JUDGMENT OF THE COURT (Third Chamber)
2 June 2005 *

In Case C-378/02,

REFERENCE under Article 234 EC for a preliminary ruling, from the Hoge Raad (Netherlands), made by decision of 18 October 2002, received at the Court on 21 October 2002, in the proceedings

Waterschap Zeeuws Vlaanderen

v

Staatssecretaris van Financiën,

THE COURT (Third Chamber),

composed of A. Rosas, President of the Chamber, J.-P. Puissochet, S. von Bahr (Rapporteur), J. Malenovský and U. Lõhmus, Judges,

* Language of the case: Dutch.

Advocate General: F.G. Jacobs,
Registrar: M. Múgica Arzamendi, Principal Administrator,

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

after considering the observations submitted on behalf of:

— Waterschap Zeeuws Vlaanderen, by H. de Kat, acting as Agent, and R. Brouwen, advocaat,

— the Netherlands Government, by S. Terstal, acting as Agent,

— the Commission of the European Communities, by E. Traversa, H. van Vliet and D.W.V. Zijlstra, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 18 November 2004,

gives the following

Judgment

1 The reference for a preliminary ruling concerns 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) ('the Sixth Directive').

2 That reference was made in proceedings between Waterschap Zeeuws Vlaanderen ('WZV') and the Staatssecretaris van Financiën concerning an application for adjustment of the value added tax ('VAT') paid by WZV in respect of the construction and supply of an industrial plant.

Relevant provisions

Community legislation

3 Article 2(1) of the Sixth Directive, in Title II headed 'Scope', is worded as follows:

'The following shall be subject to value added tax:

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

4 Article 4(1), (2), (3) and (5) of that directive provide:

'1. "Taxable person" shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.

2. The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. ...

3. Member States may also treat as a taxable person anyone who carries out, on an occasional basis, a transaction relating to the activities referred to in paragraph 2 and in particular one of the following:

(a) the supply before first occupation of buildings or parts of buildings and the land on which they stand; Member States may determine the conditions of application of this criterion to transformations of buildings and the land on which they stand.

...

(b) the supply of building land.

...

...

5. 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 where they collect dues, fees, contributions or payments in connection with these activities or transactions.

However, when they engage in such activities or transactions, they shall be considered taxable persons in respect of these activities or transactions where treatment as non-taxable persons would lead to significant distortions of competition.

...

Member States may consider activities of these bodies which are exempt under Article 13 or 28 as activities which they engage in as public authorities.'

5 Article 20(1) and (2) of the Sixth Directive provide:

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

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

(b) where after the return is made some change occurs in the factors used to determine the amount to be deducted, in particular where purchases are cancelled or price reductions are obtained; however, adjustment shall not be made in cases of transactions remaining totally or partially unpaid and of destruction, loss or theft of property duly proved or confirmed, nor in the case of applications for the purpose of making gifts of small value and giving samples specified in Article 5(6). However, Member States may require adjustment in cases of transactions remaining totally or partially unpaid and of theft.

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 10 years.'

National legislation

Law of 28 June 1968

6 By the law of 28 June 1968 on VAT (Wet van 28 juni 1968, houdende vervanging van de bestaande omzetbelasting door een omzetbelasting volgens het stelsel van heffing over de toegevoegde waarde, Stbl. 1968, p. 329, 'the law'), the Kingdom of the Netherlands introduced taxation on turnover based on a system of VAT.

7 Under Article 7 of the law, 'trader' means any person who carries out an economic activity independently. In addition, that article contains a provision on bodies governed by public law carrying out other than as traders services or supplies which, by their nature, tend to be carried out by traders. Under that provision, a ministerial decree may specify that those bodies are to be regarded as traders when they carry out those services or supplies.

8 Article 11(1)(a) and (b) of the law provides that the supply and the letting of immovable property is generally to be exempted from VAT, but provides for certain exceptions, subject to the filing of a joint application, as appropriate, by the trader carrying out the supply and the recipient of that supply or by the lessor and the lessee.

The implementation order

9 The Netherlands authorities adopted, by ministerial decree of 30 August 1968, the turnover tax implementation order (Uitvoeringsbeschikking omzetbelasting 1968, Stcrt. 1968, No 169) ('the implementation order').

10 Article 3(a) of the implementation order provides that bodies governed by public law are to be regarded as traders in so far as the supply of immovable property and the assignment or grant of rights relating to such property are concerned.

11 Articles 13 and 13a of the implementation order, which seeks in particular to transpose the provisions of Article 20 of the Sixth Directive, establish in that connection the machinery for adjusting the right to deduct.

The dispute in the main proceedings and the questions referred for a preliminary ruling

12 WZV is a body governed by public law responsible for the public management of water in the territory of the Netherlands covered by it. In carrying out that activity, WZV acts as a public authority for the purpose of Article 4(5) of the Sixth Directive and is therefore not a taxable person in respect of VAT.

