Reports of Cases

JUDGMENT OF THE COURT (Eighth Chamber)

16 February 2012 *

(Taxation — Sixth VAT Directive — Deduction of input tax — Article 17(2) and (5) and Article 19 — 'Subsidies' used for the purchase of goods and services — Restriction of the right to deduct)

In Case C-25/11,

REFERENCE for a preliminary ruling under Article 267 TFEU from the Supremo Tribunal Administrativo (Portugal), made by decision of 10 November 2010, received at the Court on 17 January 2011, in the proceedings

Varzim Sol — Turismo, Jogo e Animação SA

v

Fazenda Pública,

THE COURT (Eighth Chamber),

composed of A. Prechal, President of the Chamber, L. Bay Larsen (Rapporteur) and E. Jarašiūnas, Judges,

Advocate General: E. Sharpston,

Registrar: A. Calot Escobar,

having regard to the written procedure,

after considering the observations submitted on behalf of:

— Varzim Sol — Turismo, Jogo e Animação SA, by A. Jacinto and M. Brás, advogados,

— the Portuguese Government, by L. Inez Fernandes, acting as Agent,

— the European Commission, by L. Lozano Palacios and P. Guerra e Andrade, acting as Agents,

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

gives the following

* Language of the case: Portuguese.

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Article 17(2) and (5) and Article 19 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 has been made in the context of proceedings between Varzim Sol — Turismo, Jogo e Animação SA ('Varzim Sol') and the Fazenda Pública (the Public Exchequer) regarding demands for additional payments of value added tax ('VAT') and interest on account of late payment for the years 2002 to 2004.

Legal context

European Union law

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' and 'the importation of goods' are to be subject to VAT.

4 Article 11A(1)(a) of that directive states:

'Within the territory of the country

1. The taxable amount shall be:

(a) in respect of supplies of goods and services other than those referred to in (b), (c) and (d) below, everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies including subsidies directly linked to the price of such supplies'.

5 Article 17 of the Sixth Directive, which governs the origin and scope of the right to deduct, provides in paragraphs 2 and 5:

'2. 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) [VAT] due or paid in respect of goods or services supplied or to be supplied to him by another taxable person;

(b) [VAT] due or paid in respect of imported goods;

(c) [VAT] due under Articles 5(7)(a) and 6(3).

...

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 [VAT] is deductible, and for transactions in respect of which [VAT] is not deductible, only such proportion of the [VAT] 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.

However, Member States may:

(a) authorise the taxable person to determine a proportion for each sector of his business, provided that separate accounts are kept for each sector;

(b) compel the taxable person to determine a proportion for each sector of his business and to keep separate accounts for each sector;

(c) authorise or compel the taxable person to make the deduction on the basis of the use of all or part of the goods and services;

(d) authorise or compel the taxable person to make the deduction in accordance with the rule laid down in the first subparagraph, in respect of all goods and services used for all transactions referred to therein;

(e) provide that where the [VAT] which is not deductible by the taxable person is insignificant it shall be treated as nil.

...'

6 Article 19 of that directive, which sets out the rules applicable to the calculation of the deductible proportion, states in paragraph 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.'

National law

7 Article 23 of the VAT Code states:

'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 amount of the transactions which give rise to the right to deduct.

2. Notwithstanding the provisions of the previous paragraph, the taxable person may make the deduction in accordance with the actual use of all or part of the goods and services used, provided that prior notice is given to the Directorate-General of Direct and Indirect Taxes, without prejudice to the possibility for the latter to impose special conditions on it or to terminate that procedure in the event of significant distorsions in the taxation.

3. The tax authority may require the taxpayer to proceed in accordance with the provisions of the preceding paragraph:

(a) where the taxable person carries out separate economic activities;

(b) where the application of the procedure referred to in paragraph l results in significant distorsion in the taxation.

4. The specific proportion of deduction referred to in paragraph 1 shall be derived from a fraction whose numerator is the annual amount, exclusive of VAT, of the supplies of goods and services which give rise to the right to deduct under Articles 19 and Article 20(1) and whose denominator is the annual amount, exclusive of VAT, of all the transactions carried out by the taxable person, including exempt transactions and transactions outside the scope of VAT, particularly subsidies not subject to VAT other than subsidies for plant or equipment.

...'

8 Companies granted a concession to operate games of chance in a gaming area are subject, in particular, to the provisions of Decree-Law No 422/89 of 2 December 1989, as amended. Article 16 of that decree-law provides:

'1. Without prejudice to other obligations referred to in this text, complementary legislation and the respective concession contracts, the concessionaire companies are committed to the following:

...

