JUDGMENT OF THE COURT (Grand Chamber)

21 February 2006 *

In Case C-255/02,

REFERENCE to the Court under Article 234 EC for a preliminary ruling, brought by the VAT and Duties Tribunal, London (United Kingdom), by decision of 27 June 2002, received at the Court on 11 July 2002, in the proceedings

Halifax plc,

Leeds Permanent Development Services Ltd,

County Wide Property Investments Ltd,

v

Commissioners of Customs & Excise,

* Language of the case: English.

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann, C.W.A. Timmermans, A. Rosas, K. Schiemann, J. Makarczyk, Presidents of Chambers, S. von Bahr (Rapporteur), J.N. Cunha Rodrigues, R. Silva de Lapuerta, K. Lenaerts, P. Küris, E. Juhász and G. Arestis, Judges,

Advocate General: M. Poiares Maduro,
Registrar: K. Sztranc, Administrator,

having regard to the written procedure and further to the hearing on 23 November 2004,

after considering the observations submitted on behalf of:

— Halifax plc, Leeds Permanent Development Services Ltd, and County Wide Property Investments Ltd, by K.P.E. Lasok QC and M. Patchett-Joyce, Barrister, instructed by S. Garrett, Solicitor,

— the United Kingdom Government, by J. Collins and R. Caudwell, acting as Agents, and by J. Peacock QC, C. Vajda QC and M. Angiolini, Barrister,

— the French Government, by G. de Bergues and C. Jurgensen-Mercier, acting as Agents,

— Ireland, by D.J. O'Hagan, acting as Agent, and by A.M. Collins, SC,

— the Commission of the European Communities, by R. Lyal, acting as Agent,

after hearing the Opinion of the Advocate General at the sitting on 7 April 2005,

gives the following

Judgment

1 This reference for a preliminary ruling relates to the interpretation 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 (OJ 1977 L 145, p. 1), as amended by Council Directive 95/7/EC of 10 April 1995 (OJ 1995 L 102, p. 18, hereinafter 'the Sixth Directive').

2 The reference was made in proceedings brought by Halifax plc ('Halifax'), Leeds Permanent Development Services Ltd ('Leeds Development') and County Wide Property Investments Ltd ('County') against the Commissioners of Customs and Excise ('the Commissioners') in relation to the latter's rejection of applications for recovery of or relief from value added tax ('VAT') submitted by Leeds Development and County under a scheme designed to reduce the tax burden of the Halifax Plc Group.

Legal background

3 Article 2(1) of the Sixth Directive provides that the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such is to be subject to VAT.

4 Under Article 4(1) of the Sixth Directive, 'taxable person' means any person who independently carries out any economic activity specified in paragraph 2 of that article. 'Economic activities' are defined in Article 4(2) as comprising all activities of producers, traders and persons supplying services, including the exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis.

5 Article 5(1) of the Sixth Directive states that '"supply of goods" means the transfer of the right to dispose of tangible property as owner'.

6 Article 6(1) of the Sixth Directive provides that '"supply of services" means any transaction which does not constitute a supply of goods within the meaning of Article 5'.

7 Under Article 13B(b) of the Sixth Directive, the Member States are required, subject to certain exceptions listed there, to exempt the leasing or letting of immovable property. However, under Article 13C(a) Member States may allow taxpayers a right of option for taxation in respect of such transactions.

8 Article 13B(d) of the Sixth Directive states that the Member States are to exempt from VAT certain activities in the financial services sector.

9 Article 17(2)(a) of the Sixth Directive 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 within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person.'

10 As regards goods and services to be used by a taxable person both for transactions in respect of which VAT is deductible and for transactions in respect of which it is not, the first subparagraph of Article 17(5) of the Sixth Directive states that 'only such proportion of the value added tax shall be deductible as is attributable to the former transactions'.

11 According to the second subparagraph of that provision, '[t]his proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person'.

The main proceedings and the questions referred to the Court of Justice

12 Halifax is a banking company. The vast majority of its services are exempt from VAT. At the material time, it was able to recover less than 5% of its input VAT.