13 In order to perform the tasks entrusted to it, WZV arranged for the construction of a sewage treatment plant ('the plant'), for which it paid by way of VAT the amount of approximately NLG 7.2 million. The plant commenced operations in 1990.

14 WZV and two other public water authorities agreed to make use of the plant for centralised processing of the slurry arising from the purification of sewage. Those two bodies made financial contributions towards the additional investment required for the use of the plant by the three organisations concerned. As from 1993, WZV has passed on to the other two bodies the share of the slurry processing costs respectively attributable to each of them, without, however, charging them VAT. In that regard, the inspector of taxes, by agreement with WZV, allowed VAT not to be charged to those two bodies on condition that WZV waive its right to deduct the input VAT paid.

15 In December 1994 WZV established a foundation for the promotion of the environment in Dutch Flanders ('the foundation'), to which it sold the plant for about NLG 18 million exclusive of VAT.

16 In view of the circumstances under which the transfer of ownership took place, that transfer must, in the national court's view, be regarded as a supply within the meaning of Article 5(1) of the Sixth Directive and Article 3(1) of the law, which is based on Article 5. On the day of the sale, WZV was granted a lease of the plant by the foundation for a term of nine years and two days.

17 WZV and the foundation submitted a joint request to the inspector of taxes under Article 11(1)(a) and (b) of the law designed to implement Article 13C of the Sixth Directive on the right to opt for VAT to apply in respect of the sale and letting of

immovable property for the exemption in respect of the sale and the lease of the plant not to be applied.

18 Relying on Articles 13 and 13a of the implementation order, WZV calculated the proportion of the amount of the VAT invoiced in respect of construction of the plant, which, in its view, qualified for adjustment, at approximately NLG 3.6 million, namely 5/10 of that amount. That proportion was justified by the fact that five years had elapsed since the purchase of the plant and that an identical period had yet to elapse.

19 In its declaration relating to the fourth quarter of 1994, WZV applied to the inspector of taxes for a refund of approximately NLG 3.6 million.

20 That application was rejected on the ground that, at the time of supply of the plant, WZV was not entitled to an adjustment under the implementation order transposing Article 20 of the Sixth Directive.

21 WZV appealed against that rejection decision by the inspector of taxes. Following judgment on appeal by the Gerechtshof te Amsterdam, the case was appealed on a point of law before the Hoge Raad.

22 The national court maintains that, in so far as WZV carried out the sale transaction as a taxable person and submitted a joint request with the purchaser of the plant for the exemption in respect of that transaction not to be applied, an adjustment of the VAT paid by WZV on the construction of the property should in principle be allowed. However, the Hoge Raad has doubts in that regard in light of the Court's case-law.

23 According to the Hoge Raad, the question arises whether a body governed by public law which has used goods as a public authority and has not therefore deducted the VAT paid at the time of acquisition of those goods, is entitled, in the same way as a taxable person who has used goods to provide exempt services, to the adjustment provided for in Article 20 of the Sixth Directive where it subsequently effects a supply of those goods as a taxable person and that supply is taxable.

24 The national court states that a further difficulty arises from the fact that WZV waived its right to deduct input tax owing to its agreement with the inspector of taxes. For that reason, WZV is regarded as having waived its right partially to assign the plant to its capital assets.

25 That court asks whether the case-law of the Court on the designation of capital goods, at the option of the taxable person, as private assets or business assets applies *mutatis mutandis* to bodies governed by public law.

26 It is in those circumstances that the Hoge Raad decided to stay the proceedings and refer the following questions to the Court for a preliminary ruling:

'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 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?

2. Under the Sixth Directive, is a body governed by public law entitled wholly to exclude from its capital assets a capital item used partly for activities engaged in as a taxable person and partly for activities engaged in as a public authority, as the Court of Justice has held in respect of taxable natural persons?'

Preliminary remarks

27 According to the information given by the national court and set out in paragraphs 12 and 13 of this judgment, WZV acquired the plant in order to perform its task of public management of water in the territory covered by it and, in that context, acts as a public authority.

28 The first question must therefore be understood as seeking to ascertain whether a body governed by public law which purchases capital goods as a public authority within the meaning of the first subparagraph of Article 4(5) of the Sixth Directive and subsequently sells those goods as a taxable person may, in respect of that sale, be entitled to an adjustment within the meaning of Article 20 of the Sixth Directive for the purpose of deducting the VAT paid on the purchase of those goods.

The first question

29 It should be noted that, under the provisions of Article 2 of the Sixth Directive, application of the VAT rules to supply of goods and services transactions within the

territory of the country, including the rules on the right to deduct, is dependent on whether the person carrying out the transaction is a taxable person.

30 A taxable person may deduct from the VAT which he is liable to pay the tax he himself has paid if he satisfies the conditions laid down in Article 17 of the Sixth Directive.

31 Under Article 17(1), the right to deduct arises at the time when the deductible tax becomes chargeable. Article 10(2) of the Sixth Directive provides that that time is when the goods are delivered or the services are performed. Accordingly, where goods are purchased, the right to deduct arises when those goods are delivered. Under Article 17(2) of that directive the taxable person is entitled to deduct the VAT paid in respect of goods supplied to him by another taxable person, in so far as those goods are used for the purposes of his taxable transactions.