(b) organising regularly, in the premises of the casino intended for that purpose, entertainment programmes of good artistic quality;

(c) promoting and organising tourist, cultural and sporting events, participating in similar official initiatives which are designed to encourage tourism in the gaming area concerned, and supporting or ensuring promotion of the gaming area abroad ...

2. To fulfil the obligations set out in points (b) and (c) of the above paragraph, the concessionaires must allocate a sum amounting to not less than 3% of the gross income from gaming achieved in the previous year or, if it is the first year of the concessions, the year in question and the sum allocated with regard to the obligations laid down in each of those points must not be less than 1% of that income.'

9 The contractual regime for concessions to operate games of chance in gaming areas was amended by Decree-Law No 275/2001 of 17 October 2001. Article 2(4) of that decree-law provides:

'The annual consideration binding the concessionaires of the gaming areas of Algarve, Espinho, Estoril and Póvoa de Varzim may not be less than the amounts indicated in the table appended ...'

10 Article 5 of that decree-law, which concerns the system of deduction of expenses in the sphere of entertainment and tourism promotion, provides:

'1. From the annual consideration for operation that the concessionaire companies are bound to provide … there shall be deducted up to 1% of the gross income from gaming in respect of the expenses relating to fulfilment of the obligations referred to in Article 16(1)(b) and (c) of Decree-Law No 422/89 ..., which expenses may not be less than 3% of the gross income from gaming.

2. Should these expenses, added to the net costs incurred in connection with entertainment and catering services, and to the advertising and marketing expenses, exceed an amount corresponding to 3% of the gross income from gaming, the concessionaires ... have the right to deduct, in addition, 50% of expenses in excess of the chargeable minimum ..., which additional deduction may not exceed 3% of the gross income from gaming.

3. The latter deduction may be made only in respect of and within the limit of 25% of the increase in gross income from gaming in each financial year, compared with the previous financial year, in the cases of the gaming areas of Póvoa de Varzim ...'.

11 The rules thus laid down regarding the deduction of expenses in the sphere of entertainment and tourism promotion are reproduced in the contract granting a concession to operate games of chance in the permanent gaming area of Póvoa de Varzim, awarded to Varzim Sol.

The main proceedings and the questions referred for preliminary ruling

12 Varzim Sol operates a casino on the basis of a contract granting a concession to operate games of chance in the permanent gaming area of Póvoa de Varzim, entered into on 14 December 2001. That contract requires it to carry out a certain number of artistic and cultural activities, but also to participate in the promotion of the area where the casino is located.

13 Varzim Sol simultaneously carries out activities in the gaming sector, which are exempt from VAT, in the sectors of catering and entertainment, where they are subject to VAT, and in the administrative and finance sector, with partial deduction of VAT. In the sectors subject to VAT, VAT paid is deducted under the method of actual use, in accordance with Article 23(2) of the VAT Code.

14 Furthermore, under the applicable rules and the concession contract, Varzim Sol is bound to pay to the Portuguese State an initial consideration, but also an annual consideration calculated on the basis of income from the gaming sector. It is authorised to deduct from that annual consideration a part of the expenses incurred to fulfil its entertainment and tourism promotion obligations. The amount of that deduction depends on the amount of the expenses incurred and on the amount of the income from the gaming activity.

15 Following an inspection by the tax authorities, Varzim Sol received demands for additional payment of the amount of EUR 496 697.14 in respect of the years 2002 to 2004. Those corrections are based on a challenge to the method used by Varzim Sol to calculate the deductible amount of VAT paid for the catering and entertainment sectors.

16 The Fazenda Pública argues that the deduction made from the annual consideration to compensate for the entertainment and promotion expenses must be classified as an operating subsidy for the purposes of Article 23(4) of the VAT Code. It considers that, as that subsidy is not subject to VAT, the catering and entertainment activities must be treated as mixed activities. Consequently, the VAT paid in those sectors must be deducted on the basis of a proportion that allows both exempt and taxable activities to be taken into account.

17 Varzim Sol paid the amounts claimed but brought a legal action. That action was dismissed by the Tribunal Administrativo e Fiscal do Porto (Administrative and Tax Court, Porto). Varzim Sol appealed to the Supremo Tribunal Administrativo (Supreme Administrative Court).

18 Varzim Sol claims that, even if the amount deducted must be classified as a subsidy, which is not the case, it cannot affect the deduction of VAT by taxable persons who, in the context of the method of actual use, carry out taxable, non-exempt, transactions only, such as catering and entertainment transactions, which confer the right to deduct the VAT incurred.

19 Alternatively, Varzim Sol claims that the reasoning of the Fazenda Pública, endorsed by the Tribunal Administrativo e Fiscal do Porto, leads to a distortion in the deduction of VAT, in breach of the Sixth Directive as interpreted by the Court of Justice in Case C-204/03 *Commission* v *Spain* [2005] ECR I-8389 and in Case C-243/03 *Commission* v *France* [2005] ECR I-8411.

