OPINION OF ADVOCATE GENERAL JACOBS
delivered on 16 May 2002 [1]

1. In this case the Bundesfinanzhof (Federal Finance Court), Germany, has asked the Court whether a Member State may treat the use for private residential purposes of a dwelling in business premises forming as a whole part of the assets of the business as tax-exempt in accordance with Article 13(B)(b) of the Sixth VAT Directive [2] with the result that deduction of the VAT which arose in connection with the construction of the premises is to that extent precluded.

Relevant provisions of the Sixth Directive

2. Article 2(1) of the Sixth Directive subjects to value added tax:

'the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such'.

3. Article 6(2)(a) treats as a supply of services for consideration:

'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'.

4. Article 11(A)(1)(c) provides that the taxable amount shall be, 'in respect of supplies referred to in Article 6(2), the full cost to the taxable person of providing the services'.

5. Article 13(B) lays down a series of mandatory exemptions from VAT.

1 — Original language: English.

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.

Article 13(B)(b) exempts, subject to certain exceptions of no relevance here:

'the leasing or letting of immovable property...'

6. Article 13(C) provides:

'Member States may allow taxpayers a right of option for taxation in cases of:

(a) letting and leasing of immovable property;

(b) the transactions covered in B(d) (g) and (h) above.

Member States may restrict the scope of this right of option and shall fix the details of its use.'

7. Article 17 concerns the right of a taxable person to deduct from the output VAT payable on his taxable supplies the input VAT incurred on the goods and services used for making those supplies. The deduction mechanism ensures that traders do not themselves ultimately bear the tax which they collect by adding it to the selling price of their supplies: VAT is definitively borne only by the final consumer who, not being a taxable person, has no right of deduction.

8. Article 17(2) provides:

'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.'

9. Sometimes however it may be necessary to adjust the initial deduction. Article 20(2) [3] and (3) lay down rules for adjustment in respect of capital goods

3 — As amended by Council Directive 95/7/EC of 10 April 1995 amending Directive 77/388/EEC and introducing new simplification measures with regard to value added tax — scope of certain exemptions and practical arrangements for implementing them, OJ 1995 L 102, p. 18.

where the degree to which such goods are used for the purpose of taxable transactions varies over time:

'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.

By way of derogation from the preceding subparagraph, Member States may base the adjustment on a period of five full years starting from the time at which the goods are first used.

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

'3. In the case of supply during the period of adjustment capital goods shall be regarded as if they had still been applied for business use by the taxable person until expiry of the period of adjustment. Such business activities are presumed to be fully taxed in cases where the delivery of the said goods is taxed; they are presumed to be fully exempt where the delivery is exempt. The adjustment shall be made only once for the whole period of adjustment still to be covered.

...'

Relevant provisions of national legislation

10. Paragraph 1 of the Umsatzsteuergesetz (Law on Turnover Tax) 1993, in the version in force in the year in dispute (1995) ('the Law'),[4] is headed 'Taxable transactions' and lists transactions which are subject to VAT. Paragraph 1(2)(b) includes in that list 'private use', the definition of which there given includes cases where a trader in the course of his business effects supplies other than of goods for purposes which fall outside the business.

11. Paragraph 4 of the Law is headed 'Exempt supplies of goods and services and private use'. Paragraph 4(12)(a)

4 — BGBl I, p. 565.

includes among exempted transactions the leasing or letting of immovable property.

12. Paragraph 9(1) of the Law provides that the taxpayer may treat a transaction exempted pursuant to Paragraph 4(12) as taxable if it is a supply to another trader for his business. Paragraph 9(2) [5] provides that the exemption may be so waived in the case of a letting or leasing of immovable property only where the lessee uses or intends to use the immovable property exclusively for transactions which do not preclude the deduction of input tax.

13. In accordance with the case-law of the Bundesfinanzhof, the private use of immovable property forming part of the assets of a business is exempt pursuant to Paragraph 4(12)(a) of the Law. Waiver of the exemption pursuant to Paragraph 9 of the Law is not permissible because that provision presupposes a supply to another trader for his business.

