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Self-supply of goods in the light of the principle of fiscal neutrality

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SUMMARY

Article 16 of the VAT Directive, which regulates the self-supply of goods, is a good example of how it is complicated to achieve fraud resistance and full compliance with the principle of fiscal neutrality in the current system of VAT. This provision concerns taxation on business goods used for private purposes, which has shown to be a complex area of VAT. Although the application of this rule has been made conditional upon strict requirements, leeway for fraudulent behavior of a taxable person still remains.

The Court supplemented the current complex VAT system with the doctrine of ‘Asset labelling’ which aimed at simplifying the procedure for a taxable person to deduct input and account for output VAT on his capital goods when they are used for mixed purposes. This doctrine intended to bring the self-supply rules in VAT to perfection in the light of the principle of fiscal neutrality.

However, the Commission was of a different opinion. Granting a full right of deduction to a taxable person who acquired capital goods for mixed use was too difficult for it to digest. This led to adoption of the new Article 168a of the VAT Directive, which limits the initial deduction of input VAT to the actual use, and is applicable just to immovable property. Although the Commission tends to believe that the new provision solved problems caused by allocation of assets, the article is considered to not be in compliance with the principle of fiscal neutrality.

PREFACE

I feel very grateful for having the opportunity to follow courses in European and International Taxation as the selective courses in my two-year Master's Programme in European Business Law. My interest in those courses stimulated me to take a third specialized course in Indirect Taxation and to write my thesis within the same field.

I would like to express my gratitude towards my supervisor Oskar Henkow for the guidance writing this thesis.

ABBREVIATIONS

AG	The Advocate General
COMMISSION	The Commission of the European Union
COUNCIL	The Council of the European Union
ECJ, the Court	The Court of Justice of the European Union
EU	The European Union
FIRST DIRECTIVE	Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes
MEMBER STATES	EU Member States
SECOND DIRECTIVE	Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes - Structure and procedures for application of the common system of value added tax
SIXTH DIRECTIVE	Council Directive 77/388/EEC 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
TFEU	The Treaty on the Functioning of the European Union
VAT	Value added tax
VAT Directive	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

1. INTRODUCTION

1.1. Background

The current framework concerning self-supplies and the specific position of private use therein¹ is a scheme that intends to cover the VAT treatment of goods and services, which, without that mechanism, might escape the scope of the VAT Directive.² Though important, this framework is not entirely seamless, which creates a leeway for tax avoidance or evasion and which possibly makes the neutrality of VAT questionable.

EU VAT is a general indirect tax on end consumption which is charged on each stage in the production and distribution process. One of the main principles on which the VAT system is based and which might help to solve current issues related to self-supplies, is the principle of fiscal neutrality. Neutrality can be assessed within two different perspectives: in respect of a taxable person or in respect of the final consumer. Following the framework of the common system of VAT which is inherently aimed at the development and well-being of the entrepreneurial sector, the principle of fiscal neutrality, according to the author, should be interpreted in such a way as to fully recover input VAT of the taxable person.³ Based on that, neutrality should be assessed in the sense that a taxable person is the core figure within the system of VAT and he should neither be at risk of bearing a double burden, nor should he be deprived of a right to a full and immediate deduction after acquiring goods for his business purposes.

The deduction mechanism provided by the VAT Directive guarantees the principle of fiscal neutrality, as it concerns taxable persons and ensures that VAT is due neutrally.⁴ Accordingly, a

¹ For the purpose of this thesis, the wording of 'self-supply' will be related just to Articles 16 and 26 of the VAT Directive, accordingly excluding internal supply provisions, namely Articles 18 and 27.

² Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006.

³ Judgment in *Rompelman*, C-268/83, EU:C:1985:74, para 19.