20 It is in those circumstances that the Supremo Tribunal Administrativo decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

‘(1) Is Article 23 of the [VAT Code] compatible with Article 17(2) and (5) and Article 19 of [the] Sixth Directive …?

(2) [If the answer to Question 1 is in the affirmative], is the establishment of a specific deductible proportion of the [VAT] paid by taxable persons carrying out taxable transactions only, albeit by actual use, based on non-taxable subsidies to that sector (‘inputs’), under Article 23 of the VAT Code, compatible with Article 17(2) and (5) and Article 19 of that directive?’

Consideration of the questions referred

Admissibility

21 The Portuguese Republic submits, as its principal argument, that the reference for a preliminary ruling is inadmissible.

22 Thus, with regard to the first question, the Portuguese Republic notes that the purpose of the question is to assess the compatibility of Portuguese national law, that is, Article 23 of the VAT Code, with certain rules of the common system of VAT.

23 The Portuguese Republic states that, although the Court can, in the framework of the judicial cooperation provided for by Article 267 TFEU, provide the national court, on the basis of the material in the file, with such an interpretation as the Court may consider useful for assessing the effects of the provisions of European Union law, no passage in the order for reference sets out however, even briefly, a precise statement of the provisions of national law in question in the main proceedings.

24 The lack of precision of the first question even means that it should be regarded as a request for a general opinion, which cannot be allowed under Article 267 TFEU.

25 The Portuguese Republic contends that those considerations also apply, in essence, to the second question.

26 In its submission, therefore, the deficiencies in the order for reference prevent the Court from giving a useful answer, and they do not allow Member States and other interested parties to submit observations in this case.

27 In that connection, it should be noted, first, that the cooperative arrangements established by Article 267 TFEU are based on a clear division of responsibilities between the national courts and the Court of Justice. In proceedings brought on the basis of that article, the interpretation of provisions of national law is a matter for the courts of the Member States, not for the Court of Justice, and the Court has no jurisdiction to rule on the compatibility of national rules with European Union law. On the other hand, the Court does have jurisdiction to provide the national court with all the guidance as to the interpretation of European Union law necessary to enable that court to rule on the compatibility

of national rules with European Union law (Joined Cases C-338/04, C-359/04 and C-360/04 *Placanica and Others* [2007] ECR I-1891, paragraph 36, and Case C-42/07 *Liga Portuguesa de Futebol Profissional and Bwin International* [2009] ECR I-7633, paragraph 37).

28 Although it is true that the literal wording of the questions referred for a preliminary ruling by the national court calls on the Court to rule on the compatibility of a provision of national law with European Union law, there is nothing to prevent the Court from giving an answer of use to the national court by providing the latter with the guidance as to the interpretation of European Union law necessary to enable that court to rule itself on the compatibility of the national rules with European Union law (see, to that effect, *Placanica and Others*, paragraph 37).

29 Second, it should be recalled that the Court may reject a reference for a preliminary ruling submitted by a national court only where it is quite obvious that the interpretation of European Union law that is sought is unrelated to the actual facts of the main action or its purpose, where the problem is hypothetical, or where the Court does not have before it the factual and legal material necessary to give a useful answer to the questions submitted to it (see, inter alia, Case C-415/93 *Bosman* [1995] ECR I-4921, paragraph 61, and Case C-450/09 *Schröder* [2011] ECR I-2497, paragraph 17).

30 With regard, more particularly, to the information that must be provided to the Court in an order for reference, that information does not serve only to enable the Court to provide answers which will be of use to the national court; it must also enable the Governments of the Member States and other interested parties to submit observations in accordance with Article 23 of the Statute of the Court of Justice of the European Union. For those purposes, it is necessary that the national court should define the factual and legislative context of the questions which it is asking or, at the very least, explain the factual circumstances on which those questions are based (see *Schröder*, paragraph 18).

31 Accordingly, when the information provided by the national court is sufficient to explain the subject-matter of the dispute in the main proceedings and the main issues raised by it for the European Union legal order as well as to enable, first, the Member States to submit their observations in accordance with Article 23 of the Statute of the Court of Justice and to participate effectively in the proceedings before the Court and, second, the Court to provide an answer which will be of use to the national court, the reference for a preliminary ruling must be regarded as admissible (see, to that effect, *Schröder*, paragraphs 19, 21 and 22).

