JUDGMENT OF THE COURT (Third Chamber)

4 June 2009*

In Case C-102/08,

REFERENCE for a preliminary ruling under Article 234 EC from the Bundesfinanzhof (Germany), made by decision of 20 December 2007, received at the Court on 5 March 2008, in the proceedings

Finanzamt Düsseldorf-Süd

v

SALIX Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Offenbach KG,

THE COURT (Third Chamber),

composed of A. Rosas, President of the Chamber, A. Ó Caoimh, J.N. Cunha Rodrigues, J. Klučka and A. Arabadjiev (Rapporteur), Judges,

* Language of the case: German.

Advocate General: M. Poiares Maduro,
Registrar: L. Hewlett, Principal Administrator,

having regard to the written procedure and further to the hearing on 21 January 2009,

after considering the observations submitted on behalf of:

— SALIX Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Offenbach KG, by U. Prinz, Wirtschaftsprüfer/Steuerberater, and A. Cordewener, Rechtsanwalt,

— the German Government, by M. Lumma and C. Blaschke, acting as Agents,

— Ireland, by D. O'Hagan and M. MacGrath, acting as Agents, and N. Travers, BL,

— the Commission of the European Communities, by D. Triantafyllou, acting as Agent,

having decided, after hearing the Advocate General, to proceed to judgment without an Opinion,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of the second and fourth subparagraphs 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 (OJ 1977 L 145, p. 1) ('the Sixth Directive').

2 The reference was made in the course of proceedings between the Finanzamt Düsseldorf-Süd (tax office, Düsseldorf-Süd) ('the Finanzamt') and SALIX Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Offenbach KG ('Salix'), concerning the right to deduct input value added tax ('VAT') in the context of the construction of a building let, subsequently, to a body governed by public law which, in turn, sublet part of it on a long-term basis to third parties liable for VAT.

Legal context

Community legislation

3 Under Article 2 of the Sixth Directive 'the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such' are subject to VAT.

4 Article 4(5) of the Sixth Directive states:

‘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.

In any case, these bodies shall be considered taxable persons in relation to the activities listed in Annex D, provided they are not carried out on such a small scale as to be negligible.

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 Pursuant to the first subparagraph of Article 13B(b) of the Sixth Directive, the Member States are to exempt 'the leasing or letting of immovable property excluding: … the letting of premises and sites for parking vehicles'.

6 Article 13C of that directive permits the Member States to allow taxpayers, during the letting and leasing of immovable property, a right of option for taxation and permits them both to restrict the scope of this right of option and to fix the details of its use.

National legislation

7 Paragraph 2(1) and (3) of the 1993 Law on turnover tax (Umsatzsteuergesetz 1993 BGBl. 1993 I, p. 565), as applicable in 1995 ('the UStG'), was worded as follows:

'1. A trader is any person who independently carries out a commercial or professional activity. An undertaking comprises the whole of a trader's commercial or professional activity. Commercial or professional activity means any sustained activity carried out for the purpose of obtaining income, even where there is no intention to make a profit or an association carries out its activities only in relation to its members.

…

3. Legal persons governed by public law are commercially or professionally active only in the course of their commercial operations (Paragraph 1(1)(6) and Paragraph 4 of the Körperschaftsteuergesetz) and their agricultural or forestry operations …'

8 Paragraph 4(12)(a) of the UStG provided that, among the turnover referred to in Paragraph 1(1)(1) to (3) of the UStG, the following are exempted: 'the leasing and letting of immovable property, rights governed by provisions of civil law relating to immovable property and rights relating to a State prerogative in regard to the use of immovable goods and property'.

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

10 Under Paragraph 9(2) of the UStG, a waiver of tax exemption was permissible 'only in so far as the recipient of the service uses or intends to use that property exclusively for transactions which do not exclude input tax deduction. It is for the trader to prove compliance with these conditions'.

11 Paragraph 1(1)(6) of the Law on corporation tax (Körperschaftsteuergesetz BGBl. 1991 I, p. 637), as applicable in 1995 ('the KStG'), provided that 'commercial operations' of legal persons governed by public law whose management or seat is situated in Germany are subject to unlimited liability to corporation tax.