14. Paragraph 15(2) of the Law precludes deduction of VAT on supplies used for exempt transactions.

15. The present case is not the first occasion on which the German rules relating to the VAT treatment of private use of business assets have come before the Court. I have already explained the scheme and effect of those rules in my Opinion in *Armbrecht*, [6] and it may be helpful at this point to repeat that explanation:

'... the principle underlying the German implementing rules is that, in order to ensure fiscal neutrality between taxable persons and private individuals, a taxable person putting goods or services to private use must be placed in the same position for VAT purposes as one of his customers. The German rules therefore require a taxable person to assign goods acquired partly for business and partly for private use to the business. The taxable person is seen as having the right to deduct tax in full on the goods under Article 17(2) of the directive, but must then account for his private use of them by paying an annual charge based on the depreciation of the goods under Article 6(2)(a).

...

5 — As amended by the law of 21 December 1993, BGBl I, p. 2310.

6 — Case C-291/92 [1995] ECR I-2775, paragraphs 22 and 25.

In keeping with the logic of the German arrangements the private use of an immovable property is equated with an exempt residential letting by the business. In other words, the private use is deemed to be a supply by the taxable person under Article 6(2)(a), but is exempted under Article 13(B)(b). The effect of this is that, in contrast to the position with other goods, on the acquisition of an immovable property a taxable person is not entitled to deduct the VAT on the proportion of the property put to private use since it is referable to an exempt supply. Nor however is he obliged to pay a charge for private use under Article 6(2)(a).'

The main proceedings and the question referred

16. Mr Seeling owns a tree-surgery and horticultural business which is subject to the normal tax rules. In 1995 he erected a building which he treated (as a whole) as an asset of his business. Since its completion, he has used it partly for business and partly for private residential purposes.

17. In his turnover tax declaration for 1995, Mr Seeling claimed the deduction of sums attributable to the whole building. With regard to the private use of the building, he declared taxable personal use. However, the Finanzamt viewed the private use of the building as exempt personal use and refused the deduction to that extent.

18. The Finanzgericht (Finance Court) followed the view taken by the Finanzamt and dismissed Mr Seeling's action.

19. Mr Seeling has appealed to the Bundesfinanzhof. He submits that in accordance with Community law his private use of the dwelling is taxable and therefore deduction of the amounts attributable to the part of the building used as a dwelling is not precluded.

20. In its order for reference the Bundesfinanzhof states that according to the case-law of the Court of Justice Article 6(2)(a) of the Sixth Directive is designed to ensure equal treatment as between taxable persons and final consumers by preventing the non-taxation of business goods used for private purposes: *Kühne*,[7] *Mohsche*[8] and *Fillibeck*.[9]

7 — Case 50/88 [1989] ECR 1925, paragraph 8 of the judgment.

8 — Case C-193/91 [1993] ECR I-2615, paragraph 8 of the judgment.

9 — Case C-258/95 [1997] ECR I-5577, paragraph 25 of the judgment.

21. It adds, however, that it is open to question how far that equivalence of treatment extends, in particular whether the (partial) use of goods forming part of the assets of a business for the private use of a taxable person may be regarded as an exempt 'leasing or letting of immovable property' within the meaning of Article 13(B)(b) of the Directive.

22. The Bundesfinanzhof concludes that the question appears not to be conclusively settled, even following the judgment of the Court of Justice in *Armbrecht*. [10] It notes that in my Opinion in that case I observed that the German arrangements, which equate a taxable person who occupies privately immovable property that belongs to the business with a lessee under an exempt lease, are based on an understanding of the notion of fiscal neutrality which is contrary to the case-law of the Court of Justice. [11] However, those observations were not taken up by the Court of Justice in its judgment.

23. The Bundesfinanzhof has accordingly referred the following question to the Court:

'May a Member State treat the use for private residential purposes of a dwelling in business premises forming as a whole part of the assets of the business — which is equated to a supply of services for consideration under Article 6(2)(a) of Directive 77/388/EEC — as tax-exempt (in accordance with Article 13(B)(b) of that directive, but without the possibility of waiving the exemption), with the result that deduction under Article 17(2)(a) of the directive of the value added tax which arose in connection with the construction of the premises is precluded to that extent?'

24. Mr Seeling, the German Government and the Commission presented written observations and were represented at the hearing.

