JUDGMENT OF THE COURT (Second Chamber)

26 May 2005 *

In Case C-536/03,

REFERENCE for a preliminary ruling under Article 234 EC from the Supremo Tribunal Administrativo (Portugal), made by decision of 26 November 2003, received at the Court on 22 December 2003, in the proceedings

António Jorge L^da^

v

Fazenda Pública,

THE COURT (Second Chamber),

composed of C.W.A. Timmermans, President of the Chamber, R. Silva de Lapuerta (Rapporteur), J. Makarczyk, P. Kūris and G. Arestis, Judges,

* Language of the case: Portuguese.

Advocate General: C. Stix-Hackl,
Registrar: R. Grass,

having regard to the written procedure,

after considering the observations submitted on behalf of:

— the Portuguese Republic, by L. Fernandes, acting as Agent,

— the Commission of the European Communities, by R. Lyal and A. Alves Vieira, acting as Agents,

after hearing the Advocate General's Opinion at the sitting on 16 December 2004,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Article 19 of 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'), with regard to the determination of the extent of the right to deduct the input tax paid in the course of property construction activity.

2 The reference was made in the course of proceedings before the Supremo Tribunal Administrativo (Supreme Administrative Court) of the Portuguese Republic between the company António Jorge L^{da} and the Portuguese authorities concerning an additional tax assessment in respect of value added tax ('VAT') and compensatory interest for the years 1994 to 1997.

Legislative background

The relevant provisions of Community law

3 Article 10 of the Sixth Directive is worded as follows:

'(1)(a) "Chargeable event" shall mean the occurrence by virtue of which the legal conditions necessary for tax to become chargeable are fulfilled.

(b) The tax becomes "chargeable" when the tax authority becomes entitled under the law at a given moment to claim the tax from the person liable to pay, notwithstanding that the time of payment may be deferred.

(2) The chargeable event shall occur and the tax shall become chargeable when the goods are delivered or the services are performed. ...

However, where a payment is to be made on account before the goods are delivered or the services are performed, the tax shall become chargeable on receipt of the payment and on the amount received.'

4 Article 17 of the Sixth Directive, entitled 'Origin and scope of the right to deduct', provides:

'(1) The right to deduct shall arise at the time when the deductible tax becomes chargeable.

...

(5) As regards goods and services to be used by a taxable person both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible, only such proportion of the value added tax shall be deductible as is attributable to the former transactions.

This proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person.'

5 The third subparagraph of Article 17(5) also allows the Member States to authorise or compel taxable persons to apply criteria other than those laid down in Article 19.

6 Article 19 of the Sixth Directive is worded as follows:

'1. The proportion deductible under the first subparagraph of Article 17(5) shall be made up of a fraction having:

— as numerator, the total amount, exclusive of VAT, of turnover per year attributable to transactions in respect of which VAT is deductible under Article 17(2) and (3),

— as denominator, the total amount, exclusive of VAT, of turnover per year attributable to transactions included in the numerator and to transactions in respect of which VAT is not deductible. The Member States may also include in the denominator the amount of subsidies, other than those specified in Article 11A(1)(a).

The proportion shall be determined on an annual basis, fixed as a percentage and rounded up to a figure not exceeding the next unit.

2. By way of derogation from the provisions of paragraph 1, there shall be excluded from the calculation of the deductible proportion, amounts of turnover attributable to the supplies of capital goods used by the taxable person for the purposes of his business. Amounts of turnover attributable to transactions specified in Article 13B (d), in so far as these are incidental transactions and to incidental real estate and financial transactions shall also be excluded ... .'

The relevant provisions of domestic law

7 In Portugal VAT is regulated by the VAT Code (Código do imposto sobre of Valor Acrescentado, 'the CIVA'), approved by Decree-Law No 394B/84 of 26 December 1984 (*Diário da República*, Series A, No 297).

8 Article 23 of the CIVA is worded as follows:

'(1) Where the taxable person in the course of his business makes supplies of goods or services, some of which do not give rise to the right to deduct, input tax shall be deductible only in direct proportion to the annual turnover of the transactions which give rise to the right to deduct.

(2) Notwithstanding the preceding provision, the taxable person may make deductions on the basis of the actual use of all or part of the goods and services used, provided that the Directorate-General of Taxes is notified in advance, subject to the latter's imposing special conditions or curtailing that procedure in circumstances in which significant distortions of taxation are found.

(3) The tax authorities may compel the taxable person to act in accordance with the previous paragraph:

(a) where he carries on separate economic activities;

(b) where the application of the procedure under paragraph (1) leads to significant distortions of competition.

(4) The specific proportion of deduction referred to in paragraph (1) shall be made up of a fraction having, as numerator, the amount, exclusive of VAT, of turnover per year attributable to the supply of goods and provision of services in respect of which VAT is deductible under Articles 19 and 20(1) and, as denominator, the amount, exclusive of VAT, of turnover per year of all the transactions carried out by the taxable person, including exempt transactions and those outside the scope of the tax, particularly, grants not subject to VAT which are not subsidies for plant or equipment.

