respect of all goods and services used for all transactions referred to therein;

(e) provide that, where the [VAT] which is not deductible by the taxable person is insignificant, it is to be treated as nil.'

4. Article 19(1) of the Sixth Directive provides as follows:

'The proportion deductible under the first subparagraph of Article 17(5) shall be made up of a fraction having:

– as numerator, the total amount, exclusive of [VAT], of turnover per year attributable to transactions in respect of which [VAT] is deductible under Article 17(2) and (3),

– as denominator, the total amount, exclusive of [VAT], of turnover per year attributable to transactions included in the numerator and to transactions in respect of which [VAT] is not deductible. The Member States may also include in the denominator the amount of subsidies, other than those specified in Article 11A(1)(a).

The proportion shall be determined on an annual basis, fixed as a percentage and rounded up to a figure not exceeding the next unit.'

B – *National law*

5. Under Paragraph 1(1) of the Umsatzsteuergesetz (Law on turnover tax; 'UStG') (4), as amended by the Steueränderungsgesetz 2003 (Law on tax amendment, 2003), (5) '[t]he following transactions shall be subject to turnover tax: 1. Supplies of goods and services effected for consideration within the territory of the country by a trader in the course of his business ...'

6. In accordance with Paragraph 4 UStG, '[t]he following transactions covered by Paragraph 1(1)(1) shall be exempt: ... 12(a) the leasing and letting of immovable property ...'

7. Under Paragraph 9(1) UStG, 'a trader may treat a transaction which is exempt from tax under Paragraph 4(12) … as taxable if the transaction is performed for another trader for the purposes of his business ...'

8. Paragraph 15 UStG provides as follows:

‘(1) The trader may deduct the following amounts of input tax:

1. tax owed by law for supplies of goods and services effected by other traders for the purposes of his business.

…

(2) There shall be no deduction of tax in respect of the supply, importation or intra-Community acquisition of goods, or in respect of supplies of services, which the trader uses for the purposes of the following transactions:

1. exempt transactions;

…

(4) If a trader uses any goods supplied, imported or acquired in the Community for the purposes of his business, or a service supplied to him, only in part for effecting transactions in respect of which the right to deduct is excluded, there shall be no deduction of the part of the input tax which is economically attributable to those transactions. The trader may make an appropriate estimate of the non-deductible amounts. Determination of the non-deductible part of the input tax in accordance with the ratio between the transactions in respect of which the right to deduct is excluded and the transactions in respect of which there is a right of deduction is permissible only if no other economic allocation is possible.’

II – **Facts**

9. Between 2003 and 2004, BLC Baumarkt GmbH & Co. KG (‘BLC’) constructed a residential and commercial building. In 2004, it let the building subject to VAT as regards the commercial premises and exempt from VAT as regards the apartments.

10. In its VAT return for 2004, BLC made a partial deduction of the tax in relation to that property. In that connection, it applied a deductible proportion calculated on the basis of the turnover from the commercial letting and the turnover from the letting of the apartments (‘the turnover method’).

11. Following an inspection, the Finanzamt Hildesheim (the tax office; ‘Finanzamt’) stated that, under the third sentence of Paragraph 15(4) UStG, as amended in 2003, the deductible amount should be determined on the basis of the respective surface areas of the commercial premises and the apartments (‘the surface area method’). In this particular case, that meant a reduction of the deductible amount and a fresh assessment.

12. BLC appealed against the fresh assessment to the Finanzgericht, which upheld the appeal on the ground that the third sentence of Paragraph 15(4) UStG was contrary to European Union law. The Finanzgericht took the view that Article 17(5), third subparagraph, point (c), of the Sixth Directive precludes a Member State from providing primarily for a method of calculation other than the turnover method.

III – **The question referred**

13. The Finanzamt brought an appeal on a point of law against that judgment before the Bundesfinanzhof, which has referred the following question for a preliminary ruling:

‘Is the third subparagraph of Article 17(5) 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 to be interpreted as authorising the Member States to prescribe primarily an apportionment criterion other than the transaction formula for apportioning the input tax on the construction of a mixed-use building?'

14. The referring court asks whether, under point (c) of the third subparagraph of Article 17(5) of the Sixth Directive, a national legislature is entitled to limit the transaction formula and, therefore, replace the turnover method with another method such as the surface area method.

15. The Bundesfinanzhof states that the German legislature based the restriction of the transaction formula by the third sentence of Paragraph 15(4) UStG expressly on Article 17(5), third subparagraph, point (c), of the Sixth Directive, on the ground that the application of the transaction formula is not binding on the Member States because, under that provision, they may lay down different apportionment criteria.