13 According to the observations submitted by Halifax, Leeds Development is a property development company and County is a property development and investment company.

14 It appears from the order for reference that Leeds Development and County, and another member of the Halifax Plc Group involved in the transactions at issue, Halifax Property Investments Ltd (hereinafter 'Property'), are each wholly owned subsidiaries of Halifax. Leeds Development and County are each registered separately for VAT, and Property is unregistered.

15 For the purposes of its business, Halifax needed to construct call centres on four different sites at Cromac Wood and at Dundonald in Northern Ireland, at Livingston in Scotland and at West Bank, Leeds, in the North-East of England, on which it held a lease with about 125 years to run or the freehold or a fee simple interest.

16 On 17 December 1999, Halifax initially contracted with Cusp Ltd, an arm's length property development and contracting company, for the development of the Cromac Wood site. By a novation agreement of 28 February 2000, Halifax then disengaged itself from that contract and its rights and obligations became those of County.

17 Between 29 February and 6 April 2000, Halifax, Leeds Development, County and Property entered into a number of agreements relating to the various sites. The order for reference shows that the transactions for each of the sites followed a similar course.

18 As regards the sites at Cromac Wood, Dundonald and Livingston, on 29 February 2000 Halifax entered into loan agreements with Leeds Development, under which it agreed to lend it sufficient amounts for Leeds Development to acquire an interest in and develop the sites, for a maximum total amount of GBP 59 million.

19 Halifax and Leeds Development also entered into an agreement for the carrying out of certain construction works on the sites. For those works, Leeds Development was paid a little over GBP 120 000 by Halifax, including VAT of almost GBP 20 000, and Leeds Development issued three receipted VAT invoices to Halifax for that amount. Halifax also entered into an agreement with Leeds Development to grant leases of the sites to the latter at a premium, each for a term of 20 years, with the lessee having an option to extend the term to 99 years.

20 On 29 February 2000, Leeds Development also entered into a development and funding agreement with County, under which the latter was to carry out or procure the carrying out of construction work on the Cromac Wood, Dundonald and Livingston sites, including the works which Leeds Development had agreed to carry out or procure under the agreement between it and Halifax.

21 On the same date, Halifax made the initial advances to Leeds Development under the loans together with payment for the works, amounting in all to GBP 44 815 000. That sum was paid into a bank account which was dealt with at the direction of Leeds Development. The latter instructed that an identical sum, including VAT of more than GBP 6 600 000, be paid to County by way of an advance payment for the works carried out or procured by the latter. That transaction was confirmed on the same day by the bank concerned and the funds were then placed on overnight deposit. On the same date, County issued a receipted VAT invoice to Leeds Development.

22 29 February 2000 was also the last day of Leeds Development's February 2000 accounting period. It submitted a return claiming recovery of VAT of almost GBP 6 700 000.

23 On 1 March 2000, the sum of GBP 44 815 000, plus accrued interest, was transferred to an account opened in County's name at another bank.

24 On 6 April 2000, pursuant to the agreement of 29 February 2000, Halifax granted to Leeds Development leases of the three sites at Cromac Wood, Dundonald and Livingston in exchange for premiums totalling around GBP 7 400 000, with each lease being treated as an exempt supply for VAT purposes. Each premium was funded by Leeds Development by a further drawdown under the initial loan agreements.

25 On the same date, Leeds Development also entered into an agreement to assign each of those leases to Property for a premium, with completion of each assignment to take place on the first working day after completion of the works and each being regarded as a VAT-exempt transaction. The premium was to be calculated by reference to a formula such that it was expected that Leeds Development would generate a total profit of GBP 180 000. Property in turn entered into agreements to under-let premises at Cromac Wood, Dundonald and Livingston to Halifax for a premium, in each case to be calculated by reference to the price paid by Property to Leeds Development for the assignment of the respective lease, plus a profit. The profit to be achieved by Property from those under-letting arrangements was expected to be GBP 85 000.