⁴ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Title X.

taxable person is entitled to deduct VAT charged on his taxable transactions made only for business purposes,⁵ whatever the specific purpose or results, provided that they are subject to VAT.⁶ This means that a taxable person, who uses goods or services for private purposes, cannot recover any input tax. The latter scenario indicates that a taxable person who buys goods or services for private use is in the same situation as a non-taxable person, since they both are not entitled to deduct input VAT.⁷ In the common system of VAT, the right to deduct input VAT by a taxable person corresponds to the obligation to account for output VAT, as the deduction of input tax is linked to the collection of output tax in order to maintain neutrality.⁸

Often a taxable person seeks to deduct input VAT on his business goods and uses them for private purposes without paying VAT on private use of goods which a non-taxable person, in the same situation, would have been due to pay. Article 16 of the VAT Directive restricts the latter situation, namely the untaxed end use.⁹ It provides that acquired goods or services, which have been used for private purposes by a taxable person, and in respect of which the taxable person wholly or partly deducted input tax on those goods or services, are considered as supplies for consideration, and therefore, taxable.¹⁰

The application of Article 16 of the VAT Directive by national tax authorities has not always produced fair results and in some cases it has complicated the system of VAT. This has led the ECJ to ‘supplement’ the core aspect of the VAT system that input tax deduction is based on actual use of goods and services with introducing the so-called doctrine of ‘Asset labelling’.¹¹ According to this doctrine, a taxable person who acquires capital goods and is planning to use them for both business and private purposes has the choice at the time of purchase, for the

⁵ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Article 168.

⁶ Judgment in *Rompelman*, C-268/83, EU:C:1985:74, para 19, Judgment in *Commission v France*, Case 50/87, EU:C:1988:429, para 15.

⁷ Judgment in *Puffer*, C-460/07, EU:C:2009:254, para 55.

⁸ Judgment in *Uudenkaupungin kaupunki*, C-184/04, EU:C:2006:214, para 20, Judgment in *Wollny*, C-72/05, EU:C:2006:573, para 20.

⁹ Judgment in *Seeling*, C-269/00, EU:C:2003:254.

¹⁰ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Articles 16 and 26. Previously enshrined in Articles 5(6) and 6(2)(a) of the Council Directive 77/388/EEC 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, OJ L 145, 13.6.1977.

¹¹ J.P. Swinkels, ‘Asset labelling for VAT purposes’, *International VAT Monitor*, January/February 2006, IBFD, p. 8.

purposes of VAT, of allocating those goods wholly to private assets, to business assets or integrating them partly to private and partly to business assets. Since 1 January 2011 with the adoption of Article 168a of the VAT Directive, the situation concerning mixed use goods has changed.

The brief description of the current EU VAT system demonstrates that overall the common system of EU VAT is complex, sometimes inefficient and prone to fraud.¹² According to the Commission, modern methods of collecting and monitoring of VAT used by the Member States should maximize the revenues actually collected and limit fraud as much as possible. Besides, simplifying compliance for business, this will require the national tax authorities to focus more on potential and actual fraudsters.¹³ The difficulty for a taxable person of establishing in advance the proportions of private and business use to which his capital goods will be put, the difficulty of proving precisely what use is made of the capital good, and the discovery of irregularities in almost all cases where verification is carried out, are the factors which show a serious risk of fraud, meaning tax avoidance or evasion.¹⁴ In such circumstances, Member States might impose measures, such as a flat-rate limit on the right to deduct, to prevent that risk and at the same time simplify verification and thereby the system for charging VAT.¹⁵ However, this flat-rate limit has to be proportional to the aims pursued.¹⁶

These difficulties faced by a taxable person might have a significant impact on the core aspect of the system of VAT, namely the immediate and full deduction of input VAT. Due to the fact that the VAT Directive does not explicitly regulate issues related to how and when a taxable person needs to establish the proportions of private and business use of goods, these matters have been dealt with on a case by case basis by the ECJ. The Court in its case law has always relied on the fundamental principles of the EU VAT system and the principle of fiscal neutrality has formed the basis of the ECJ's assessments of cases for preventing tax avoidance or evasion.