12 Paragraph 4 of the KStG provided:

‘1. Subject to subparagraph 5, commercial operations of legal persons governed by public law within the meaning of Paragraph 1(1)(6) are all establishments which pursue an economic activity on a continuing basis for the purposes of obtaining income other than in agriculture and forestry and which stand out in economic terms from the overall activity of the legal person. There is no need for an intention to make a profit and involvement in general business transactions.

2. A commercial operation shall also be subject to unlimited tax liability if it is itself a legal person governed by public law.

…

4. The leasing of a commercial operation shall be regarded as such an operation.

5. Commercial operations shall not include operations which serve predominantly to exercise public authority (public service operations). The right of coercion or monopoly shall not be sufficient to assume the existence of a public service operation.’

13 It is apparent from the order for reference that, in the corporation tax system, the long-term letting of immovable property is considered not to fall within the activities of a 'commercial operation'. That assessment follows, in the view of some commentators, from the legal fiction in Paragraph 4(4) of the KStG and, in that of others, from Paragraph 14 of the 1977 Tax Code (Abgabenordnung 1977), as applicable in 1995 ('the AO').

14 Paragraph 14 of the AO stated that 'commercial exploitation is a permanent activity carried on independently, which allows profits or other economic advantages to be made and which is outside the framework of property management. The intention to make a profit is not necessary. As a rule, property management exists where property is exploited, for example where capital assets are invested and produce interest or a property is let or leased.'

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

15 On 20 March 1995, Salix, a property letting company, concluded a 'property leasing agreement' with the Industrie- und Handelskammer Offenbach (Chamber of Industry and Commerce, Offenbach) ('the IHK'), a body governed by public law. By that agreement, it undertook to lease to the IHK, for a term of 27 years, an office building to be constructed with an underground car park.

16 That year, Salix completed the building and leased it to the IHK. The latter allocated part of the offices for its own use and sublet the rest of the offices on a long-term basis to third parties that were liable to turnover tax. The IHK also reserved some of the spaces in the underground car park for its own use, sublet some on a long-term basis to the lessees of the offices and made the rest of the spaces available on a short-term basis for consideration to external customers.

17 In order to be able to deduct the input VAT paid in connection with the construction of the building and relating to the part of the building sublet by the IHK, Salix waived, pursuant to Paragraph 9(1) of the UStG, the exemption from turnover tax in respect of its letting transactions under Paragraph 4(12)(a) of the UStG. It considered that that waiver would entitle it to the deduction, since it let the building to another trader, the IHK, for the purposes of its business, which, in turn, used it in part for transactions giving rise to the right to deduct input tax.

18 However, in a tax inspection of Salix, the tax auditor refused that deduction for the part of the property sublet on a long-term basis on the ground that, in the context of that subletting, the IHK did not act as a 'trader' within the meaning of Paragraph 9(1) of the UStG.

19 In that regard, the tax auditor stated that it followed from the first sentence of Paragraph 2(3) of the UStG that legal persons governed by public law could act as a trader only in the context of a 'commercial operation', as defined in Paragraph 1(1)(6) and Paragraph 4 of the KStG.

20 According to the tax auditor, only short-term letting could be considered to be an activity carried out in the context of a 'commercial operation' within the meaning of those provisions, as long-term letting, being mere 'property management', does not come within that activity.

21 Consequently, on 20 April 2001 the Finanzamt issued an amended notice of VAT assessment for 1995 refusing the deduction of the input VAT paid by Salix in connection with the construction of the building and relating to the part of the property sublet on a long-term basis by the IHK.

22 The financial authorities responsible for the tax assessment of the IHK did not, however, share that view. They affirmed both that the IHK was a trader with respect to the entirety of its subletting activities and that its waiver of tax exemption of those activities was lawful.

23 Following the dismissal of its appeal against the amended notice of tax assessment, Salix brought proceedings before the Finanzgericht Düsseldorf (Finance Court, Düsseldorf).

24 The Finanzgericht Düsseldorf upheld the action brought by Salix. Whilst holding that the IHK had not carried on its long-term subletting transactions as a trader for the purposes of German tax law, the Finanzgericht Düsseldorf concluded that the IHK should nevertheless be considered to have acted, in that regard, as a taxable person and, therefore, as a 'trader', in accordance with an interpretation of the domestic law in conformity with the second and fourth subparagraphs of Article 4(5) of the Sixth Directive.