26 With respect to the Leeds West Bank site, on 13 March 2000 Halifax and Leeds Development concluded a loan agreement and an agreement for a lease and also an agreement for works. Halifax paid the sum of GBP 41 900, including a little over GBP 6 000 VAT, in relation to the initial works carried out and Leeds Development issued a receipted VAT invoice for the full amount. Halifax made a first advance of funds to Leeds Development of around GBP 3 000 000 under the loan agreement.

27 On the same day, Leeds Development and County entered into a development and funding agreement. Leeds Development made a prepayment to County, which issued receipted VAT invoices in relation to the works carried out under that agreement for over GBP 3 000 000, including VAT of about GBP 455 000. In its return for the March 2000 accounting period, Leeds Development claimed recovery of around GBP 455 000 input VAT.

28 On 6 April 2000, Halifax granted to Leeds Development the lease of the West Bank site and an agreement was entered into for the assignment of that lease by Leeds Development, for a premium, to Property. By a separate agreement, Property undertook to grant an underlease to Halifax.

29 In order to carry out the works under the various agreements entered into with Leeds Development, County engaged independent main contractors and professionals ('the arm's-length builders') for each of the sites. It appears that agreements were entered into with the independent contractors by stages and that those agreements were accompanied by separate agreements to which Halifax was a party. Those agreements gave warranties to Halifax relating inter alia to the carrying out by the arm's-length builder concerned of its duties and obligations.

30 The referring tribunal states that the tax consequences of the abovementioned agreements were as follows:

— Halifax could deduct the deductible proportion of input VAT on the works to be carried out under the agreements for works entered into with Leeds Development.

— Leeds Development could deduct for the February 2000 period the VAT shown on the County invoice of 29 February 2000, totalling more than GBP 6 600 000 and, for the March 2000 period, the VAT shown on the invoice of 13 March 2000 of about GBP 455 000.

— County would account for all the output VAT shown on those invoices and could deduct the input VAT paid for the works carried out by the arm's length builders.

— The agreements entered into by Leeds Development of 6 April 2000 in relation to the assignment to Property of the leases of the four sites would be exempt

transactions. As they took place in a different year, those supplies would not cause any adjustments to Leeds Development' input tax recovery position for the February and March 2000 accounting periods, which fell within the year ending on 31 March 2000.

31 The referring tribunal also states that for that solution to be effective:

— Halifax, Leeds Development and County each had to be separately registered for VAT,

— throughout the first year in question, the standard-rated outputs of Leeds Development should be as high a proportion of its total outputs as possible. To that end, the exempt supplies of Leeds Development, made when it assigned its interests in the sites to Property, had to be delayed until a later year, and

— the property interests of Leeds Development in the sites had to be designed so that they did not rank as capital items. Otherwise the transfer of those rights to Property would affect the former's rights of deduction.

32 By decisions of 4 and 7 July 2000, the Commissioners refused Leeds Development's claims for deduction and those of County in relation to the VAT charged to it by the arm's-length builders.

33 According to the national tribunal, the Commissioners considered that:

— Leeds Development made no supplies of works to Halifax, nor did it obtain supplies of construction works from County — those transactions accordingly did not fall to be taken into account for VAT purposes.

— On a proper analysis of the arrangements as a whole, Halifax received supplies from the arm's-length builders and not from Leeds Development. Halifax could therefore deduct the VAT on those works, applying its normal recovery percentage.

34 Halifax, Leeds Development and County appealed against the Commissioners' decisions before the VAT and Duties Tribunal London. Halifax claimed that those decisions operate so as to treat it as having received taxable supplies of construction services, which should have been treated as supplies to County. Leeds Development and County contended that those decisions operated so as to disallow their claims for recovery of or relief from input VAT.