(5) However, the computation referred to in the preceding paragraph does not include supplies of fixed assets which have been used in the business, or real estate and financial transactions that are incidental to the taxable person's business.'

9 Decree-Law No 241/86 of 20 August 1986 (*Diário da República*, Series A, No 190) subsequently supplemented the system under the CIVA with regard to the business of the supply of real property.

10 Article 5 of that Decree-Law is worded as follows:

'(1) The VAT in respect of each building or autonomous part of a building shall be deducted according to the method applicable to the actual use of all the goods and services used, in accordance with the provisions of Article 23(2) of the CIVA.

(2) If the Directorate-General of Direct and Indirect Taxes considers that the criteria for the charging of the tax used in respect of actual use are inadequate, it shall fix other criteria and inform the taxpayer thereof, stating the reasons for that decision.'

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

11 The company António Jorge L^da^ ('António Jorge'), which has its registered office at Santarém (Portugal), has brought an action before the Supremo Tribunal Administrativo, challenging the judgment of the Tribunal Tributário de Primeira Instância de Santarém (Tax Court of First Instance, Santarém), which had allowed in part the appeal lodged against the assessment to additional VAT and compensatory interest for the years 1994 to 1997.

12 The facts, as set out in the judgment at first instance, are as follows:

'1. In the years 1994 to 1997, ... [António Jorge] was subject to corporation tax (general regime) and included, for VAT purposes, in the ordinary regime ...

2. Under service order No 9097 of 5 September 1996, ... [António Jorge] was the subject of a tax inspection, on completion of which a report was produced on 26 June 1997, which ... is annexed to the case-file [in the main proceedings].

3. Following that report, the Tax Inspectorate of the district of Santarém concluded, with regard to VAT:

— that there were difficulties regarding the exact determination of the tax improperly deducted in respect of "general expenses" because the complainant made a total deduction, even though its purchases were intended for one sector that was exempt and one that was taxable;

— for the acquisition of fixed assets, the latter are regarded as appropriated to the sector which is subject to VAT (deductible), part of the amount of the depreciation of those fixed assets being distributed or considered allocated to an exempt sector at the end of every financial year.

...

4. In the light of the facts established and described in paragraph 3, the expert who carried out the inspection calculated the amount of VAT which he considered that ... [António Jorge] had improperly deducted in breach of Article 23 of the CIVA and on the basis of "documents not in due legal form", and also the tax which had not been paid ...

...

8. In the years 1994 to 1997 ... [António Jorge] provided services (under public works contracts) which gave it the right to deduct VAT paid on the purchases and building transactions with a view to sale which were subject to sisa [property transfer tax, now repealed], which did not give rise to deduction.

9. During the same years, about 50% of its turnover comprised works contracts for the construction of buildings for housing cooperatives and local authorities, paying VAT at 5% and deducting it at 17% (16% in 1994), whereas on about 20% of its turnover it paid VAT at 17% (16% in 1994), the rest of its transactions being subject to transfer tax, exempt from VAT and not giving rise to the right to deduct.'

13 In support of its action before the national court, António Jorge has raised the issue of the interpretation of Article 19 of the Sixth Directive.

14 In those circumstances, the Supremo Tribunal Administrativo has decided to stay proceedings and to refer the following questions to the Court for a preliminary ruling:

'(1) In what sense must Article 19 of the Sixth Council Directive of 17 May 1977 (77/388/CEE) be interpreted?

(2) Is Article 23(4) of the CIVA compatible with the abovementioned provision, when interpreted to the effect that, where the taxable person is an undertaking

engaged in real property business, carrying out work in two sectors of activity, one being the construction of buildings for sale (exempt from VAT) and the other public works contracts (subject to VAT), in order to calculate the deductible percentage of VAT or the proportion borne by that taxable person on the purchase of goods and services intended for both those activities, it is necessary to include in the denominator of the fraction to be calculated, in addition to the annual turnover, the value of work in progress which at the end of every year has not yet been put on the market and the value of which has not, in whole or in part, been received?

(3) Or in the sense that that denominator comprises turnover only?'

On the questions referred for a preliminary ruling

On the framing of the questions

15 In view of the way in which the questions are worded, it is first of all to be pointed out that, although the Court has no jurisdiction under Article 234 EC to apply a rule of Community law to a particular case and thus to judge a provision of national law by reference to such a rule it may, in the framework of the judicial cooperation provided for by that article, and on the basis of the material presented to it, provide a national court with an interpretation of Community law which may be useful to it in assessing the effects of that provision (Case 204/87 *Bekaert* [1988] ECR 2029, paragraph 5).

16 However, if questions have been improperly formulated or go beyond the scope of the powers conferred on it by Article 234 EC, the Court is free to extract from all the factors provided by the national court, and in particular from the statement of the grounds contained in the reference, the elements of Community law requiring an interpretation — or, as the case may be, an assessment of validity — having regard to the subject-matter of the dispute (see Case C-105/96 *Codiesel* [1997] ECR I-3465, paragraph 13).

