JUDGMENT OF THE COURT (Sixth Chamber)
11 July 1991 *

In Case C-97/90,

REFERENCE to the Court under Article 177 of the EEC Treaty by the Finanzgericht München (Finance Court, Munich) for a preliminary ruling in the proceedings pending before that court between

H. Lennartz, Munich,

and

Finanzamt München III,

on the interpretation of Article 20(2) of the Sixth Council Directive (77/388/EEC) of 17 May 1977 on harmonization of the laws of the Member States concerning turnover taxes: uniform basis of assessment (Official Journal 1977 L 145, p. 1),

THE COURT (Sixth Chamber),

composed of: G. F. Mancini, President of the Chamber, T. F. O'Higgins, C. N. Kakouris, F. A. Schockweiler and P. J. G. Kapteyn, Judges,

Advocate General: F. G. Jacobs,
Registrar: V. Di Bucci, Administrator,

* Language of the case: German.

after considering the written observations submitted on behalf of:

— the German Government, by Ernst Röder and Joachim Karl, of the Bundesministerium für Wirtschaft, acting as Agents,

— the French Government, by Edwige Belliard, acting as Agent, and Géraud de Bergues, acting as Assistant Agent, of the Directorate for Legal Affairs, Ministry of Foreign Affairs,

— the United Kingdom, by John Collins, Treasury Solicitor, acting as Agent,

— the Commission of the European Communities, by Henri Étienne, Legal Adviser to the Commission, acting as Agent,

having regard to the Report for the Hearing,

after hearing the oral observations of the German Government, represented by Claus-Dieter Quassowski, of the Bundesministerium für Wirtschaft, acting as Agent, the United Kingdom, represented by David Anderson, Barrister, and the Commission, at the hearing on 7 March 1991,

after hearing the Opinion of the Advocate General at the sitting on 30 April 1991,

gives the following

Judgment

1 By order of 24 January 1990, which was received at the Court on 10 April 1990, the Finanzgericht München referred to the Court for a preliminary ruling under Article 177 of the EEC Treaty a number of questions on the interpretation of Article 20(2) of the Sixth Council Directive (77/388/EEC) of 17 May 1977 on harmonization of the laws of the Member States concerning turnover taxes: uniform basis of assessment (Official Journal 1977 L 145, p. 1, hereinafter referred to as 'the Sixth Directive').

2 Those questions were raised in proceedings instituted by H. Lennartz, a tax consultant in Munich, concerning the refusal of the Finanzamt (Finance Office), Munich III, to allow a retrospective adjustment of the VAT declaration submitted by him for 1985.

3 In 1985 and 1986, Mr Lennartz worked partly as an employed person and partly as a self-employed tax consultant. He submitted annual VAT declarations for that period in respect of his self-employed activity. In 1985, Mr Lennartz purchased a car for DM 20 206.15, plus VAT of DM 2 826.86. In 1985 he used his car mainly for private purposes and only to a limited extent — about 8% — for business purposes. On 1 July 1986 he opened his own tax consultancy office and contributed the motor car to the business. In his VAT declaration for 1986 he claimed retroactively, on the basis of Paragraph 15(a) of the 1980 Umsatzsteuergesetz (German Law on turnover tax, hereinafter referred to as 'the UStG'), which implements Article 20(2) of the Sixth Directive, a deduction of DM 282.98 for the purchase of a car, being 6/60ths of the total VAT which he had paid on the car.

4 The Finanzgericht decided that Mr Lennartz should be regarded as having initially acquired the car solely for private purposes and that he was not therefore entitled to any adjustments under Paragraph 15(a) of the UStG if the car was subsequently used for business purposes. The Finanzamt based its view that the car was used initially only for private purposes on an administrative practice followed by the German tax authorities whereby in general no account is taken of the business use of goods where such use accounts for less than 10% of total use. Consequently, the Finanzamt refused to grant Mr Lennartz a retrospective adjustment of the VAT declaration filed by him for 1985.