35 Halifax, Leeds Development and County submitted that all the transactions forming part of the arrangements with which their action was concerned were genuine. Not only did the supplies of goods and services by the arm's-length builders serve commercial purposes, but so also did the supplies of construction services by County and the supplies of construction services and land by Leeds Development. Each of those two companies and Property were to earn profits from their participation in those arrangements. Although the arrangements had been structured so as to achieve an advantageous fiscal result, the VAT system imposed a charge to tax on a transaction-by-transaction basis.

36 The Commissioners' first submission was that a transaction entered into solely for the purpose of VAT avoidance was neither itself a 'supply', nor a step taken in the course or furtherance of an 'economic activity' as those terms in the Sixth Directive are properly to be interpreted. The application of that principle of interpretation to the arrangements at issue meant that the undertakings of Leeds Development to Halifax did not count as 'supplies'; nor did the undertakings of County to Leeds Development.

37 The Commissioners' second submission was that transactions entered into solely for the purpose of VAT avoidance should, in accordance with the general principle of Community law preventing 'abuse of rights', be disregarded and the terms of the Sixth Directive be applied to the true nature of the transactions at issue. However those arrangements were viewed, only the arm's length builders actually supplied construction services, and those supplies were made directly to Halifax.

38 By decision of 5 July 2001, the VAT and Duties Tribunal dismissed the appeals.

39 Halifax, Leeds Development and County appealed to the High Court of Justice of England and Wales, Chancery Division, which quashed that decision and remitted the matter to the VAT and Duties Tribunal.

40 The referring tribunal states that, in its original decision; of 5 July 2001, it had relied on an interpretation of Article 4(2) of the Sixth Directive according to which regard had to be had to the objective characteristics of the transactions in determining that the transactions in question were not supplies for VAT purposes. It considers that the interpretation of that provision should now be referred to the Court.

41 Furthermore, the original decision of the referring tribunal had decided the points at issue in the main proceedings without regard to the question whether there had been any 'abuse of rights' on the part of the participators in the transactions concerned. That decision having been quashed, it would also be appropriate to refer a question on the interpretation of the 'abuse of rights' principle to the Court

42 In that regard, the referring tribunal states that the evidence given by the directors of Halifax, Leeds Development and County shows that the sole purpose of the two latter companies in entering into the transactions concerned was the avoidance of VAT. In other words, it was the intention of Halifax, Leeds Development and County to obtain a tax advantage through the implementation of an artificial tax avoidance scheme. The referring tribunal mentions Case C-110/99 *Emsland Stärke* [2000] ECR I-11569, paragraph 53.

43 In those circumstances, the VAT and Duties Tribunal, London, decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

'(1) (a) In the relevant circumstances, do transactions

(i) effected by each participator with the intention solely of obtaining a tax advantage and

(ii)which have no independent business purpose

qualify for VAT purposes as supplies made by or to the participators in the course of their economic activities?

(b) In the relevant circumstances, what factors should be considered in determining the identity of the recipients of the supplies made by the arm's-length builders?

(2) Does the doctrine of abuse of rights as developed by the Court operate to disallow the appellants their claims for recovery of or relief for input tax arising from the implementation of the relevant transactions?'

Question 1(a)

44 By question 1(a), the referring tribunal seeks essentially to ascertain whether transactions of the kind at issue in the main proceedings constitute supplies of goods or supplies of services and an economic activity within the meaning of Article 2(1), Article 4(1) and (2), Article 5(1) and Article 6(1) of the Sixth Directive, when they are effected for the sole purpose of obtaining a tax advantage, without any other economic aim.

Observations submitted to the Court

45 Halifax, Leeds Development and County submit that, under the scheme of the Sixth Directive, operations that have been carried out with the sole purpose of obtaining a tax advantage and without pursuing any independent economic objective are, for VAT purposes, supplies of goods or services made by the participants or for their benefit in the context of their economic activities.

46 The United Kingdom and Ireland submit that transactions which, first, are carried out by each participant solely in order to obtain a tax advantage and, second, do not pursue any independent economic objective, are not supplies of goods or services in the context of their economic activities.

47 The Commission considers that the purpose for which a transaction is carried out is irrelevant for the purposes of Article 2 of the Sixth Directive.