25 The Finanzgericht Düsseldorf was of the opinion that, by depriving the IHK of the possibility to opt for treatment as a taxable person and, consequently, to deduct input VAT, the refusal to recognise it as a trader would place it in a disadvantageous position compared to its private competitors on the relevant markets. That could create 'significant distortions of competition' that the second subparagraph of Article 4(5) of the Sixth Directive seeks to avoid.

26 Having brought an appeal before the Bundesfinanzhof, the Finanzamt claims that the judgment of the Finanzgericht Düsseldorf should be set aside and that Salix's action be dismissed. In support of its appeal, the Finanzamt claims that it is apparent from the case-law of the Court that the concept of 'significant distortions of competition' aims exclusively to protect the private sector, that is to say taxable private undertakings, against competition from non-taxable bodies governed by public law. Consequently, an

application of that provision in favour, also, of bodies governed by public law would run counter to the objective of that provision.

27 First, the Bundesfinanzhof tends towards the view that the Member States may rely on the option, under the fourth subparagraph of Article 4(5) of the Sixth Directive, to treat activities of bodies governed by public law which are exempt under Article 13 or Article 28 of that directive as activities of public authorities only if express legal provision is made to that effect.

28 In that regard, it is apparent from the order for reference that no express legal provision has been adopted in Germany concerning the treatment as taxable persons of bodies governed by public law carrying on activities of letting and leasing of immovable property. In the main proceedings, the treatment as taxable persons of those bodies where they carry on such transactions depends solely on the interpretation of the concept of 'property management'. However, that concept does not appear in the relevant legislation, that is to say neither in Paragraph 2(3) of the UStG, nor in Paragraph 1(1)(6) of the KStG, nor in Paragraph 4 of the KStG, nor in a statutory authorisation conferred on the authorities by those provisions.

29 Second, the Bundesfinanzhof is uncertain whether the application of the fourth subparagraph of Article 4(5) of the Sixth Directive is precluded in the main proceedings, due to the fact that IHK itself, rather than one of its private competitors, could suffer significant distortions of competition within the meaning of the second subparagraph of that provision, if its long-term subletting transactions were treated as non-taxable.

30 The Bundesfinanzhof considers that, although the main objective of the second subparagraph of Article 4(5) of the Sixth Directive is to protect the private sector against the untaxed activities of bodies governed by public law, that would not, however, preclude those bodies from being able also to benefit from the competition exception provided for by that provision. In that regard, the Bundesfinanzhof points out

that there is no restriction to that competition exception in the wording of that second subparagraph, the relevant factor being the occurrence of significant distortions of competition, no matter who is the victim of them. However, the Bundesfinanzhof considers that both of the two conflicting interpretations could find support in the case-law of the Court.

31 In those circumstances, the Bundesfinanzhof decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

'1. May the Member States "treat" activities of States, regional and local government authorities and other bodies governed by public law which are exempt from tax under Article 13 of the Sixth … Directive … as activities in which they engage as public authorities within the meaning of the fourth subparagraph of Article 4(5) of the Sixth … Directive … only where the Member States make express legal provision to that effect?

2. Can "significant distortions of competition" within the meaning of the fourth subparagraph in conjunction with the second subparagraph of Article 4(5) of the Sixth … Directive … exist only where treatment of a body governed by public law as a non-taxable person would lead to significant distortions of competition to the detriment of competing private taxable persons or also where treatment of a body governed by public law as a non-taxable person would lead to significant distortions of competition to its detriment?'

The questions referred for a preliminary ruling

The first question

32 By its first question, the Bundesfinanzhof asks whether the Member States may rely on the option, under the fourth subparagraph of Article 4(5) of the Sixth Directive, to consider the activities of bodies governed by public law which are exempt from tax under Article 13 or Article 28 of that directive as 'activities engaged in as public authorities' only where an express legal provision is adopted to that effect.