16. However, the Bundesfinanzhof acknowledges that, against that interpretation, it could be argued that the wording of Article 17(5), third subparagraph, point (c), of Sixth Directive 77/388/EEC is far from clear and that the scheme and the purpose of the provision suggest that the transaction formula should be retained.

IV – **The procedure before the Court of Justice**

17. The reference for a preliminary ruling was lodged at the Court Registry on 27 October 2010.

18. Written observations were submitted by the German, United Kingdom and Greek Governments and by the Commission. No hearing was held.

19. The Commission and all the governments which have participated in these proceedings take the view that the question referred should be answered in the affirmative. Accepting that, in principle, the applicable method is the turnover method, they maintain that, in accordance with the *RBS* judgment,(6) Article 17(5), third subparagraph, of the Sixth Directive allows Member States to provide for derogations of greater or lesser scope from that rule, extending even as far as excluding the right of deduction. That, they submit, is supported by the wording and the scheme of Article 17(5), third subparagraph, point (c), of the Sixth Directive, from which it is clear that the European Union legislature does not impose on the Member States a specific formula for calculating the deductible percentage. That is also borne out by the explanatory memorandum to the proposal for the Sixth Directive. Finally, the parties point out that, in their opinion, in addition to being more readily applicable, the surface area method produces more accurate results and therefore ensures better application of the principle of fiscal neutrality.

20. For its part, the United Kingdom Government argues that the exceptions cannot become the rule, meaning that the turnover formula is merely a subsidiary formula. The United Kingdom Government submits that the exceptions may be allowed as such only when the turnover method gives an unfair or inaccurate result.

V – **Assessment**

21. It is appropriate to make some preliminary remarks about the question referred by the Bundesfinanzhof before proceeding to provide the appropriate answer to it. First of all, it should be observed that the question refers to two aspects: one is a particular type of property which is intended to give rise to a possible right to deduct VAT; the other is a particular way of calculating that deductible amount in – to put it simply – cases of 'mixed use'.

22. Thus, on the one hand, as I stated at the outset, the Bundesfinanzhof appears only to have

doubts concerning the calculation of the amount of input tax which may be deducted on the construction of a very specific type of property – a building – where that property is put to 'mixed use', in other words is used in a manner which entails both transactions in respect of which there is a right to deduct VAT and transactions in respect of which there is no such right.

23. On the other hand, the referring court refers to a rather specific method of calculating the deductible amount, which it describes using the phrase 'primarily an apportionment criterion other than the transaction formula', in a barely concealed reference to the applicable national provision (Paragraph 15(4) UStG). As far as that aspect is concerned, it is common knowledge that the Sixth Directive is far more explicit. Article 17(5) of the directive sets out a large number of binding criteria for the Member States. As already pointed out, the difficulty lies in determining the discretion available to the Member States when it comes to establishing the formula which must apply in such cases in order to determine the deductible amount.

24. Formulated in that way, the question referred by the Bundesfinanzhof immediately raises the following question for the Court: is the referring court asking whether the formula described in those terms is valid as such and, therefore, valid in general for the purposes of quantifying the deductible amount in the case of any goods and services, or, on the other hand, is it asking about the lawfulness of the formula solely and exclusively in the case of the type of property concerned?

25. Having regard to the wording of the question as it is formulated, the referring court could appear to require a reply concerning the case of mixed-use buildings alone. However, the structure of the order for reference and the written observations are sufficient to reveal the limited significance of the property which has given rise to the proceedings. The dispute concerns to a large extent the latitude available to the Member States under Article 17(5), third subparagraph of the Sixth Directive, at all times against the background of the decision made by the national legislature.

26. In short, the question concerns the extent to which the Member States may give priority to a method based on use, thereby departing from the turnover rule. In that connection, it is certainly significant that the proceedings concern the calculation of the deductible amount of input tax on the construction of a mixed-use building. However, in my view, a consideration of the more general legislative framework in which this particular case has arisen proves conclusive.

27. Having framed the question in those terms, I shall deal with the reply which I propose in three stages. In the first stage, I shall attempt to provide an essentially systematic and purposive interpretation of the relevant section of Article 17(5) of the Sixth Directive, which is also capable of providing a criterion in respect of the method of calculation which the referring court describes using the phrase cited. In the second stage, I shall deal much more briefly with the specific case of input tax on the construction of a mixed-use building. Finally, in the third stage, I shall set out my thoughts on the task which still falls to the national court in the circumstances of the present case.