Analysis

25. Mr Seeling and the Commission, in contrast to the German Government, are of the view that the question referred must be answered in the negative. I agree.

26. The starting point must be the principle, well established in the case-law of the Court, [12] that a taxable person may choose

10 — Cited in note 4.

11 — See paragraphs 22 et seq. and 47 of the Opinion.

12 — See in particular *Armbrecht*, cited in note 4, paragraph 20 of the judgment.

whether or not to integrate into his business, for the purposes of applying the Directive, that part of an asset which is given over to his private use. Where a taxable person has opted to treat as business assets goods used for both business and private purposes, the VAT on those goods is in principle wholly deductible. [13] It is clear that by 'in principle' the Court meant simply in the absence of any relevant derogation in the Sixth Directive: subject to that, the Court has stressed the absolute nature of the 'right of deduction' even where the use of the goods for the purposes of the business is very limited. [14]

27. Where a taxable person has exercised that option and VAT has been fully deducted, Article 6(2)(a) — which it will be recalled treats the private use of such goods as a supply of services — is designed to ensure equal treatment as between taxable persons and final consumers by preventing the non-taxation of business goods used for private purposes; it therefore requires the taxation of the private use of such goods where the tax paid on their acquisition was deductible. [15]

28. It may seem surprising at first sight that an asset that is used partly for private purposes may be treated as assigned wholly to the business. However, such an analysis may in some circumstances promote the neutrality of the tax by allowing proper account to be taken of changes in the degree of private use over the useful life of the asset by a taxable person or as between a taxable vendor and a taxable purchaser. [16]

29. The case-law of the Court therefore permits two alternative methods of dealing for VAT purposes with goods used partly for private purposes: the taxable person may either retain the goods to that extent outside the VAT system altogether or integrate them into his business, deduct the input VAT on the goods and pay the charge for use under Article 6(2)(a). The German rules however permit a third method where the goods in question are immovable property: in that case they equate the service deemed to be supplied in accordance with Article 6(2)(a) with a letting and treat it as exempt by virtue of the exemption which would in the case of a genuine leasing arrangement be applicable [17] under Article 13(B)(b) of the Directive. On the basis that the letting is exempt, deduction of input tax is precluded.

13 — Case C-97/90 *Lennartz* [1991] ECR I-3795, paragraph 26 of the judgment.

14 — *Lennartz*, cited in note 13, paragraph 29 of the judgment.

15 — See *Kühne*, cited in note 7, paragraph 8 of the judgment, and *Fillibeck*, cited in note 9, paragraph 25.

16 — For further discussion illustrated by an example see my Opinion in *Armbrecht*, cited in note 6, paragraphs 34 to 36.

17 — Unless the lessor was a taxable person and had opted for taxation in accordance with Article 13(C)(a).

30. In support of that approach the German Government submits that it follows from the wording of Article 6(2)(a) that all the provisions of the Directive applicable to supplies of services are in principle also applicable to the private use of business assets. In the present case treating the private use of the property as a supply of services for consideration pursuant to Article 6(2) of the Directive implies that Article 13(B)(b) should be applied by analogy. The fact that there is no use by a third party does not in the German Government's submission preclude that interpretation: the fact that Article 6(2)(a) treats private use as a supply of services shows that a link with a third party is not critical.

31. In my view, and as Mr Seeling and the Commission submit, Article 13(B)(b) cannot support that interpretation.

32. It is settled law that the exemptions provided for by Article 13 of the Directive must constitute independent concepts of Community law so that the basis for assessing VAT is determined uniformly and according to Community rules. [18] Moreover the terms used to specify the exemptions are to be interpreted strictly since they constitute exceptions to the general principle stated in Article 2 of the Directive according to which VAT is to be levied on all supplies of goods or services made for consideration by a taxable person. [19] Although that requirement of strict interpretation does not mean that the terms used to specify exemptions should be construed narrowly or restrictively so as to deprive the exemptions of their intended effect, [20] it is clear that exemptions cannot in any event be extended by analogy, as the German Government's argument seems to require.