5 According to the Finanzgericht, the interpretation of Paragraph 15(a) of the UStG whereby capital goods which have initially been put to private use by a taxable person and then, in subsequent years, to business use qualify for no VAT deduction whatsoever raises certain doubts with respect to the Sixth Directive, since the latter does not exclude the right to such a deduction. The national court

therefore decided to stay the proceedings before it and refer the following questions to the Court for a preliminary ruling:

'1. Is Article 20(2) of the Sixth Directive applicable to all capital goods which

(a) were supplied by one taxable person to another taxable person and at some point within a period of five years, including the year in which the goods were acquired, are used by the recipient for the purposes of his taxable transactions,

or is it also necessary for the capital goods in question to have been

(b) used from the time of acquisition for the purposes of the taxable or exempted transactions (business purposes) of the taxable person, or

(c) applied at the time of acquisition for the purposes of the business of the taxable person?

2. If alternative (b) is correct:

Does the application of Article 20(2) of the Sixth Directive to capital goods which are used by a taxable person both for business purposes and for other, in particular private, purposes (mixed use) depend on their having been used to a specific minimum extent for business purposes in the year in which they were acquired and, if so, how is that minimum to be defined?

3. If alternative (c) is correct:

Is the application of the capital goods a matter for the taxable person's discretion or does it presuppose that the taxable person

(a) acquires them with the intention of using them for business purposes and, if so, must that use be intended to begin

— immediately from the time of acquisition, or

— from some point within the year of acquisition, or

— from some point before the expiry of a period of five years, including the year of acquisition?

and/or

(b) actually uses the capital goods for business purposes and, if so, does it matter whether such use begins

— from the time of acquisition, or

— within the year in which the capital goods were acquired, or

— within the period of five years, including the year in which the goods were acquired?

As far as Questions 3(a) and (b) are concerned:

Where the capital goods are used for mixed purposes, must the intended use or actual use (or both) for business purposes attain a specific minimum proportion and, if so, how is that minimum to be defined?'

6 Reference is made to the Report for the Hearing for a fuller account of the legal background and of the circumstances of the case before the national court, the procedure and the written observations submitted to the Court, which are mentioned or discussed hereinafter only so far as is necessary for the reasoning of the Court.

The scope of Article 20(2) of the Sixth Directive (first question)

7 The purpose of the first part of this question is, essentially, to determine whether the rules for the adjustment of input tax laid down in Article 20(2) of the Sixth Directive apply where a taxable person initially acquires goods wholly for private use but later uses them for business purposes during the five-year adjustment period. In the second part, the Court is asked whether it is sufficient, for the application of Article 20(2), for a person to acquire goods as a taxable person or whether there must be immediate use of the goods for the purposes of economic activities within the meaning of Article 4 of the Sixth Directive.

The first part of the first question

8 Pursuant to Article 17(1) of the Sixth Directive, which is entitled 'Origin and scope of the right to deduct', the right to deduct arises at the time when the deductible tax becomes chargeable. Consequently, only the capacity in which a person is acting at that time can determine the existence of the right to deduct. By virtue of Article 17(2), in so far as a taxable person, acting as such, uses the goods for the purposes of his taxable transactions, he is entitled to deduct the tax due or paid in respect of those goods.

9 Conversely, where the goods are not used for the taxable person's economic activities within the meaning of Article 4 but are used by him for his private consumption, no right to deduct can arise.

10 Moreover, where a taxable person acquires goods in his private capacity, he does not meet the administrative and accounting requirements governing the exercise of the right to deduct provided for in Articles 18 and 22 of the Sixth Directive.

11 The very wording of paragraph 2 of Article 20, which is entitled 'Adjustments of deductions', confirms that interpretation. That article contains no provision concerning the origin of any right to deduct. Since it does no more than refer to adjustments of deductions provided for in respect of capital goods it must be

concluded that the origin of the right to make such deductions is dealt with in other provisions of the Sixth Directive.

12 It is apparent from the scheme of the Sixth Directive and from the actual wording of Article 20(2) that the latter provision does no more than establish the procedure for calculating the adjustments to the initial deduction. It 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.

The second part of the first question

13 In order to answer the second part of the first question, it must be borne in mind that, according to the judgment of the Court in Case 268/83 *Rompelman* v *Minister van Financiën* [1985] ECR 655, paragraph 22, the economic activities referred to in Article 4(1) may consist in several consecutive transactions, as is indeed, suggested by the wording of Article 4(2). Amongst such transactions preparatory activities, such as the acquisition of operating assets, must be treated as constituting economic activities within the meaning of that article.