Findings of the Court

48 It must be remembered first of all that the Sixth Directive establishes a common system of VAT based, inter alia, on a uniform definition of taxable transactions (see, in particular, Case C-305/01 *MGK-Kraftfahrzeuge-Factoring* [2003] ECR I-6729, paragraph 38).

49 In that regard, under the Sixth Directive the scope of VAT is very wide in that Article 2 thereof, which concerns taxable transactions, refers not only to imports of goods but also to the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such.

50 As regards, first, the term 'supply of goods', Article 5(1) of the Sixth Directive states that any transfer of the right to dispose of tangible property as owner constitutes such a supply.

51 It is clear from the case-law of the Court that that term covers any transfer of tangible property by one party who empowers the other party actually to dispose of it as if he were the owner of the property (see, in particular, Case C-320/88 *Shipping and Forwarding Enterprise Safe* [1990] ECR I-285, paragraph 7, and Case C-25/03 *HE* [2005] ECR I-3123, paragraph 64).

52 As regards the term 'supply of services', it is clear from Article 6(1) of the Sixth Directive that it covers all transactions not constituting a supply of goods within the meaning of Article 5 of that directive.

53 Next, according to Article 4(1) of the Sixth Directive, any person who independently carries out any economic activity, whatever the purpose or results of that activity, is regarded as a taxable person.

54 Finally, the term 'economic activity' is defined in Article 4(2) of the Sixth Directive as comprising 'all' activities of producers, traders and persons supplying services, and, according to the case-law, it includes all stages of production, distribution and the provision of services (see, in particular, Case C-186/89 *Van Tiem* [1990] ECR I-4363, paragraph 17, and *MGK-Kraftfahrzeuge-Factoring*, paragraph 42).

55 As the Court held in paragraph 26 of its judgment in Case C-260/98 *Commission* v *Greece* [2000] ECR I-6537, an analysis of the definitions of taxable person and economic activities shows that the scope of the term economic activities is very wide, and that the term is objective in character, in the sense that the activity is considered per se and without regard to its purpose or results (see also Case 235/85 *Commission* v *Netherlands* [1987] ECR 1471, paragraph 8, and, to that effect, in particular Case 268/83 *Rompelman* [1985] ECR 655, paragraph 19, and Case C-497/01 *Zita Modes* [2003] ECR I-14393, paragraph 38).

56 That analysis and that of the terms 'supply of goods' and 'supply of services' show that those terms, which define taxable transactions under the Sixth Directive, are all objective in nature and apply without regard to the purpose or results of the transactions concerned (see, to that effect, Joined Cases C-354/03, C-355/03 and C-484/03 *Optigen and Others* [2006] ECR I-483, paragraph 44).

57 As the Court held in paragraph 24 of its judgment in Case C-4/94 *BLP Group* [1995] ECR I-983, an obligation on the tax authorities to carry out inquiries to determine the intention of the taxable person would be contrary to the objectives of the common system of VAT of ensuring legal certainty and facilitating the application of VAT by having regard, save in exceptional cases, to the objective character of the transaction in question.

58 It follows that transactions of the kind at issue in the main proceedings are supplies of goods or services and an economic activity within the meaning of Article 2(1), Article 4(1) and (2), Article 5(1) and Article 6(1) of the Sixth Directive, provided that they satisfy the objective criteria on which those concepts are based.

59 It is true that those criteria are not satisfied where tax is evaded, for example by means of untruthful tax returns or the issue of improper invoices. The fact nevertheless remains that the question whether a given transaction is carried out for the sole purpose of obtaining a tax advantage is entirely irrelevant in determining whether it constitutes a supply of goods or services and an economic activity.

60 It follows that the answer to Question 1(a) must be that transactions of the kind at issue in the main proceedings constitute supplies of goods or services and an economic activity within the meaning of Article 2(1), Article 4(1) and (2),

Article 5(1) and Article 6(1) of the Sixth Directive, provided that they satisfy the objective criteria on which those concepts are based, even if they are carried out with the sole aim of obtaining a tax advantage, without any other economic objective.