Observations submitted to the Court

33 Salix claims that it is apparent from the case-law of the Court that, in order to rely on the option under the fourth subparagraph of Article 4(5) of the Sixth Directive, the Member States must adopt legal provisions referring expressly to that option. The Member States are obliged, when transposing Community directives, to choose binding legislative provisions under domestic law in order to establish a clear legal framework, without ambiguity and clearly recognisable for the economic operators. It adds that those provisions could, nevertheless, include the delegation to the authorities of implementing powers.

34 The German Government considers that the transposition of the fourth subparagraph of Article 4(5) of the Sixth Directive requires the adoption of a legal provision, but that it need not necessarily be express. With regard to the transposition of the option provided

for by that provision, it suffices that the legislature's intention can be clearly deduced from the legal provisions applicable by means of recognised methods of judicial interpretation. However, contrary to the information provided by the referring court, legal provisions were adopted for the transposition of that provision.

35 Ireland submits that it follows from the settled case-law of the Court that the Member States, when transposing a directive into their domestic law, must achieve the objectives of that directive whilst being free to choose the appropriate form and method to attain that result. In the main proceedings, Ireland is of the view that the German rules, clearly distinguishing between property management and commercial transactions, provide a sufficiently certain legal basis for the application of the fourth subparagraph of Article 4(5) of the Sixth Directive, such that the absence of express provisions is irrelevant.

36 The Commission of the European Communities is of the view that compliance with the general principles of Community law requires that the transposition of Community directives be effected by means of clear and formal rules of domestic law which have direct effect vis-à-vis the citizens, are officially published and are not subject to amendment at the will of the authorities. Consequently, the Member States must lay down provisions of a legislative or regulatory nature. In the main proceedings, an express and precisely defined provision is all the more necessary since at issue is the determination of the scope of application of an exception to the principle that all persons carrying on, independently, one of the economic activities referred to in Article 4(2) of the Sixth Directive are liable to tax.

Findings of the Court

37 First of all, it is apparent from the first subparagraph of Article 13B(b) of the Sixth Directive that the letting of premises and sites for parking vehicles is not included amongst the exempted activities. Consequently, such an activity cannot be treated under the fourth subparagraph of Article 4(5) of the Sixth Directive as an activity engaged in as a public authority within the meaning of the first subparagraph of that provision, if it does not in itself satisfy that condition (see, to that effect, Case C-446/98 *Fazenda Pública* [2000] ECR I-11435, paragraph 44).

38 However, the concept of 'letting of immovable property', which is the subject of the exemption laid down in Article 13B(b) of the Sixth Directive, necessarily also encompasses, in addition to the letting of the property which is the principal subject of the transaction, the letting of all property which is accessory to it. Thus, the letting of premises and sites for parking vehicles cannot be excluded from the exemption where the letting thereof is closely linked to the letting of immovable property to be used for another purpose, so that the two lettings constitute a single economic transaction (Case 173/88 *Henriksen* [1989] ECR 2763, paragraphs 14 and 15).

39 In the main proceedings, it would, where relevant, be for the referring court to determine, taking account of all the relevant facts, whether the subletting on a long-term basis, by the IHK, of some of the underground premises and sites for parking vehicles to long-term lessees of the offices in the same building constitutes a single economic transaction for the purposes of the case-law mentioned in paragraph 38 above. If that were not the case, the subletting by the IHK of those parking premises and sites could not, in any event, be treated, under the fourth subparagraph of Article 4(5) of the Sixth Directive, in the same way as an activity in which it engages as a public authority, within the meaning of the first subparagraph of that provision.

40 As regards the question whether the Member States can rely on the option provided for by the fourth subparagraph of Article 4(5) of the Sixth Directive only if they have previously adopted an express legal provision to that effect, it should be pointed out that, according to the settled case-law of the Court, the transposition of a directive into domestic law does not necessarily require that its provisions be incorporated formally and verbatim in express, specific legislation; a general legal context may be adequate for the purpose provided that it does indeed guarantee the full application of the directive in a sufficiently clear and precise manner (Case C-131/88 *Commission* v *Germany* [1991] ECR I-825, paragraph 6; Case C-49/00 *Commission* v *Italy* [2001] ECR I-8575, paragraph 21; and Case C-410/03 *Commission* v *Italy* [2005] ECR I-3507, paragraph 60).