32 It follows from the provisions of Articles 2 and 17 that only a person who is a taxable person and who is acting as such at the time of the purchase of goods, has a right to deduct in respect of those goods and may deduct the VAT due or paid in respect of those goods if he uses them for the purposes of his taxable transactions (see, as regards Article 17 of the Sixth Directive, Case C-97/90 *Lennartz* [1991] ECR I-3795, paragraph 8).

33 By contrast, a non-taxable person does not have a right to deduct the VAT it may have paid on the purchase of goods. That person's activities — its supplies of goods or services — do not fall within the scope of the VAT rules set out in Article 2 of the Sixth Directive.

34 Under Article 4(5) of that directive the bodies governed by public law are not to be considered taxable persons in respect of the activities or transactions in which they engage as public authorities.

35 It follows that, when those bodies, which include WZV, act as public authorities at the time of the purchase of capital goods, they do not, as a rule, have any right to deduct in respect of those goods.

36 Nevertheless, it is necessary to raise the question whether a change which occurs in the situation of the body concerned as regards liability to VAT can have an impact on the right to deduct. Thus the question arises in particular whether the fact that, subsequently, the body becomes a taxable person in respect of certain transactions relating to the goods bought by it as a non-taxable person can entitle it to deduct the VAT paid on those goods and give rise to an adjustment under Article 20 of the Sixth Directive.

37 The *Lennartz* case, cited above, concerned a private individual liable to VAT who had bought and used a vehicle for private purposes. Subsequently, after also using those goods for professional purposes, he sought to deduct the VAT paid on the purchase thereof.

38 The Court noted that Article 17 of the Sixth Directive specifies the time when the right to deduct arises and makes it clear that only the capacity in which the individual is acting at the time of purchase of the goods can determine the existence of a right to deduct. It then pointed out that Article 20 of that directive, entitled 'Adjustments of deductions', contains no provision concerning the conferral of entitlement to deduct. It held that Article 20 does no more than establish the procedure for calculating the adjustments to the initial deduction and 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 (see *Lennartz*, cited above, paragraphs 11 and 12).

39 That argument must be applied to a body governed by public law which acts as a public authority at the time when it purchases capital goods. Since that body did not at that time act as a taxable person it does not have, in the same way as an individual acting in furtherance of his own needs, any right to deduct the VAT paid by it in respect of those goods.

40 The fact that that body subsequently acted as a taxable person cannot, under Article 20 of the Sixth Directive, result in the deductibility, within the meaning of Article 17 of that directive, of the tax paid by that same body in respect of transactions effected as a public authority, which are on that ground not taxable.

41 Contrary to the argument put forward by WZV, such a body cannot be equated to a taxable person carrying out some taxable activities and other exempt activities. As was stated above, the capacity in which the person acts is the decisive factor and that is assessed at the time of acquisition by that body of the goods concerned.

42 WZV submits, in addition, that the impossibility of deducting the input VAT paid creates a significant distortion of competition which, in its view, justifies application of the exception laid down in the second subparagraph of Article 4(5) of the Sixth Directive under which bodies governed by public law must be regarded as taxable persons. To illustrate the existence of a distortion of competition, WZV compares the situation of an economic operator on the market with that of a body governed by

public law, and maintains that in similar circumstances the economic operator could deduct the input VAT paid from the output VAT payable.

43 That argument must also be rejected. Any distortion of competition in circumstances such as those in the case in the main proceedings stem more from the exercise by the body governed by public law of the right to opt for taxation in respect of the sale and letting of the immovable property concerned than from application of the rule that bodies governed by public law are not regarded as taxable persons in respect of the transactions in which they engage as public authorities. As the Advocate General pointed out at point 38 of his Opinion, 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.

44 The answer to the first question must therefore be that a body governed by public law which purchases capital goods as a public authority within the meaning of the first subparagraph of Article 4(5) of the Sixth Directive, that is to say as a non-taxable person, and subsequently sells those goods as a taxable person, is not entitled, in respect of that sale, to a right of adjustment based on Article 20 of that directive in order to deduct the VAT paid on the purchase of those goods.

The second question

45 That question arises by implication where a body governed by public law such as WZV is considered, at the time of the purchase of capital goods, to have carried out

both economic activities within the meaning of Article 4(1) of the Sixth Directive and activities referred to the first subparagraph of Article 4(5). In the light of the arguments developed in the answer to the first question, from which it is clear that such a body did not act as a taxable person at the time of making that purchase, it is not necessary to answer the second question.

Costs

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

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

A body governed by public law which purchases capital goods as a public authority within the meaning of the first subparagraph of Article 4(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, that is to say as a non-taxable person, and subsequently sells those goods as a taxable person, is not entitled, in respect of that sale, to a right of adjustment based on Article 20 of that directive in order to deduct the VAT paid on the purchase of those goods.

[Signatures]