¹² R. de la Feria, *The EU VAT System and the Internal Market*, IBFD, Amsterdam 2009, p. 100.

¹³ Communication from the Commission to the European Parliament, the Council and the European Economic and social committee on the future of VAT. Towards the simpler, more robust and efficient VAT system tailored to the single market. Brussels, 6.12.2011 COM (2011) 851.

¹⁴ Judgment in *Sudholz*, C-17/01, EU:C:2004:242, para 54.

¹⁵ *Ibid*, para 55.

¹⁶ R. de la Feria, *The EU VAT System and the Internal Market*, IBFD, Amsterdam 2009, p. 246.

1.2. Research question

These issues form the topic of this research. The question which should be kept in mind during this research is the following:

To what extent does Article 16 of the VAT Directive, on the self-supply of goods, comply with the necessity to be fraud proof, bearing in mind the principle of fiscal neutrality?

The purpose of the question in the context of this thesis is related to several aspects. By the raised question, the research shall focus on determining what the difficulties are of the application of self-supply of goods under Article 16 of the VAT Directive, particularly with regard to fraud. Moreover, it intends to assess whether the application of the provision in respect of the allocation of capital goods, following the doctrine of ‘Asset labelling’, provides for a better protection against fraud. Also, it shall be discussed to what extent the situation has changed after the adoption of Article 168a of the VAT Directive. Finally, the central issue of this research shall remain to analyze whether the application of Article 16 of the VAT Directive is in line with the principle of fiscal neutrality.

1.3. Methods of assessment

In order to get a good understanding of the problem covered by the research question and to achieve a comprehensive outcome, this thesis intends to give a critical view on the developments of the issue in the EU VAT system. For achieving this purpose, the research will be conducted based on the legal dogmatic method, consisting mainly of a case-by-case analysis and discussion of current doctrinal debate.

1.4. Outline

The following chapter starts with a brief analysis of the principle of fiscal neutrality and the relevance of the principle for this thesis. Thereafter, a closer look is taken to the application of the provision on self-supply of goods under Article 16 of the VAT Directive and the exemptions stemming from the article. Moreover, the private use and allocation of assets are discussed in the light of the doctrine of ‘Asset labelling’, concluding with a brief look on the future, based on a newly adopted provision in that regard. Finally, this paper is concluded and the research outcome is presented.

2. THE PRINCIPLE OF FISCAL NEUTRALITY

2.1. Introductory remarks

In accordance with the research question, it is first of utmost importance to obtain a comprehensive understanding of the principle of fiscal neutrality. As stipulated in Article 113 of the TFEU, the Council shall adopt provisions for the harmonization of legislation concerning indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.¹⁷ The avoidance of the distortion of competition mentioned in the TFEU bears the same meaning as the neutrality in competition,¹⁸ namely the compliance of provisions with the principle of fiscal neutrality within the common system of VAT. The Preamble of the VAT Directive reflects Article 113 of the TFEU and specifies that neutrality is one of the main goals of the VAT system and that provisions of the VAT Directive should be compatible with the principle.¹⁹

The principle of fiscal neutrality is the most important principle of the EU VAT system on which the Court relies as a basis for its decisions, especially when provisions of the VAT Directive do not provide with a clear solution of a case.²⁰ As was stated in the Introduction, the VAT system achieves the highest degree of simplicity and of neutrality when the tax is levied in the most general manner and when its scope covers all stages of production and distribution.²¹ Neutrality in the VAT system is achieved by the right of a taxable person to deduct input VAT paid on goods or services used for his business purposes, regardless their specific purpose or results, provided that they are subject to VAT.²² This right is meant to relieve the trader entirely of the burden of VAT directly and immediately related to all his taxable transactions.²³ In principle, the

¹⁷ Consolidated Version of the Treaty on the Functioning of the European Union, 2008, OJ C 326/47, 26.10.2012, Article 113.