Question 2

61 By Question 2, which it is appropriate to consider before Question 1(b), the national tribunal seeks essentially to ascertain whether the Sixth Directive must be interpreted as meaning that a taxable person has no right to deduct input VAT where the transactions on which that right is based constitute an abusive practice.

Observations submitted to the Court

62 Halifax, Leeds Development and County consider that, in the context of the VAT system, Community law does not contain any theory of abuse of rights which the tax authorities of a Member State can invoke against individuals in order to reject their applications for recovery or deduction of input tax.

63 The United Kingdom Government considers that the principle of abuse of rights is a general principle of Community law and prevents a taxable person from deducting VAT under Article 17 of the Sixth Directive and any applicable national legislation implementing that article where it is apparent from the application for deduction that the objectives of VAT, laid down by the Sixth Directive, are not being attained and that the taxable person is artificially creating conditions to justify the application for deduction.

64 The French Government submits that Community law, in so far as it allows a Member State to take measures to ensure that none of its nationals can abusively or fraudulently exploit Community provisions by taking advantage of the possibilities made available by virtue of the EC Treaty, does not preclude a Member State from withholding a right of deduction from a taxable person or a group of taxable persons having links with one another, who have undertaken purely artificial transactions for the sole purpose of obtaining an improper refund of VAT.

65 Ireland considers that the principle of abuse of rights, as developed by the Court, enables the tax authorities to reject taxable persons' applications for recovery or deduction of input VAT paid on transactions such as those at issue in the main proceedings.

66 The Commission is of the opinion that where a taxable person or a group of taxable persons having links with one another engage in a series of transactions which, taken together, give rise to an artificial situation motivated solely by the aim to create the conditions necessary for the recovery of input VAT, those transactions should be disregarded.

Findings of the Court

67 As a preliminary point, it must be noted that the problems raised by the questions submitted by the VAT and Duties Tribunal appear, at least in part, to stem from national rules which allow a taxable person who undertakes at the same time taxed and untaxed transactions, or only untaxed transactions, to transfer leases of immovable property to another entity under its control, which is entitled to opt for taxation of the letting of that property and thereby to deduct the total input VAT paid on construction or renovation costs.

68 Notwithstanding that finding, it must be borne in mind that, according to settled case-law, Community law cannot be relied on for abusive or fraudulent ends (see, in particular Case C-367/96 *Kefalas and Others* [1998] ECR I-2843, paragraph 20; Case C-373/97 *Diamantis* [2000] ECR I-1705, paragraph 33; and Case C-32/03 *Fini H* [2005] ECR I-1599, paragraph 32).

69 The application of Community legislation cannot be extended to cover abusive practices by economic operators, that is to say transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law (see, to that effect, Case 125/76 *Cremer* [1977] ECR 1593, paragraph 21; Case C-8/92 *General Milk Products* [1993] ECR I-779, paragraph 21; and *Emsland-Stärke*, paragraph 51).

70 That principle of prohibiting abusive practices also applies to the sphere of VAT.

71 Preventing possible tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see Joined Cases C-487/01 and C-7/02 *Gemeente Leusden and Holin Groep* [2004] ECR I-5337, paragraph 76).

72 However, as the Court has held on numerous occasions, Community legislation must be certain and its application foreseeable by those subject to it (see, in particular, Case C-301/97 *Netherlands* v *Council* [2001] ECR I-8853, paragraph 43). That requirement of legal certainty must be observed all the more strictly in the case of rules liable to entail financial consequences, in order that those concerned may know precisely the extent of the obligations which they impose on them (Case 326/85 *Netherlands* v *Commission* [1987] ECR 5091, paragraph 24, and Case C-17/01 *Sudholz* [2004] ECR I-4243, paragraph 34).