A – *Article 17(5) of the Sixth Directive: a 'relaxed' rule*

28. I must begin this first stage by admitting that there are undeniable difficulties with regard to the interpretation of Article 17(5) of the Sixth Directive, in particular the third subparagraph thereof which provides the Member States with a number of varied and disparate options, all introduced by the adversative particle 'however' (7) which has the effect of endowing them all with a certain derogating effect. It is essentially the scope of that capacity or effect of the third subparagraph of weakening the subject-matter of the first two subparagraphs with which the present case is concerned.

29. Under the third subparagraph of Article 17(5), Member States may (A) provide for an

optional or compulsory separate calculation for each sector of business (points (a) and (b)); (B) provide for a principal deductible proportion which is either compulsory or optional, and which, in the latter case, entails the possibility of other deductible proportions (point (d)); or lastly, as far as the present case in particular is concerned, (C) provide for the deduction to be calculated on the basis of the criterion of use of all or part of the goods and services used in all transactions (point (c)). (8)

30. Giving advance notice of my conclusion in that regard, I believe that Article 17(5) of the Sixth Directive lays down a clear rule for calculating the amount of the deductible proportion in the cases of mixed use referred to therein, which is that the deductible proportion must be based on turnover and calculated in accordance with the formula laid down in Article 19(1) of the directive.

31. The Court observed as much in the *RBS* judgment, case?law to which all the parties have referred in support of their respective positions. In that judgment, the Court began by stating that 'Article 17(5) of the Sixth Directive lays down the rules applicable to the right to deduct VAT where the VAT relates to goods or services used by the taxable person "both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible". In such a case, the first subparagraph of Article 17(5) of the Sixth Directive provides that only such proportion of the VAT is deductible as is attributable to the former taxable transactions (*Abbey National*, paragraph 37, and Case C?16/00 *Cibo Participations* [2001] ECR I?6663, paragraph 34)' (paragraph 17).

32. As the judgment goes on to explain, that amount is calculated, '[u]nder the second subparagraph of Article 17(5) of the Sixth Directive ... according to a proportion fixed in accordance with Article 19 of that directive' (paragraph 18).

33. Thus, as the United Kingdom Government has stated, the general rule laid down in Article 19 of the Sixth Directive, based on the correlation between the amount of turnover relating to transactions in respect of which VAT may be deducted and the amount of turnover relating to transactions in respect of which VAT may not be deducted, relies on accounting information which is readily available for all taxable persons and enables, in principle, a fair and reasonably accurate calculation of the amount which is ultimately deductible. Further, that rule is, naturally, the one which the European Union legislature primarily chose, since, while the directive merely mentions other possible methods available to the Member States, the turnover method is the only one which is defined and for which the details of the calculation process are laid down.

34. Certainly, paragraph 19 of the *RBS* judgment contains an assertion which, to my mind, is the source of a fairly widespread misunderstanding (9) and is the basis for the view that, under the rules laid down in Article 17(5) of the Sixth Directive, the Member States may lay down certain exceptions which, in my opinion, are not supported either by a reading of the provision or by the *RBS* judgment.

35. In paragraph 19 of the *RBS* judgment, the Court held that '[t]he third subparagraph of Article 17(5) nevertheless allows derogation from that rule [the one in the second subparagraph] by permitting Member States to employ one of the other methods for determining the deductible amount listed in that subparagraph, namely determination of a separate proportion for each sector of business or deduction on the basis of the use made of all or part of the goods and services for a specific activity, or they may even exclude the right of deduction in certain circumstances.' It could follow from the foregoing that the method laid down in the first two subparagraphs is not binding on the Member States, since the third subparagraph allows them to adopt 'other methods' which differ from it.

36. To my mind, that conclusion, inferred from the passage quoted, is hasty. First, account

should be taken of its context. In the scheme of a decision dealing with the possibilities relating to the rounding up of figures when calculating a deduction, a matter which is governed by Article 19(1), second subparagraph, of the Sixth Directive, I would go so far as to say that the section reproduced above is an *obiter dictum*.

37. The *RBS* judgment did not rule in general terms on the scheme of the subparagraphs of Article 17(5) and instead only did so on a very specific aspect of the method of calculating the deductible proportion. In the instant case, however, notwithstanding the apparent precision of the question referred by the Bundesfinanzhof, a general ruling is required, as I stated in point 25.