41 It is particularly important, so as to conform with the requirement of legal certainty, that, where that directive is intended to create rights for individuals, the persons concerned can ascertain the full extent of their rights and rely on them, if necessary, before the national courts (see Case *Commission* v *Germany*, paragraph 6; Case C-49/00 *Commission* v *Italy*, paragraphs 21 and 22; and Case C-410/03 *Commission* v *Italy*, paragraph 60).

42 Each Member State is bound to implement the provisions of directives in a manner that fully meets the requirements of clarity and certainty in legal situations imposed by the Community legislature, in the interests of the persons concerned established in the Member States. To that end, the provisions of a directive must be implemented with unquestionable legal certainty and with the requisite specificity, precision and clarity (Case C-354/99 *Commission* v *Ireland* [2001] ECR I-7657, paragraph 27 and the case-law cited).

43 In particular, mere administrative practices, which by their nature are alterable at will by the authorities and are not given the appropriate publicity, cannot be regarded as

constituting the proper fulfilment of obligations under the EC Treaty (see Case C-334/94 *Commission* v *France* [1996] ECR I-1307, paragraph 30, and Case C-197/96 *Commission* v *France* [1997] ECR I-1489, paragraph 14).

44 While it is for the referring court to assess whether the conditions of transposition, set out in paragraphs 40 to 43 of the present judgment, have been fulfilled in the main proceedings, the Court may nevertheless, in order to give the national court a useful answer, provide it with all the guidance that it deems necessary (see, in particular, Case C-49/07 *MOTOE* [2008] ECR I-4863, paragraph 30, and Case C-414/07 *Magoora* [2008] ECR I-10921, paragraph 33).

45 In the present case, it is apparent from the order for reference that, under German tax law, the possibility for the IHK to opt for liability to tax depends solely on the question whether the letting of properties by bodies governed by public law is treated as being a business activity performed in the context of a commercial operation or as coming within simple property management.

46 In that regard, it is apparent from the order for reference, as has been pointed out in paragraph 28 of this judgment, that the decisive concept of property management does not appear in the relevant legislation, that is to say neither in the UStG, nor in the KStG, nor in a statutory authorisation conferred on the authorities by their provisions.

47 To the extent that the German Government states that Paragraph 14 of the AO provides for the concept of property management and distinguishes it from business activities, it is however necessary to point out that it is apparent from the order for reference that situations such as that in the main proceedings do not fall directly within the scope of application of Paragraph 14 of the AO.

48 Indeed, the referring court stated, first, that there is no distinction between property management and business activities in the relevant legislation. Second, it expressly stated that, to the extent that that distinction is nevertheless considered to apply to the area of corporation tax, that finding follows only from a deduction based, for some commentators, on Paragraph 14 of the AO, and, for others, on Paragraph 4(4) of the KStG.

49 Finally, it is apparent from the order for reference that, unlike the Finanzamt, the tax authority with jurisdiction in respect of IHK's application for deduction of input VAT considered that letting on a long-term basis is also a business activity ultimately giving rise to the right of deduction. There are thus differing administrative practices.

50 It is also apparent from the order for reference that no express legal provision has been adopted in Germany concerning the treatment as taxable persons of bodies governed by public law carrying on the leasing and letting of immovable property.

51 In that connection, it must be pointed out that the fourth subparagraph of Article 4(5) of the Sixth Directive provides that the Member States have the option, and not the obligation, to consider the activities of bodies governed by public law exempted under Article 13 or Article 28 of the Sixth Directive as activities which they engage in as public authorities. Consequently, the transposition of that provision into domestic law is not obligatory.

52 It follows that, in order to use the option provided for by that provision, the Member States are required to make a choice to rely on it.

53 It must also be observed that that option permits the Member States to rely, for those activities, on the derogation, provided for in the first subparagraph of Article 4(5) of the Sixth Directive, from the general rule set out in Article 2(1) and Article 4(1) and (2) of that directive, according to which any economic activity is, in principle, subject to VAT.

54 However, since the fourth subparagraph of Article 4(5) of the Sixth Directive provides for a derogation from one of the general rules laid down by that directive, that provision must be strictly construed.