17 The grounds of the order for reference make it apparent that the Supremo Tribunal Administrativo asks the Court to interpret Article 19(1) of the Sixth Directive, and seeks more specifically to ascertain whether 'where the taxable person is an undertaking engaged in real property business, carrying out work in two sectors of activity, one being the construction of buildings for sale (exempt from VAT) and the other public works contracts (subject to VAT), in order to calculate the deductible percentage of VAT or the proportion borne by that taxable person on the purchase of goods and services intended for both those activities, it is necessary to include in the denominator of the fraction to be calculated, in addition to the annual turnover, the value of work in progress which at the end of every year has not yet been put on the market and the value of which has not, in whole or in part, been received'.

18 The national court seeks, therefore, to know whether, for the application of Article 19 of the Sixth Directive, and more particularly for the calculation of the fraction giving the deductible proportion provided for by Article 17 of that directive, it is appropriate or not to include in the denominator the value of work in progress which at the end of every year has not yet been put on the market and the value of which has not, in whole or in part, been received by the taxable person.

Observations submitted to the Court

19 The Commission of the European Communities and the Portuguese Government assert that the interpretation of a rule of domestic law that leads to the inclusion, in the denominator of the fraction making it possible to calculate the deductible proportion, of the value of work in progress carried out by a taxable person in the course of its civil construction activity is not compatible with Article 19 of the Sixth Directive, in so far as that work in progress does not correspond to the supply of goods or the provision of services already effected by the taxable person or to other situations determining the existence of the chargeable event or the chargeability of the tax.

20 The Portuguese Government states, however, that it would be possible, pursuant to the third subparagraph of Article 17(5) of the directive, for the national authorities to adopt a criterion making it possible to establish the extent of the undertaking's activity, taking account of variations in production or the value of work in hand on the basis of its actual use. For its part, the Commission refers to possible subsequent adjustments, in accordance with Article 20 of the directive.

Findings of the Court

21 It is to be noted, to begin with, that the deduction system is intended 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 (Case C-98/98

Midland Bank [2000] ECR I-4177, paragraph 19, and Case C-408/98 *Abbey National* [2001] ECR I-1361, paragraph 24).

22 It is apparent from the order for reference that in the course of its business activity António Jorge provides services corresponding to civil construction works contracts subject to VAT pursuant to Articles 2(1) and 6 of the Sixth Directive. The company also carries out transfers of real property subject to VAT pursuant to Articles 2(1) and 5 of the directive, but exempted from the tax pursuant to Article 28(3)(b) of and Annex F(16) to the directive.

23 In so far as those are not incidental transactions, mentioned in the second sentence of Article 19(2) of the Sixth Directive, which are excluded from the calculation of the deductible proportion provided for in the first indent of Article 17(5) of that directive, it must be determined what transactions are to be taken into account in the calculation of that proportion.

24 Article 17(1) of the Sixth Directive provides that the right to deduct arises at the time when the deductible tax becomes chargeable. Article 10(2) of that directive provides that such is the case as soon as the goods are delivered or the services performed (Case C-400/98 *Breitsohl* [2000] ECR I-4321, paragraph 36). It must be borne in mind that under Article 10(1)(b) of the Sixth Directive the tax is chargeable 'when the tax authority becomes entitled under the law at a given moment to claim the tax from the person liable to pay'.

25 It follows that, in the system of the Sixth Directive, the event giving rise to the tax, its chargeability and the possibility of deduction are linked to the actual performance of the delivery of goods or of the provision of services, except in the case of payments on account, where the tax becomes chargeable on receipt of payment. There is in

Article 19(1) nothing to exclude application of that general rule to the calculation of the deductible proportion and nothing in the wording of that provision to suggest that the system contains a derogation as regards the taking into account, in the denominator of the fraction making it possible to calculate the proportion, of transactions not yet completed other than those giving rise to payments on account or statements of account of works.

26 From that point of view, it is contrary to the system to allow the determination of the extent of deduction to take into account transactions not yet performed and which may never actually take place, whilst the chargeable event for the tax, and as a result the right to deduct, depend on a transaction's having actually been carried out. Now, in so far as the taxable person has not issued any invoice in respect of work in progress, or any statements of account of work and has received no payments on account, that work does not constitute the delivery of goods or the provision of services already made by the taxable person or any other situation constituting the event which gives rise to the chargeability of the tax. It must not therefore be included in the denominator of the fraction referred to in Article 19(1) of the Sixth Directive for the calculation of the deductible proportion.

27 The answer to be given to the questions referred by the national court must therefore be that it is contrary to Article 19(1) of the Sixth Directive to include, in the denominator of the fraction making it possible to calculate the deductible proportion, the value of work in progress carried out by a taxable person in the course of civil construction activity, where that value does not correspond to the supply of goods or the provision of services which has already been effected by the taxable person or which has given rise to statements of account of work and/or the receipt of payments on account.

Costs

28 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 (Second Chamber) rules as follows:

It is contrary to Article 19(1) of 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 to include, in the denominator of the fraction making it possible to calculate the deductible proportion, the value of work in progress carried out by a taxable person in the course of civil construction activity, where that value does not correspond to the supply of goods or the provision of services which has already been made by the taxable person or which has given rise to statements of account of work and/or the receipt of payments on account.

[Signatures]