33. With particular regard to the interpretation of Article 13(B)(b) of the Directive, the Court has in a series of recent cases given guidance on the scope of the concept 'leasing or letting'. First, it has stated that the term 'letting of immovable property' cannot be considered to cover contracts in which the parties have not agreed on any duration for the right of enjoyment of the immovable property, which is an essential element of a contract to let. [21] Second, it has ruled that the letting of immovable property for the purposes of Article 13(B)(b) essentially involves the landlord of property assigning to the tenant, in return for rent and for an agreed

18 — See for example Case C-358/97 *Commission* v *Ireland* [2000] ECR I-6301, paragraph 51 of the judgment, and Case C-359/97 *Commission* v *United Kingdom* [2000] ECR I-6355, paragraph 63, and the earlier cases there cited.

19 — See, as regards in particular the exemption for leasing and letting of immovable property, Case C-326/99 *'Goed Wonen'* [2001] ECR I-6831, paragraph 46 of the judgment, and the cases there cited.

20 — See further Case C-267/00 *London Zoological Society*, in which judgment was delivered on 21 March 2002, paragraph 19 of my Opinion delivered on 13 December 2001.

21 — *Commission* v *Ireland*, paragraph 56 of the judgment, and *Commission* v *United Kingdom*, paragraph 68, both cited in note 18.

period, the right to occupy his property and to exclude other persons from it.[22] The exemption provided for in Article 13(B)(b) cannot therefore in my view apply to a fictional leasing by the taxpayer to himself, where there can by definition be no genuine agreement as to consideration or term (or indeed anything else).

34. If moreover the legislature had intended Article 6(2)(a) to be read in conjunction with Article 13(B)(b), it might have been expected that Article 6(2)(a) would contain an express reference to Article 13(B)(b):[23] the effect of such a reading is, after all, to transform a taxable supply into an exempt supply.

35. Furthermore, the German Government's approach involves an interpretation of Article 6(2)(a) which is contradictory. That provision explicitly states that the rules on the private use of goods there laid down are to apply 'where the value added tax on [the] goods is wholly or partly deductible'. The German rules purportedly implementing Article 6(2)(a) however refuse to allow the VAT on the goods to be deducted where the goods are immovable property.

36. Finally, as the Commission points out, the Court has held that both Article 6(2)(a) and Article 13(B)(b) may be relied upon by an individual as against a Member State before a national court.[24] It would perhaps be surprising if two provisions which have separately been held to be sufficiently clear, precise and unconditional to have direct effect were to be construed so as to be interdependent in the absence of any explicit or implicit reference to that effect.

37. Since I do not accept the German Government's argument that Article 13(B)(b) applies by analogy to the private use of immovable property forming part of the taxable person's business assets, it is not necessary to deal with its submissions as to the relevance and effect of Article 13(C), which permits Member States to allow taxable persons[25] a right of option for taxation in cases of letting and leasing of immovable property.

38. I accordingly consider that the German rules governing the VAT treatment of the private use by a taxable person of immovable property integrated into the assets of the business are contrary to the scheme of the Sixth Directive. Mr Seeling is therefore entitled to deduct in full the input tax attributable to the whole building and will

22 — Case C-409/98 *Mirror Group* [2001] ECR I-7175, paragraph 31 of the judgment, and Case C-108/99 *Cantor Fitzgerald International* [2001] ECR I-7257, paragraph 21, and the cases there cited.

23 — See in an analogous context my Opinion in *Mohsche*, cited in note 8, paragraph 14.

24 — See *Kühne*, cited in note 7, paragraph 27 of the judgment; *Mohsche*, cited in note 8, paragraph 19; and Case C-150/99 *Stockholm Lindöpark* [2001] ECR I-493, paragraph 32.

25 — Although the English text refers to 'taxpayers', it is clear that 'taxable persons' is what is meant: see for exemple the French text, which uses the term 'assujettis', and the German which uses 'Steuerpflichtigen'.

be liable to pay an annual charge under Article 6(2)(a) of the Directive.

39. The German Government submits however that that approach would enable a taxable person in Mr Seeling's position to obtain a cash-flow advantage and a tax advantage which would not be available under the German rules.

40. First, the taxable person would obtain a cash-flow advantage in that he would have the full benefit of the deduction at the outset whereas the tax charge under Article 6(2)(a) which is designed in effect to offset the deduction is staggered over the period of private use.