¹⁸ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Recital 7.

¹⁹ Ibid, Recitals 2, 5, 7, 30, 34.

²⁰ R. de la Feria, *The EU VAT System and the Internal Market*, IBFD, Amsterdam 2009, p. 263.

²¹ Council Directive 1967/228/EC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes - Structure and procedures for application of the common system of value added tax OJ 71, 14.4.1967, Recital 5.

²² Judgment in *Rompelman*, C-268/83, EU:C:1985:74, para 19.

²³ Ibid.

principle of fiscal neutrality is aimed at precluding a taxable person from acting fraudulently, by participating in tax avoidance or evasion.

In this chapter, the principle of fiscal neutrality is briefly introduced. The following subchapter focuses on the manifoldness of the principle followed by the Court's case law. Moreover, the legislative background of the principle is presented. Thereafter, the relevance and the definition of the principle in cases of self-supply of goods are defined. Finally, the chapter is concluded and findings are presented.

2.2. The manifoldness of the principle

The principle of fiscal neutrality is a fundamental principle and the Commission even went further stating that the whole VAT system is based on neutrality.²⁴ It is important to mention that neutrality can be assessed in different aspects.²⁵ Firstly, neutrality means that the system of VAT aims to relieve traders entirely of the burden of VAT in respect of their economic activities²⁶ and to preclude double taxation.²⁷ Secondly, neutrality reflects the general principle of equal treatment²⁸ and sometimes is applicable with the principle of non-discrimination enshrined in Article 18 of the TFEU²⁹. This means that similar goods and services, being in competition with each other, have to be treated in the same way for the purposes of VAT³⁰ and accordingly, supplies that are not similar to each other do not fall within the field of the application of the principle of fiscal neutrality.³¹ Moreover, the amount of VAT to be collected by the tax authorities cannot exceed the amount paid by the final consumer.³²

²⁴ European Commission, Directorate General, Taxation and Customs Union, Indirect Taxation and Tax Administration, VAT and other turnover taxes, Consultation Paper on modernising Value Added Tax obligations for financial services and insurances, (n 8), 13 March 2006, p. 10.

²⁵ Judgment in *Zimmermann*, C-174/11, EU:C:2012:716.

²⁶ Judgment in *Rompelman*, C-268/83, EU:C:1985:74, para 19.

²⁷ Judgment in *Cookies World*, C-155/01, EU:C:2003:449, para 60

²⁸ Judgment in *NCC Construction Danmark*, C-174/08, EU:C:2009:669, para 41.

²⁹ Judgment in *Idéal Tourisme*, Case C-36/99, EU:C:2000:405, para 16, Judgment in *Arcelor Atlantique and Lorraine and Others*, C-127/07, EU:C:2008:728, para 23.

³⁰ Judgment in *Commission v. France*, C-94/09, EU:C:2010:253, para 40.

³¹ *Ibid*, para 41.

³² Judgment in *Elida Gibbs*, C-317/94, EU:C:1996:400.

Fiscal neutrality can be assessed either in the perspective of a final consumer, meaning that the burden of VAT is carried only by a consumer and a taxable amount cannot exceed what the consumer pays, or in the advantage of a taxable person, meaning that he can never bear VAT as a charge, since he is entitled to full and immediate VAT deduction on his business transactions. Moreover, this inherent principle of the VAT system³³ might imply that it is a principle of primary EU law, but, following the ECJ's view, the principle in question 'is a particular expression at the level of secondary EU law and in the specific area of taxation'.³⁴

2.3. Legislative background

The main principles on which the VAT system is based are stemming from the First VAT Directive.³⁵ Article 2 of the First Directive (of which the first three paragraphs were reproduced in Article 1(2) of the VAT Directive) sets out the economic basis of VAT with its multi-stage collection system and the basic rule that input tax attributed to taxable supplies should be recoverable.³⁶ On the basis of that provision, the ECJ held that one of the underlying principles of the VAT system is neutrality, in the sense that a taxable person who acquires goods should bear the same tax burden regardless the length of the production and distribution chain.³⁷