55 Accordingly, it must be held that, in order to rely on the option provided for in the fourth subparagraph of Article 4(5) of the Sixth Directive, the Member States must make a specific choice to that effect. They must therefore provide that the specified activities of the bodies governed by public law which are exempt under Article 13 or Article 28 of the Sixth Directive are considered to be activities which they engage in as public authorities.

56 It should be pointed out that the Member States may choose the legislative technique which they regard as the most appropriate. Thus they may, for example, merely incorporate into national law the form of words used in the Sixth Directive or an equivalent expression or they may draw up a list of activities of bodies governed by public law exempted under Article 13 or Article 28 of the Sixth Directive which are considered to be activities of the public authority (see, to that effect, Joined Cases 231/87 and 129/88 *Comune di Carpaneto Piacentino and Others* [1989] ECR 3233, paragraph 18).

57 An executive authority may be authorised by a legal provision to specify the activities of bodies governed by public law exempted under Article 13 or Article 28 of the Sixth Directive which are considered to be activities of public authorities, provided that its decisions of application have an unquestionable binding force, comply with the requirements that they be specific, precise and clear so as to guarantee legal certainty and may be reviewed by the national courts (see, by analogy, *Fazenda Pública*, paragraph 35).

58 In light of the foregoing, the answer to the first question is that the Member States must lay down an express provision in order to be able to rely on the option provided for in the fourth subparagraph of Article 4(5) of the Sixth Directive, according to which specific activities of bodies governed by public law that are exempt under Article 13 or Article 28 of that directive are considered as activities of public authorities.

The second question

59 By its second question, the Bundesfinanzhof asks, in essence, whether the second subparagraph of Article 4(5) of the Sixth Directive must be interpreted as meaning that bodies governed by public law must be considered taxable persons in respect of activities or transactions in which they engage as public authorities, not only where their treatment as non-taxable persons under the first or fourth subparagraphs of that provision would lead to significant distortions of competition to the detriment of their private competitors, but also where it would lead to such distortions to their own detriment.

Observations submitted to the Court

60 Salix, the German Government and the Commission observe that the wording of the second subparagraph of Article 4(5) of the Sixth Directive refers without distinction to all 'significant distortions of competition', no matter who is the victim of them. However, the treatment of those bodies as non-taxable persons, which excludes them from the right to deduct input VAT, could also lead to distortions of competition to the detriment of the non-taxable person. Since competition is distorted, whether that be to the advantage of the bodies governed by public law or that of their private competitors, it should be held that the principle of fiscal neutrality, the expression in the area of VAT of the principle of equal treatment, is infringed. Such an interpretation would be compatible with the protection of competition *per se,* without regard to the particular characteristics of the relevant individual operator.

61 By contrast, Ireland observes that, even if the wording of the second subparagraph of Article 4(5) of the Sixth Directive does not further define the concept of 'significant distortions of competition', Article 4(5) seeks to exclude bodies governed by public law from the scope of the Sixth Directive. It was never the intention of the Community legislature to permit bodies governed by public law themselves to invoke that exception in order to obtain taxable status for their activities. Furthermore, such an interpretation would deprive the discretion granted to the Member States by the fourth subparagraph of that provision of its substance and would contradict the objective of the second subparagraph of that provision, which is, in accordance with the case-law of the Court, to protect private competitors from the activity of bodies governed by public law.

Findings of the Court

62 As a preliminary point, it should be noted that, under the first subparagraph of Article 4(5) of the Sixth Directive, bodies governed by public law are not considered liable for VAT in respect of the activities or transactions of an economic nature in which they engage as public authorities, and that, under the fourth subparagraph of that provision, Member States may consider activities of those bodies that are exempt under Article 13 or Article 28 of that directive as activities of public authorities.

63 However, even where those bodies carry out such activities as public authorities, they must be considered taxable persons, in accordance with the second subparagraph of Article 4(5), where their treatment as non-taxable persons would lead to significant distortions of competition.

64 It is, therefore, for the referring court to ascertain, as a preliminary point, whether the letting activity of the IHK constitutes an activity engaged in by a body governed by public law acting as a public authority within the meaning of the first or fourth subparagraphs of Article 4(5) of the Sixth Directive. It is only if such is the case that the second subparagraph of Article 4(5) is applicable (see, to that effect, *Fazenda Pública*, paragraph 43, and Case C-288/07 *Isle of Wight Council and Others* [2008] ECR I-7203, paragraphs 30 to 32).