73 Moreover, it is clear from the case-law that a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system (see, in particular, *BLP Group*, paragraph 26, and Case C-108/99 *Cantor Fitzgerald International* [2001] ECR I-7257, paragraph 33). Where the taxable person chooses one of two transactions, the Sixth Directive does not require him to choose the one which involves paying the highest amount of VAT. On the contrary, as the Advocate General observed in point 85 of his Opinion, taxpayers may choose to structure their business so as to limit their tax liability.

74 In view of the foregoing considerations, it would appear that, in the sphere of VAT, an abusive practice can be found to exist only if, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions.

75 Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. As the Advocate General observed in point 89 of his Opinion, the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages.

76 It is for the national court to verify in accordance with the rules of evidence of national law, provided that the effectiveness of Community law is not undermined, whether action constituting such an abusive practice has taken place in the case before it (see Case C-515/03 *Eichsfelder Schalchtbetrieb* [2005] ECR I-7355, paragraph 40).

77 However, the Court, when giving a preliminary ruling, may, where appropriate, provide clarification designed to give the national court guidance in its interpretation (see, in particular, Case C-79/01 *Payroll and Others* [2002] ECR I-8923, paragraph 29).

78 In that connection, it must be borne in mind that the deduction system under the Sixth Directive is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT (see, in particular, Case C-408/98 *Abbey National* [2001] ECR I-1361, paragraph 24, and *Zita Modes*, paragraph 38).

79 According to settled case-law, Article 2 of 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) and Article 17(2), (3) and (5) of the Sixth Directive must be interpreted as meaning that, in principle, the existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to entitlement to deduct is necessary before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement (Case C-98/98 *Midland Bank* [2000] ECR I-4177, paragraph 24; *Abbey National*, paragraph 26; and Case C-16/00 *Cibo Participations* [2001] ECR I-6663, paragraph 29).

80 To allow taxable persons to deduct all input VAT even though, in the context of their normal commercial operations, no transactions conforming with the deduction rules of the Sixth Directive or of the national legislation transposing it would have enabled them to deduct such VAT, or would have allowed them to deduct only a

part, would be contrary to the principle of fiscal neutrality and, therefore, contrary to the purpose of those rules.

81 As regards the second element, whereby the transactions concerned must essentially seek to obtain a tax advantage, it must be borne in mind that it is the responsibility of the national court to determine the real substance and significance of the transactions concerned. In so doing, it may take account of the purely artificial nature of those transactions and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden (see, to that effect, *Emsland Stärke*, paragraph 58).

82 In any event, it is clear from the order for reference that the VAT and Duties Tribunal considers that the sole purpose of the transactions at issue in the main proceedings was to obtain a tax advantage.

83 Finally, it must be borne in mind that the right of deduction provided for in Article 17 et seq. of the Sixth Directive is an integral part of the VAT scheme and in principle may not be limited. It must be exercised immediately in respect of all the taxes charged on transactions relating to inputs (see, in particular, Case C-62/93 *BP Supergas* [1995] ECR I-1883, paragraph 18, and Joined Cases C-110/98 to C-147/98 *Gabalfrisa and Others* [2000] ECR I-1577, paragraph 43).

84 However, as the Court has already had occasion to observe, it is only in the absence of fraud or abuse, and subject to adjustments which may be made in accordance with the conditions laid down in Article 20 of the Sixth Directive, that the right to deduct, once it has arisen, is retained (see, in particular, Case C-400/98 *Breitshol* [2000] ECR I-4321, paragraph 41, and Case C-396/98 *Schlossstraße* [2000] ECR I-4279, paragraph 42).

85 Accordingly, the answer to be given to the second question must be that the Sixth Directive must be interpreted as precluding any right of a taxable person to deduct input VAT where the transactions from which that right derives constitute an abusive practice.

86 For it to be found that an abusive practice exists, it is necessary, first, that the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and of national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage.

Question 1(b)

87 In view of the answers given to Question 1(a) and Question 2, Question 1(b) must be taken to mean that the national court seeks, essentially, to ascertain under what conditions VAT may be recovered where an abusive practice has been found to exist.

