

OPINION OF ADVOCATE GENERAL

JACOBS

delivered on 18 November 2004¹

1. In these proceedings, the Hoge Raad of the Netherlands asks for the Court's guidance on the interpretation of the Sixth VAT Directive² (hereinafter 'the Directive') as it applies, in particular, to public bodies.

2. In the main proceedings, a Netherlands water authority built a sewage plant in its capacity as a public authority. Later, it sold the plant to a third party, whilst simultaneously agreeing to lease the plant back. It then sought to claim a deduction by way of adjustment of the input tax which it had paid when constructing the plant on the basis that it acted as a taxable person in respect of the sale of the plant.

3. The referring court therefore wishes to know whether a body governed by public law has a right pursuant to Article 20 of the Directive to adjust the VAT paid in respect of

the acquisition of a capital good, which it has used for activities in which it engages as a public authority, when it subsequently sells that good as a taxable person.

4. The referring court also asks whether a body governed by public law has the right wholly to exclude from its capital assets a capital good used partly for activities engaged in as a taxable person and partly for activities engaged in as a public authority, as in the case of taxable natural persons.

Legal framework

5. By Article 2(1) of the Directive, VAT applies to 'the supply of goods and services effected for consideration ... by a taxable person acting as such'. 'Taxable person' is defined in Article 4(1) to mean 'any person who independently carries out in any place any economic activity specified in paragraph 2'.

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.

6. The first subparagraph of Article 4(5) provides that 'States, regional and local government authorities and other bodies governed by public law shall not be considered taxable persons in respect of the activities or transactions in which they engage as public authorities, even when they collect dues, fees, contributions or payments in connection with these activities or transactions'. By the second subparagraph of Article 4(5), however, those bodies are to be considered taxable persons when they engage in such activities or transactions where their treatment as non-taxable persons 'would lead to significant distortions of competition'. The final subparagraph of Article 4(5) further provides that 'Member States may consider activities of these bodies which are exempt under Articles 13 or 28 as activities which they engage in as public authorities'.

7. Article 13 deals with exemptions from the VAT system. The leasing or letting of immovable property is, with certain exceptions, normally exempt from VAT by virtue of Article 13B(b), as is the supply of buildings or parts thereof, and of the land on which they stand, by virtue of Article 13B (g). However, Article 13C permits Member States to allow taxpayers a right of option for taxation in respect of those activities.

8. Articles 17 to 20 of the Directive are concerned with deductions. Article 17(1)

provides that 'the right to deduct shall arise at the time when the deductible tax becomes chargeable'. Under Article 17(2), 'in so far as the goods or services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay ... value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person'.

9. Adjustments of deductions are the subject of Article 20, which provides, in so far as is relevant, as follows:

'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; ...

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.

specifies that public bodies are to be treated as taxable persons as far as supply of immovable property and transfer or creation of rights in such property are concerned.

...

Facts and national proceedings

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.'

10. Netherlands law extends to taxable persons the right of option for taxation permitted under Article 13C. It also

11. Waterschap Zeeuws Vlaanderen (hereinafter 'WZV') operates as a water authority in part of the Netherlands. Under the applicable national legislation, it is a body governed by public law. In its capacity as a public authority, it arranged for the construction of a sewage plant, which was completed in 1990.

12. WZV subsequently agreed to allow two other water authorities also to make use of the plant. The cost of modifying the plant was partly borne by those two authorities, and from 1993, so also were the costs which arose periodically owing to their use of the plant. Pursuant to an agreement with the tax inspector, WZV charged no VAT on the costs which it passed on, on condition that it did not exercise its right to deduct VAT paid on inputs.

13. I should point out here that, whilst the basis for that arrangement with the tax inspector has not been made clear, any difficulty in that regard seems unlikely to influence the approach to be taken in this case.

14. In 1994, WZV initiated the establishment of a foundation for the promotion of the environment in its district, to which it sold the sewage plant. On the same day, the foundation agreed to lease the plant back to WZV for a nine-year period.

15. Both the sale and lease were in principle exempt transactions. However, WZV and the foundation each exercised the option for taxation which was available to them under Netherlands law. VAT therefore became payable on both transactions.

16. WZV then sought deduction of part of the VAT which had been charged in respect of the initial construction of the plant, adjusted in accordance with Article 20 of the Directive. Deduction was thus sought for five tenths of the total, since five years of the ten-year adjustment period had elapsed. The tax inspector refused WZV's request.

17. WZV has brought proceedings to challenge the inspector's decision. The case is now before the Hoge Raad on appeal from the *Gerechtshof te Amsterdam* (Amsterdam Regional Court of Appeal).