38. Second, even if it is accepted that the third subparagraph offers the Member States the possibility of adopting 'other methods', under no circumstances does it set out a general, unconditional right to derogate from the rule laid down in the two subparagraphs which precede it, the details of which are contained in Article 19.

39. In short, it is my view that on a systematic interpretation of the provision, the third paragraph of Article 17(5) of the Sixth Directive is not capable of converting the rule laid down in the first two subparagraphs into a rule which may be derogated from generally or without limitation.

40. Further, a purposive interpretation leads to the same conclusion. The explanatory memorandum to the proposal for the Sixth Directive (10) explains the reason for Article 17(5) as the need to avoid inequalities in the application of the tax, for which purpose it is provided that the Member States 'may authorise or oblige the taxable person to determine special proportions and to make deductions on the basis of actual use to which all or part of the goods or services are put in the business concerned'.

41. Also in that connection, in the context of a directive which, according to its twelfth recital, serves the purpose of harmonising the rules governing deductions 'to the extent that they affect the actual amounts collected', and states for that purpose that 'the deductible proportion should be calculated in a similar manner in all the Member States', it is clear that if Member States were able to provide in general terms and without limitation for the introduction of any of the options set out in the third subparagraph, it would be contrary to the aim pursued by the European Union legislature. It would make no sense to re-introduce diversity by authorising the Member States to derogate from the method laid down as the general rule, at least, as will be seen below, in the absence of any justification based on the aim of better satisfying the requirements inherent in the philosophy and the system of the rules governing VAT.

42. All of this leads me to conclude that the aim of the third subparagraph of Article 17(5) is essentially to avoid the strictness of the rule in the preceding two subparagraphs by making available to the Member States, for that purpose, a number of measures which are flexible in their design and scope and are in all cases in the interests of the traditional neutrality of the tax. (11)

43. That right to 'relax' the rule, which is made available to the Member States, can be justified only in so far as the measures by which it is secured are capable of enabling the attainment of the aim pursued by the European Union legislature in allowing the Member States to choose any of the options provided for in points (a) to (d) of the third paragraph of Article 17(5) of the Sixth Directive. In the words of paragraph 24 of the *RBS* judgment, that aim is 'to permit Member States to achieve greater accuracy by taking into account the specific characteristics of the taxable person's activities.' In short, the ultimate aim pursued is, as is obligatory in the sphere of taxation, the accurate calculation of the deduction to which the taxable person concerned has a legitimate right and the guarantee of neutrality, a principle which informs VAT. (12)

44. As a result of those arguments, it is possible to reach an initial, general conclusion: Article

17(5) of the Sixth Directive permits Member States to derogate from the general proportion rule based on turnover, which is laid down in the first two subparagraphs in conjunction with Article 19, and to do so in accordance with the various alternatives laid down in the third subparagraph of Article 17(5). In particular, point (c) of the third subparagraph unquestionably grants Member States the right to derogate from the general rule since it allows them to opt for a deductible proportion based on use. A systematic and purposive interpretation of that specific provision precludes the attribution to it of a scope whereby the rule stipulated as the starting point can be almost de-activated in a general way or else relegated to a position which is distinctly subordinate or which is clearly difficult to apply.

45. To put it another way, Article 17(5) does not permit alteration of the nature of the basic structure of the rules for calculation of a deduction, which were laid down by the European Union legislature with the aim of harmonising the rules on deduction in force in the Member State by imposing a similar method of calculation in all of them. However, it is compatible with that harmonising aim for the Member States to lay down an unlimited number of cases which are not necessarily governed by the general rule and are justified by the need to comply fully with the principle of the neutrality of the tax and to ensure the utmost accuracy in the calculation of the deduction in each case. (13) That being so, it is now necessary to ascertain whether, in the light of its characteristics which the referring court has asked the Court to take into account, the instant case merits the application of a calculation criterion which is potentially different from the transaction formula.

B – *'Mixed-use' buildings*

46. As has already been observed, the Bundesfinanzhof does not seek a general reply to the question as it has been addressed so far but rather a specific reply concerning the calculation of the deductible amount of input tax on the construction of a mixed-use building. The considerations set out above should enable that reply to be dealt with in a relatively straightforward manner.

47. All the parties have observed that, in certain circumstances, the turnover method which is laid down as the general rule in the Sixth Directive may be less fair and accurate than other possible methods. Or, to put it the other way round, it could be the case that, having regard to the specific features of the transactions concerned, there are more accurate methods of determining the deductible amount than the one primarily laid down by the legislature in the Sixth Directive. Since greater fairness and accuracy in the calculation of the deductible amount must lead to better compliance with the principle of the neutrality of VAT, it should be acknowledged that that factor is a sufficient reason justifying the replacement of the turnover rule by a rule which guarantees that result.