32 In this case, the order for reference states that, with regard to the catering and entertainment activities which are carried on by Varzim Sol and which are subject to VAT, the VAT paid is deducted under the method of actual use. Moreover, Varzim Sol is authorised to deduct from the annual consideration — calculated on the basis of the income from the gaming sector — which it is bound to pay to the State a portion of the expenses incurred to fulfil its entertainment and tourism promotion obligations. According to the tax authority, as that deduction constitutes an operating subsidy that is not subject to VAT, the catering and entertainment activities must be treated as mixed activities and, consequently, the VAT paid in those sectors must be deducted on the basis of a proportion that allows both exempt and taxable activities to be taken into account. Varzim Sol claims that that alleged subsidy cannot affect the deduction of VAT by taxable persons who, in the context of the method of actual use, carry out taxable, non-exempt, transactions only, such as catering and entertainment transactions, which confer the right to deduct the VAT incurred.

33 Those details are sufficient with regard to the case-law set out in paragraphs 30 and 31 of this judgment. Furthermore, there is no evidence to suggest that the information provided by the national court would not have allowed the interested parties referred to in Article 23 of the Statute of the Court of Justice to submit their observations in accordance with that article and to participate effectively in the proceedings before the Court.

34 It follows that the reference for a preliminary ruling is admissible.

Substance

35 By its questions, which it is appropriate to examine together, the national court asks essentially whether Article 17(2) and (5) and Article 19 of the Sixth Directive must be interpreted as precluding a Member State, where it authorises mixed taxable persons to make the deduction provided for in those provisions on the basis of the use of all or part of the goods and services, from calculating the deductible amount, for sectors in which such taxable persons carry out taxable transactions only, by including untaxed 'subsidies' in the denominator of the fraction used to determine the deductible proportion.

36 It should be remembered that, according to settled case-law, the right to deduct 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. That right must be exercised immediately in respect of all the taxes charged on input transactions. Any limitation of the right to deduct VAT affects the level of the tax burden and must be applied in a similar manner in all the Member States. Consequently, derogations are permitted only in the cases expressly provided for by the Sixth Directive (see, inter alia, *Commission* v *France*, paragraph 28).

37 In that regard, Article 17(1) of the Sixth Directive provides that the right to deduct is to arise at the time when the deductible tax becomes chargeable and Article 17(2) entitles the taxable person, in so far as the goods and services are used for the purposes of his taxable transactions, to deduct from the VAT which he is liable to pay the tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person (see *Commission* v *France*, paragraph 29).

38 As regards mixed taxable persons, under the first and second subparagraphs of Article 17(5) of the Sixth Directive the right to deduct is calculated according to a proportion determined in accordance with Article 19 thereof. The third subparagraph of Article 17(5) nevertheless permits Member States to provide for one of the other methods for determining the right to deduct that are listed in that paragraph, namely, in particular, determination of a separate proportion for each sector of business or deduction on the basis of the use of all or part of the goods and services for a specific activity (see *Commission* v *France*, paragraph 30).

39 Article 11A(1)(a) of the Sixth Directive provides that subsidies directly linked to the price of goods or services are taxable in the same way as those goods or services. As regards subsidies which are not directly linked to the price, Article 19(1) of that directive provides that the Member States may include them in the denominator for calculating the proportion applicable where a taxable person carries out, at the same time, transactions in respect of which VAT is deductible and others which are exempt (see *Commission* v *France*, paragraph 31).

40 It is not disputed that, with regard to the main proceedings, Varzim Sol was authorised to make the deduction according to a method other than the method whereby a proportion is determined under Article 19 of the Sixth Directive, namely on the basis of the use of all or part of the goods and services for a specific activity, a method set out in the third subparagraph of Article 17(5) of that directive.

41 As the activities of Varzim Sol in the catering and entertainment sectors are subject to VAT, the right to deduct on the basis of the method of actual use relates to all the taxes charged on the input transactions.

42 Since the taxable person was authorised to make the deduction on the basis of the method of actual use, the provisions of Article 19 of the Sixth Directive are not applicable and therefore cannot limit the right to deduct in those sectors as provided for in the directive.

43 In the light of the above considerations, the answer to the questions referred is that Article 17(2) and (5) and Article 19 of the Sixth Directive must be interpreted as precluding a Member State, where it authorises mixed taxable persons to make the deduction provided for in those provisions on the basis of the use of all or part of the goods and services, from calculating the deductible amount, for sectors in which such taxable persons carry out taxable transactions only, by including untaxed 'subsidies' in the denominator of the fraction used to determine the deductible proportion.

Costs

44 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 (Eighth Chamber)

hereby rules:

Article 17(2) and (5) and Article 19 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, must be interpreted as precluding a Member State, where it authorises mixed taxable persons to make the deduction provided for in those provisions on the basis of the use of all or part of the goods and services, from calculating the deductible amount, for sectors in which such taxable persons carry out taxable transactions only, by including untaxed 'subsidies' in the denominator of the fraction used to determine the deductible proportion.

[Signatures]