18. In so far as the inspector held that the supply of the plant to the foundation was not a taxable transaction, the Hoge Raad upholds WZV's appeal. It is clear under Netherlands law that a public authority acts as a taxable person when it makes a supply of immovable property — and, of course, WZV had in that capacity exercised its option for taxation.

19. On the issue whether WZV was eligible for an adjustment under Article 20(2) of the Directive, the Hoge Raad refers to the Court's judgment in *Lennartz*.³ It considers that, if that judgment were applicable, WZV would not be so eligible, since the Court stated in that case that it is Article 17, not Article 20, which determines the origin and scope of any right to deduct, and only the capacity in which a person is acting at the time of acquisition can determine the existence of such a right.

20. The Hoge Raad is uncertain, however, whether the judgment in *Lennartz*, which concerned a natural person acting in both a

3 — Case C-97/90 [1991] ECR I-3795; see in particular paragraphs 8 and 11 of the judgment.

private and a business capacity, can be applied to a body governed by public law.

pursuant to Article 20 (in particular paragraphs 2 and 3) of the Sixth Directive in so far as it has used that item for activities in which it engages as a public authority under Article 4(5) of that directive?

21. The Hoge Raad also notes that the Gerechtshof found that adjustment was not possible because WZV had opted not to include part of the plant in its business assets when it entered into its arrangement with the tax inspector not to charge VAT on the operating costs which it passed on to the other two water authorities which made use of the plant. In the Hoge Raad's view, that argument raises the question whether the case-law of the Court concerning the option of the taxable person to designate capital goods as private assets or business assets applies *mutatis mutandis* to bodies governed by public law.

- (2) Does a body governed by public law have, under the Sixth Directive, the right wholly to exclude a capital item used partly for activities engaged in as a taxable person and partly for activities engaged in as a public authority from its capital assets, as the Court of Justice has ruled in respect of taxable natural persons?

22. The Hoge Raad has therefore decided to stay the proceedings before it and to refer the following questions to the Court:

- (1) Does a body governed by public law have, as regards a capital item acquired by it which it supplies for consideration to a third party, in respect of which supply it must be regarded as a taxable person, a right to adjust the turnover tax paid in respect of that acquisition

Analysis

23. As a preliminary point, I note that some of the submissions before the Court concern the question whether WZV built the plant in its capacity as a public authority. However, that is clearly a matter for the national court to determine. No questions have been referred to the Court regarding the criteria to be applied in making such a determination. The correct approach is however indicated in *Lennartz*⁴ and from the first

⁴ — See paragraph 21 of the judgment.

question referred it may be presumed that the national court has determined that WZV initially built the plant in its capacity as a public authority.

24. Another point which has not been raised, and which cannot properly be examined without full submissions, is whether national rules which have the effect of requiring a public body to be treated as a non-taxable person when it acquires capital goods, but as a taxable person when it disposes of them, can be considered compatible with the Directive.

25. I shall therefore confine my analysis to the legal issues actually raised by the order for reference.

26. As regards the first question, there is a general consensus amongst the parties and the referring court that it must receive a negative answer if the Court's judgment in *Lennartz*⁵ is applicable to bodies governed by public law when they enter into transactions in respect of their activities as public authorities.

27. In *Lennartz*, the Court was asked in effect to consider whether the input tax adjustment rules in Article 20(2) of the Directive apply where a taxable person initially acquires goods wholly for private use but subsequently uses them for business purposes at some point during the adjustment period.

28. The Court held that since the right to deduct arises at the time when the deductible tax becomes chargeable, 'only the capacity in which a person is acting at that time can determine the existence of the right to deduct'. By virtue of Article 17(2), in so far as a taxable person, acting as such, uses the goods for the purposes of his taxable transactions, he is entitled to deduct the tax due or paid in respect of those goods. Conversely, where the goods are not used for the taxable person's economic activities within the meaning of Article 4 of the Directive, but are used by him for his private consumption, no right to deduct can arise.⁶

29. Whilst that conclusion may appear somewhat harsh in its effects in some situations, and not wholly consistent with the principle of the neutrality of VAT, it must be acknowledged that it flows from the wording of Article 17(1) and (2) and that a

5 — Cited above in note 3.

6 — Paragraphs 8 and 9 of the judgment.

contrary approach would raise serious problems as regards legal certainty.

than with a taxable person who acquires goods for his own private purposes.

30. As regards Article 20(2), the Court held that it does no more than establish the procedure for calculating the adjustments to the initial deduction. It cannot therefore give rise to any right to deduct or convert the tax paid by a taxable person in respect of his non-taxable transactions into a tax that is deductible within the meaning of Article 17.⁷

33. In my view, the Netherlands and the Commission are correct to contend that *Lennartz* applies also where an initial acquisition is made by a body governed by public law for activities in which it engages as a public authority.