65 First, it should be recalled that, under the second subparagraph of Article 4(5) of the Sixth Directive, bodies governed by public law must be considered, when they engage in

activities or transactions as public authorities, to be taxable persons in respect of those activities or transactions 'where treatment as non-taxable persons would lead to significant distortions of competition'.

66 Accordingly, the wording of the second subparagraph of Article 4(5) of the Sixth Directive does not specify the persons it seeks to protect from those significant distortions of competition caused by the treatment as non-taxable persons of bodies governed by public law.

67 Second, it should be recalled that, by providing for a derogation from treatment as non-taxable persons for bodies governed by public law in respect of the activities or transactions in which they engage as public authorities, the second subparagraph of Article 4(5) of the Sixth Directive aims to restore the general rule set out in Articles 2(1) and 4(1) and (2) of that directive, according to which any activity of an economic nature is, in principle, to be subject to VAT (see *Isle of Wight Council and Others*, paragraph 38).

68 Consequently, the second subparagraph of Article 4(5) of the Sixth Directive cannot be construed narrowly (see *Isle of Wight Council and Others*, paragraph 60).

69 Third, with regard to the objectives of the second subparagraph of Article 4(5) of the Sixth Directive, referred to in particular by Ireland, there is nothing to suggest that that provision seeks to ensure that bodies governed by public law suffer the consequences of significant distortions of competition that could be caused by their treatment as non-taxable persons under the first and fourth subparagraphs thereof.

70 Fourth, it should be recalled 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. The right to deduct is exercisable 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; Joined Cases C-110/98 to C-147/98 *Gabalfrisa and Others* [2000] ECR I-1577, paragraph 43; and Joined Cases C-439/04 and C-440/04 *Kittel and Recolta Recycling* [2006] ECR I-6161, paragraph 47).

71 The deduction system 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 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; Case C-25/03 *HE* [2005] ECR I-3123, paragraph 70; and *Kittel and Recolta Recycling*, paragraph 48).

72 It follows that the right to deduct is, in principle, applicable to the entire chain of supply of goods and services performed by taxable persons acting as such for the purpose of the economic activities of other taxable persons (see Joined Cases C-354/03, C-355/03 and C-484/03 *Optigen and Others* [2006] ECR I-483, paragraph 52, and *Kittel and Recolta Recycling*, paragraph 45).

73 However, it cannot be ruled out that the treatment as a non-taxable person of a body governed by public law carrying on certain activities and transactions which precludes that the right to deduct VAT could affect the supply chain of goods and services to the detriment of taxable persons operating in the private sector.

74 In the main proceedings, as was pointed out in paragraphs 17 to 21 of this judgment, the treatment of the IHK as a non-taxable person prevented Salix, a legal person governed by private law, from benefiting from the right to deduct input VAT.

75 It follows from the foregoing that the second subparagraph of Article 4(5) of the Sixth Directive covers also distortions of competition to the detriment of bodies governed by public law.

76 In those circumstances, the answer to the second question is that the second subparagraph of Article 4(5) of the Sixth Directive must be interpreted as meaning that bodies governed by public law are to be considered taxable persons in respect of activities or transactions in which they engage as public authorities not only where their treatment as non-taxable persons under the first or fourth subparagraphs of that provision would lead to significant distortions of competition to the detriment of their private competitors, but also where it would lead to such distortions to their own detriment.

Costs

77 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:

1. **The Member States must lay down an express provision in order to be able to rely on the option provided for in the fourth 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, according to which specific activities of bodies governed by public law that are exempt under Article 13 or Article 28 of that directive are considered as activities of public authorities.**

2. **The second subparagraph of Article 4(5) of Sixth Directive 77/388 must be interpreted as meaning that bodies governed by public law are to be considered taxable persons in respect of activities or transactions in which they engage as public authorities not only where their treatment as non-taxable persons under the first or fourth subparagraphs of that provision would lead to significant distortions of competition to the detriment of their private competitors, but also where it would lead to such distortions to their own detriment.**

[Signatures]