Observations submitted to the Court

88 The United Kingdom Government considers that it is necessary to examine the factors which demonstrate the true economic basis of the transactions and to determine whether or not the purposes of the Sixth Directive have been attained.

89 In this case, those factors are the ones established by the VAT and Duties Tribunal in its first decision, namely that:

(a) Halifax was the guiding mind behind the transactions;

(b) Halifax provided all of the funding for the transactions on an interest-free basis;

(c) Halifax remained in occupation of the sites throughout, so that the benefit of the construction works enured to it directly;

(d) Halifax had direct contractual links with the arm's-length builders in the form of the warranties; and

(e) neither County nor Leeds Development had any property interests of substance.

Those factors prompt the conclusion that Halifax is the recipient of the supply made by the arm's-length builders and thus give rise to a result that achieves the purpose of the Sixth Directive.

Findings of the Court

90 It must be noted at the outset that no provision of the Sixth Directive deals with the recovery of VAT. That directive merely defines, in Article 20, the conditions which must be complied with in order that deduction of input taxes may be adjusted at the level of the person to whom goods or services have been provided (see the order of 3 March 2004 in Case C-395/02 *Transport Service* [2004] ECR I-1991, paragraph 27).

91 It is therefore, as a rule, for the Member States to lay down the conditions under which the tax authorities may recover VAT after the event, while remaining within the limits imposed by Community law (*Transport Service*, paragraph 28).

92 It is important, however, to note in that respect that the measures which the Member States may adopt under Article 22(8) of the Sixth Directive in order to ensure the correct levying and collection of the tax and for the prevention of fraud must not go further than is necessary to attain such objectives (see *Gabalfrisa and Others*, paragraph 52, and the order in *Transport Service*, paragraph 29). They may not therefore be used in such a way that they would have the effect of undermining the neutrality of VAT, which is a fundamental principle of the common system of VAT established by the relevant Community legislation (see Case C-454/98 *Schmeink & Cofreth and Strobel* [2000] ECR I-6973, paragraph 59).

93 It must also be borne in mind that a finding of abusive practice must not lead to a penalty, for which a clear and unambiguous legal basis would be necessary, but rather to an obligation to repay, simply as a consequence of that finding, which rendered undue all or part of the deductions of input VAT (see, to that effect, *Emsland Stärke*, paragraph 56).

94 It follows that transactions involved in an abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice.

95 In that regard, the tax authorities are entitled to demand, with retroactive effect, repayment of the amounts deducted in relation to each transaction whenever they find that the right to deduct has been exercised abusively (*Fini H*, paragraph 33).

96 However, they must also subtract therefrom any tax charged on an output transaction for which the taxable person was artificially liable under a scheme for reduction of the tax burden and, if appropriate, they must reimburse any excess.

97 Similarly, it must allow a taxable person who, in the absence of transactions constituting an abusive practice, would have benefited from the first transaction not constituting such a practice, to deduct, under the deduction rules of the Sixth Directive, the VAT on that input transaction.

98 It follows that the answer to Question 1(b) must be that, where an abusive practice has been found to exist, the transactions involved must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice.

Costs

99 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national tribunal, the decision on costs is a matter for that tribunal. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) hereby rules:

1. **Transactions of the kind at issue in the main proceedings constitute supplies of goods or services and an economic activity within the meaning of Article 2(1), Article 4(1) and (2), Article 5(1) and Article 6(1) 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, as amended by Council Directive 95/7/EC of 10 April 1995, provided that they satisfy the objective criteria on which those concepts are based, even if they are carried out with the sole aim of obtaining a tax advantage, without any other economic objective.**

2. **The Sixth Directive must be interpreted as precluding any right of a taxable person to deduct input VAT where the transactions from which that right derives constitute an abusive practice.**

For it to be found that an abusive practice exists, it is necessary, first, that the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and of national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage.

3. **Where an abusive practice has been found to exist, the transactions involved must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice.**

[Signatures]