48. More specifically, all the parties to the proceedings agree that, in cases such as the present one, that is cases concerning the construction of a mixed-use building, the method of actual use based on the surface area criterion ensures a more accurate result in respect of the deductible amount to which a taxable person is lawfully entitled.

49. In those terms, I believe that it is possible, in any event as a starting hypothesis, for mixed-use buildings to be regarded as plausible 'candidates' for an alternative method of calculation to the proportion method based on turnover.

50. If that is the case, a matter which it is for the referring court to establish, there is no reason why, under European Union law, the method used for calculating the deductible amount should not be the method of actual use.

51. However, the question remains whether, in those terms, the Member State made a specific

choice in the sense of providing for that category of property to be treated in accordance with a calculation which, at least primarily, is not based on the turnover method. That is because it is clear at the very least that it is not a choice which takes effect automatically and that instead it requires a decision of the Member State in that regard. I shall now deal with the last point to which I referred at the beginning of this Opinion.

C – *The decision of the Member State under Article 17(5)*

52. I should say at the outset that a specific decision of the national legislature with regard to calculation of the deduction in the case of mixed-use buildings would certainly have made matters easier for the national court. As has been seen, the national legislature opted for a provision which, by allowing taxable persons, as a general rule, to determine the amounts which are partially non-deductible by means of an objective calculation, sufficiently covers a case of this kind. However, at the same time, as the considerations I have set out above show, it is that general nature which may give rise to a problem from the point of view of European Union law, because the national provision makes the turnover formula a final, subsidiary option which applies only if no other economic allocation of goods and services used in the same transactions is possible.

53. In short, the consequence of that 'all-inclusive' treatment by the national legislature is that it is not possible to identify the reason which specifically led the Member State to derogate in this case – as in others – from the general rule.

54. That situation with regard to the national legislation leads me to conclude that, in circumstances such as these, even though the case which the Court has been asked to consider appears prima facie to be one where it is possible to derogate from the general rule, it must be for the national court to confirm, if appropriate, the decision of the national authority which, in the main proceedings, did not allow the deductible amount to be calculated on the basis of turnover.

VI – **Conclusion**

55. In the light of the foregoing considerations, I propose that the Court should reply in the following terms to the question referred by the Bundesfinanzhof:

Article 17(5) 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 must be interpreted as meaning that, in principle, in a case such as that of the apportionment of input tax on the construction of a mixed-use building, it does not preclude the Member States from prescribing primarily an apportionment criterion other than the transaction formula. However, in the circumstances arising from the situation with regard to the national legislation applicable to the case, it is for the national court to ensure in the instant case that that formula is aimed at guaranteeing a more accurate result than the one laid down as the general rule.

1 – Original language: Spanish.

2 – 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).

3 – ‘Use’ is the term used in point (c) of the third subparagraph of Article 17(5) of the English-language version of the Sixth Directive. The German version uses the term ‘Zuordnung’, the Spanish version uses the term ‘afectación real’, while the French version uses the term ‘affectation’.

4 – BGBl 1999 I, p. 1270.

5 – BGBl. 2003 I, p. 2645.

6 – Case C?488/07 *Royal Bank of Scotland* [2008] ECR I?10409. ‘*RBS* judgment’.

7 – That adversative particle has now been deleted from Article 173 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1).

8 – Point (e) is irrelevant for the present purposes since it merely provides for the exclusion of the right of deduction where the amount of tax is insignificant.

9 – That is clear from the positions adopted by the parties which have participated in these proceedings.

10 – Published in the *Official Journalof the European Communities*, Supplement 11/73.

11 – It is highly symptomatic that, without amending the subject-matter of the provision, Article 173(2) of Directive 2006/112 reproduces the third subparagraph of Article 17(5) of the Sixth Directive, providing that ‘Member States may take the following measures ...’ followed by a transcription of points (a) to (e) of the third subparagraph. That makes even clearer the fact that it is not true exceptions to the general rule which are permitted but rather ‘measures’ which qualify or relax it without, obviously, altering its nature.

12 – In that connection, see Case C?174/08 *NCC Construction Danmark* [2009] ECR I?10567, paragraph 27.

13 – The Court gave a clear ruling in that regard in, for example, Case C?437/06 *Securenta Göttinger Immobilienanlagen und Vermögensmanagement* [2008] ECR I?1597, paragraphs 34 to 39.