41. However, in my view and as Mr Seeling's representative suggested at the hearing, that advantage is inherent in the structure of Article 6(2)(a) and appears to be regarded by the Court — which has never suggested in the numerous cases on Article 6(2)(a) that that provision is flawed — as an acceptable consequence of the private use mechanism. Private use of goods could equally have been accounted for by adjusting the initial deduction made by the taxable person. However it appears from the Explanatory Memorandum to the Commission's proposal for the Sixth Directive [26] that it was accepted that the same aim could have been attained by other means (specifically, adjustments to deductions already made), but that 'the technique of treating these transactions as taxable supplies was chosen for reasons of impartiality and simplicity'. [27] Thus the output tax charge under Article 6(2)(a) was specifically chosen as an alternative to a restriction on the right to deduct input tax. [28]

42. Second, the German Government submits that a taxable person in Mr Seeling's position would obtain a tax advantage if he were to sell the building more than 10 years after its acquisition and deduction in full of the input tax. An analysis of that argument requires a brief explanation of the mechanism used in the Sixth Directive for the adjustment of deductions.

43. Article 20 of the Directive provides for subsequent adjustment of the initial deduction made on the acquisition of capital goods in order to take account of changes of use thereafter. Article 20(2) provides for an adjustment period of five years; that may be extended to 20 years (originally [29] 10 years) for immovable property.

26 — *Bulletin of the European Communities*, Supplement 11/73, commentary on Article 5(3), the predecessor of Article 5(6) in the Directive which is the equivalent provision in Article 5 ('supplies of goods') to Article 6(2)(a).

27 — See further P. Farmer and R. Lyal, *EC Tax Law* (1994), p. 102.

28 — See also my Opinion in *Lennartz*, cited in note 13, paragraph 59.

29 — Before amendment by Directive 95/7, cited in note 3, which came into force on 25 May 1995.

Article 20(3) deals with the situation where capital goods are disposed of during the adjustment period: if the taxable person makes a supply of goods during that period, their use for the remainder of the period is deemed to be wholly taxable or exempt business use (depending on whether the supply is taxable or exempt). It appears that Germany has extended the five-year period mentioned in Article 20(2) to 10 years for immovable property in accordance with the original option.

44. The German Government notes that in accordance with Article 11(A)(1)(c) the taxable amount in the case of supplies referred to in Article 6(2) is the full cost to the taxable person of providing the service. Where that service consists in the private use of immovable property, that cost will principally consist in the depreciation of the property or that part of it which is subject to private use. It is unlikely that within ten years of acquisition immovable property will have depreciated fully or consequently that the input tax deducted will have been fully extinguished by the annual charge paid. If therefore the taxable person sells the property after the 10-year period without any VAT being payable on that supply, [30] he will have had the benefit of deduction of input tax in full with no further possibility of adjusting that deduction. Such a result would in the German Government's submission conflict with the principle of fiscal neutrality.

45. While there may be some justification for those concerns, they can now be at least partially allayed by opting to permit adjustment within a 20-year period. Mr Seeling moreover points out a further anomaly arising from the German rules on private use of immovable property. Where there has been deduction in full of the input tax attributable to immovable property forming part of business assets and used in the 10 years following its acquisition wholly for business purposes, there is no mechanism for adjusting that deduction to reflect subsequent private use of the property if that private use starts ten years after its acquisition. Even where — as in the present case — private use began on acquisition of the property, there will be no possibility of making adjustments to the proportion of input tax whose deduction was permitted in order to reflect changes in the proportion of private and business use after the 10-year period. Fiscal neutrality can be attained only if deduction in full is permitted at the outset, since in that case private use is taxed throughout its duration in accordance with Article 6(2)(a).

30 — Presumably because the supply would be exempt by virtue of Article 13(B)(g). It should however be noted that in some circumstances the vendor may opt for taxation in accordance with the German rules implementing Article 13(C)(b).

Conclusion

46. I accordingly consider that the question referred by the Bundesfinanzhof should be answered as follows:

A Member State may not treat the use for private residential purposes of a dwelling in business premises forming as a whole part of the assets of the business as tax-exempt in accordance with Article 13(B)(b) of the 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.