31. The Netherlands and the Commission submit that the Court's judgment in *Lennartz* is applicable by analogy to a situation in which an initial acquisition is made not by a person purchasing for private use but by a body governed by public law purchasing for its activities as a public authority. In each case, the person acquiring is not a taxable person for the purposes of the transaction, with the consequence that no right of deduction arises.

34. As the Netherlands and the Commission submit, the correct analogy seems to be between a body governed by public law when acting as a public authority and a taxable person who acquires goods for private use. By contrast with a taxable person making an exempt supply, both such parties fall wholly outside the scope of VAT. A person who purchases for private use does not carry out any economic activity within the meaning of Article 4(1) of the Directive. Similarly, Article 4(5) of the Directive clearly states that bodies governed by public law are not normally to be considered taxable persons in respect of the activities or transactions in which they engage as public authorities. Because they are not taxable persons, their transactions as such can never give rise to a right of deduction. By contrast, a taxable person engaging in an exempt transaction is within the scope of VAT. No right of deduction arises only because, only for as long as and only to the extent that the supplies are exempt.

32. By contrast, WZV argues that a public authority should be compared with a taxable person providing an exempt service rather

⁷ – Paragraph 12 of the judgment.

35. However, as the Commission rightly points out, an exclusion from the VAT rules such as that effected by Article 4(5) differs in nature and effect from the exemptions contained in Title X of the Directive.⁸ Indeed, were that not so, there would be no reason for the final subparagraph of Article 4(5) to allow Member States to bring certain exempt activities within the scope of that exclusion.

36. WZV submits that a distortion of competition would result if bodies governed by public law were unable to deduct VAT in the circumstances as stated in the first question. Such bodies would be unfairly disadvantaged by comparison with taxable persons who could deduct the VAT payable on the initial acquisition of a capital item. WZV refers in that regard to the second subparagraph of Article 4(5), which provides that bodies governed by public law, even when acting as public authorities, are to be considered as taxable persons if significant distortions of competition would otherwise result.

37. I am not convinced by that argument, although I can sympathise with it.

38. It is inherent in the existence of exceptions to the VAT system that they will

interfere to some extent with the application of the principles of neutrality and of equality of treatment. Whatever the merits of the decision to treat public bodies as final consumers, it forms an integral part of the Directive. In that and in comparable situations, the treatment of taxable persons and persons excluded from the VAT system will inevitably be different.

39. At the moment of acquisition, a public authority acting as such is subject to a tax burden different in nature from that which applies to a taxable person. It acquires its supplies at a price inclusive of VAT but, unlike a taxable person, is unable to deduct input tax. Its VAT burden is thus fixed at the moment of acquisition and will not be altered by any subsequent output transaction.

40. However, that difference in treatment alone cannot in my view be regarded as giving rise to a significant distortion of competition for the purposes of the second subparagraph of Article 4(5) of the Directive. If it were, almost any transaction carried out by a public body acting as such would fall within that provision.

41. The purpose of the first subparagraph of Article 4(5) is to exclude the activities of public bodies acting in their capacity as

⁸ — See, for example, Case C-45/95 *Commission v Italy* [1997] ECR I-3605, at paragraph 20 of the judgment and paragraph 42 et seq. of the Opinion of Advocate General Ruiz-Jarabo.

public authorities from the sphere of VAT, in principle with whatever consequences that entails. The purpose of the second subparagraph is to avoid any significant distortions of competition, which must necessarily be exceptional in comparison to the normal consequences of the exclusion if the second subparagraph is not wholly to override the first. The difference in treatment in the present case is a normal consequence of the exclusion and so cannot fall within the second subparagraph.

42. Consequently, a body such as WZV must be treated as a non-taxable person in

relation to the acquisition of supplies in pursuit of its activities as a public authority. It can thus enjoy no right to deduct, and the issue of a right to adjust deductions, mooted in the national court's first question, cannot arise.

43. Furthermore, because the status of a public body for VAT purposes is determined at the moment of acquisition, the subsequent employment of the supplies acquired cannot alter that status. In the light of the referring court's finding that WZV constructed the plant in its capacity as a public authority, the second question thus does not arise for consideration.

Conclusion

44. Accordingly, for the reasons stated above, I am of the opinion that the questions referred to the Court should be answered as follows:

A body governed by public law which acquires a capital item and later supplies it for consideration to a third party, thereby acting as a taxable person, has a right to adjust the VAT paid in respect of that acquisition pursuant to Article 20 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, only in so far as it acted as a taxable person when it initially acquired the item.