Although the First Directive did not provide with explicit guidelines on how to apply the common system of VAT, this was supplemented by the subsequent Directives. The Second Directive, the Sixth Directive and the VAT Directive were focused on setting up detailed documents which would explain the VAT provisions in more depth, while complying with general principles of EU law. According to Article 1(2) of the current VAT Directive, the

³³ Judgment in *Fischer*, C-283/95, EU:C:1998:276, para. 27, Judgment in *Gregg and Gregg*, C-216/97, EU:C:1999:390, para. 19, Judgment in *AB SKF*, C-29/08, EU:C:2009:665, para 67.

³⁴ Judgment in *Orfey Bulgaria*, C-549/11, EU:C:2012:832, para 33, Judgment in *NCC Construction Denmark*, C-174/08, EU:C:2009:669, para 44.

³⁵ First Council Directive 67/227/EEC of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes, OJ No. 71 of 1 April 1967, p. 1 01. The First Directive was repealed when the VAT Directive entered into force, i.e. on 1 January 2007. The first three paragraphs of Article 2 of the First Directive were reproduced in Article 1(2) of the VAT Directive.

³⁶ J. Watson and K. Garcia, 'EU VAT and the Rule of Economics', *International VAT Monitor*, 2009(3), p. 191.

³⁷ Judgment in *Hong-Kong Trade*, Case 89/81, EU:C:1982:121.

conclusion can thus be drawn that a taxable person should never experience VAT as a cost, as VAT is a tax on final consumption and only consumers should bear the tax.³⁸

The First VAT Directive gave a good start by introducing the principle of fiscal neutrality and the later Directives developed this notion very carefully. Although there is still no definition of the principle in VAT Directive, all the provisions of the VAT Directive (and former Directives) need to be interpreted in the light of fiscal neutrality. Following Watson and Garcia, in situations where the detailed provisions of the Directives do not follow the principles of the First Directive, they are corrected by the ECJ taking account to the principle of fiscal neutrality.³⁹

2.4. Definition in self-supply of goods cases

The purpose of this research is to analyze the provision of self-supply of goods, which seeks to prevent fraudulent behavior of a taxable person, and to determine the potential field of the application of the provision. Therefore the principle of fiscal neutrality for the purposes of this thesis must be interpreted as follows:

The principle of fiscal neutrality as being an inherent principle of the common system of VAT ensures that traders are relieved entirely of the burden of VAT paid on their taxable transactions and do not face double taxation.⁴⁰

2.5. Final remarks

As we have seen, the principle of fiscal neutrality is a principle of EU secondary law and is the cornerstone on which the VAT system is based. Neutrality can be assessed either in the advantage of a taxable person or of a final consumer. For the purpose of this thesis, the principle

³⁸ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Article 1(2).

³⁹ J. Watson and K. Garcia, 'EU VAT and the Rule of Economics', *International VAT Monitor*, 2009(3), p. 191.

⁴⁰ The definition is based on Judgment in *Rompelman*, C-268/83, EU:C:1985:74, para 19, Judgment in *Cookies World*, C-155/01, EU:C:2003:449, para 60.

of fiscal neutrality shall be thoroughly assessed in the perspective of a taxable person, since he is a core figure on which the entire system of VAT is created. Neutrality within this research shall mean that a taxable person needs to be entirely relieved of the burden of VAT and double taxation should be prevented for a taxable person in any circumstances.

Bearing this important characterization of the principle of fiscal neutrality in mind, the following chapter will analyze the private use of goods under Article 16 of the VAT Directive in the light of the principle, touching upon the legislative history and peculiarities of the provision.