14 It follows from that judgment that a person who acquires goods for the purposes of an economic activity within the meaning of Article 4 does so as a taxable person, even if the goods are not used immediately for such economic activities.

15 Consequently, it is the acquisition of the goods by a taxable person acting as such that gives rise to the application of the VAT system and therefore of the deduction mechanism. The use to which the goods are put, or intended to be put, merely determines the extent of the initial deduction to which the taxable person is entitled under Article 17 and the extent of any adjustments in the course of the following periods.

16 It follows that the immediate use of the goods for taxable or exempt supplies does not in itself constitute a condition for the application of Article 20(2).

17 It must therefore be stated in reply to Question 1 as a whole that Article 20(2) of the Sixth Directive applies where a person acquires capital goods in his capacity as a taxable person and allocates them to his economic activity within the meaning of Article 4 of the Sixth Directive.

Minimal use of capital goods (Question 2)

18 In view of the answer given to the first question, it is unnecessary to consider the second question.

The criteria to be used in determining whether a person acquires goods in his capacity as a taxable person (Questions 3(a) and (b))

19 In the first two parts of its third question, the national court essentially seeks clarification as to the criteria to be used in determining whether a person acquires goods in his capacity as a taxable person where they are not allocated immediately to his economic activities.

20 The answer to that question depends on an assessment of all the relevant circumstances, *inter alia* the nature of the goods concerned and the period which elapsed between their acquisition and their use for the taxable person's economic activities. However, the adjustment periods provided for in Article 20(2) of the Sixth Directive do not as such have any bearing on the question whether the goods are acquired for the purposes of those economic activities.

21 It must therefore be stated in reply to the first two parts of the third question that whether, in a particular case, a taxable person has acquired goods for the purposes of his economic activity within the meaning of Article 4 of the Sixth Directive is a question of fact which must be determined in the light of all the circumstances of the case, including the nature of the goods concerned and the period between the acquisition of the goods and their use for the purposes of the taxable person's economic activity.

The validity of a rule imposing a restriction on the right to deduct VAT (Question 3(c))

22 In the last part of the third question, the national court asks essentially whether, under the Sixth Directive, a person who acquires goods as a taxable person and has the right to deduct input tax in respect of such goods may do so even where, upon acquisition and for some time thereafter, he makes relatively little use of them for the purposes of economic activities.

23 At the hearing, the German Government maintained that the dispute pending before the national court was limited to the question whether Mr Lennartz was entitled to make adjustments under Article 20(2) of the Sixth Directive. Since he did not apply for an initial deduction under Article 17(2) for 1985, the classification adopted for that year became final. Consequently, in its view, the answer to the questions submitted should be based on the premise that Mr Lennartz had no right to make any deduction in respect of the purchase of the car.

24 The order for reference appears to support the German Government's contention. Furthermore, the latter rightly considers that the limit applies to Mr Lennartz's right to an initial deduction for 1985 under Article 17(2). Consequently, in the event of the rule in question not being valid, Mr Lennartz could not rely on it unless he were able to make a retroactive application for an initial deduction under Article 17(2) pursuant to the German legislation adopted pursuant to Article 18(3) of the Sixth Directive.

25 Nevertheless, since the national court expressly raises the question of the requirement that use should attain a specific minimum proportion, it is necessary to consider whether the measure in question may lead to refusal of the right of deduction in cases of actual, but limited, use of the capital goods for the purposes of a taxable person's economic activities.

26 In reply to the national court's question, it must be emphasized in the first place that, pursuant to Article 6 of the Sixth Directive, the use of capital goods for the private use of a taxable person or for purposes other than those of his business, where the VAT on such goods is wholly or partly deductible, is treated as a supply

of services for consideration. It is apparent from the combined provisions of Article 6(2)(a) and of Article 11A(1)(c) that, where a taxable person acquires goods which he employs partly for private use, he is deemed to effect for consideration a supply of services taxed on the basis of the cost of providing the services. Consequently, a person who uses goods partly for the purposes of taxable business transactions and partly for private use and who, upon acquiring the goods, recovered all or part of the input VAT, is deemed to use the goods entirely for the purposes of his taxable transactions within the meaning of Article 17(2). Consequently, such a person is in principle entitled to a right of total and immediate deduction of the input tax paid on purchasing the goods.

27 The provisions concerning the apportionment of input tax contained in Article 17(5) concern only the adjustment after the initial deduction. As the Court observed in its judgment in Case 50/87 *Commission* v *France* [1988] ECR 4797, paragraphs 16 and 17, it is apparent from the scheme of the Sixth Directive, and in particular from Articles 4 and 17, that in the absence of any provision empowering the Member States to limit the right of deduction granted to taxable persons, that right must be exercised immediately in respect of all the taxes charged on transactions relating to inputs. Such limitations on the right of deduction must be applied in a similar manner in all the Member States and therefore derogations are permitted only in the cases expressly provided for in the directive.

28 In view both of the absence of any rule excluding the right of deduction where the use of goods for the purposes of economic activities falls below a certain threshold and of the express provisions of Article 17(5)(e) and Article 18(4) of the Sixth Directive, there are no grounds for interpreting Article 17 as including such a rule by implication.

29 It must therefore be concluded that the Member States are not authorized to limit the right of deduction, even where the use of the goods for the purposes of economic activities is very limited, except where they may rely on one of the derogations provided for in the Sixth Directive.

30 Article 27(1) and (5) of the Sixth Directive, which forms part of Title XV ('Simplification Procedures'), provide for two procedures for authorization of measures derogating from the directive, each of which may in principle apply to the contested national legislation.

31 As far as the application of Article 27(5) is concerned, the Commission published a list of the measures notified to it under that provision in Annex 1 to its First Report of 14 September 1983 on the application of the common VAT system, submitted in accordance with Article 34 of the Sixth Directive (COM(83) 426 final). Since the measure in question does not appear on that list, it seems that it has not been notified under Article 27(5).

32 As regards Article 27(1), it appears from the reply given by the German Government to a written question from the Court that it did not seek authorization under that provision since, in its view, the contested legislation does not derogate from the directive.

33 The Court has already held that, by virtue of the third paragraph of Article 189 of the Treaty, Member States are bound to observe all the provisions of the Sixth Directive. In so far as a derogation has not been established in accordance with Article 27, which imposes a duty of notification on the Member States, the tax authorities of a Member State may not rely, as against a taxable person, on a provision derogating from the scheme of the directive (judgment in Case 5/84 *Direct Cosmetics* [1985] ECR 617, paragraph 37).

34 Since the measure in question has neither been notified to the Commission under Article 27(5) nor authorized by a Council decision pursuant to Article 27(1), the German Government cannot rely on that measure to the detriment of taxable persons.

35 It must therefore be stated in reply to the national court that a taxable person who uses goods for the purposes of an economic activity has a right on the acquisition of those goods to deduct input tax in accordance with the rules laid down in

Article 17, however small the proportion of business use. A rule or administrative practice imposing a general restriction on the right of deduction in cases where there is limited, but none the less genuine, business use constitutes a derogation from Article 17 of the Sixth Directive and is valid only if the requirements of Article 27(1) or Article 27(5) of the directive are met.

Costs

36 The costs incurred by the French, German and United Kingdom Governments and the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT (Sixth Chamber),

in answer to the questions referred to it by the Finanzgericht München, by order of 24 January 1990, hereby rules:

1. **Article 20(2) of the Sixth Council Directive (77/388) of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — common system of value added tax: uniform basis of assessment applies where a person acquires capital goods in his capacity as a taxable person and allocates them to his economic activity within the meaning of Article 4 of the Sixth Directive;**

2. **Whether, in a particular case, a taxable person has acquired goods for the purposes of his economic activity within the meaning of Article 4 of the Sixth Directive is a question of fact which must be determined in the light of all the circumstances of the case, including the nature of the goods concerned and the period between the acquisition of the goods and their use for the purposes of the taxable person's economic activity;**

3. A taxable person who uses goods for the purposes of an economic activity has the right on the acquisition of those goods to deduct input tax in accordance with the rules laid down in Article 17 of the Sixth Directive, however small the proportion of business use. A rule or administrative practice imposing a general restriction on the right of deduction in cases where there is limited, but none the less genuine, business use constitutes a derogation from Article 17 of the directive and is valid only if the requirements of Article 27(1) or Article 27(5) of the directive are met.

Mancini O'Higgins

Kakouris Schockweiler Kapteyn

Delivered in open court in Luxembourg on 11 July 1991.

J.-G. Giraud
Registrar

G. F. Mancini
President of the Sixth Chamber