3. PRIVATE USE AND APPLICATION OF ARTICLE 16

3.1. Introductory remarks

The principle of fiscal neutrality aims at safeguarding the VAT mechanism and at preventing fraudulent behavior of a taxable person. Often, a taxable person acquires business goods (such as items from stock, cars or computers) for business purposes, deducts input VAT on those goods and then uses them for private purposes without paying VAT on private use of goods, which a non-taxable person, in the same situation, would have been due to pay. Article 16 of the VAT Directive precludes the former situation, namely the untaxed end use. As stated in the Introduction, it establishes that acquired goods or services, which have been used for private purposes by a taxable person, and in respect of which the taxable person wholly or partly deducted input tax, are considered supplies for consideration, and therefore, are taxable.⁴¹

The purpose of this provision is to ensure equal treatment between a taxable person and an ordinary consumer who buys goods of the same type. For achieving this result, the provision prevents a taxable person who had a right to deduct VAT on his business goods from escaping the payment of VAT when he starts using those goods for his private purposes.⁴²

In this chapter, the private use of goods under Article 16 of the VAT Directive is analyzed. The next subchapter introduces the legislative history of the article. Thereafter, the conditions on the application of the provision within the case law of the ECJ follow. Furthermore, a closer look is taken to the exemptions from the general rule on deemed supplies. Finally, concluding remarks are drawn from the findings conducted in this chapter.

⁴¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Articles 16 and 26. Previously enshrined in Articles 5(6) and 6(2)(a) of the Council Directive 77/388/EEC 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, OJ L 145, 13.6.1977.

⁴² Judgment in *Bakcsi*, C-415/98, EU:C:2001:136, para 42.

3.2. Legislative history of the article

The provision of the self-supply of goods (currently Article 16 of the VAT Directive) was introduced for the first time in 1967 with the adoption of the Second Directive. According to Article 5(3)(a) of that Directive, ‘*the use for the needs of his undertaking, by a taxable person, of goods which he applies to his own private use or transfers free of charge*’ shall be ‘*treated as a supply against payment*’ and, therefore, is taxable.⁴³ Moreover, Annex A(6) with regard to Article 5(3)(a) supplemented that Member States were permitted, as an alternative to taxing such supplies, to disregard the exercise of the right of deduction or, if a deduction had already taken place, to adjust it.⁴⁴ The Annex also established that gifts of small value and samples shall not be considered as taxable supplies.⁴⁵

Clearly, the authors of the Second Directive were concerned that goods acquired by a taxable person, when he is entitled to claim a deduction, should not be capable of being supplied free of charge without paying VAT on those goods.⁴⁶ This objective was reflected in the Commission’s proposal for the Sixth Directive.⁴⁷ Finally, the scope of the article, including the sentence concerning samples and gifts of small value, was transposed to the Sixth Directive.

Following the Commission’s proposal, the Sixth Directive, which replaced the Second Directive, came into force in 1977. Article 5(6) of the Sixth Directive replaced Article 5(3)(a) of the Second Directive, and provided with essentially the same wording as is found now in Article 16 of the VAT Directive. The current provision has undergone just some slight differences and provides with a better expression of the purpose of this provision. The current Article 16 of the VAT Directive reads as follows:

⁴³ Council Directive 1967/228/EC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes - Structure and procedures for application of the common system of value added tax OJ 71, 14.4.1967, Article 5(3).

⁴⁴ Ibid, Annex A(6), regarding Article 5(3)(a).

⁴⁵ Ibid.

⁴⁶ Opinion of AG Fennelly in *Kuwait Petroleum*, C-48/97, EU:C:1998:342, para 26.

⁴⁷ Proposal for a Sixth Council Directive on the harmonization of legislation of Member States concerning turnover taxes — Common system of value added tax: uniform basis of assessment, OJ Volume 16 No C 80 5.10.1973.

‘The application by a taxable person of goods forming part of his business assets for his private use or for that of his staff, or their disposal free of charge or, more generally, their application for purposes other than those of his business, shall be treated as a supply of goods for consideration, where the VAT on those goods or the component parts thereof was wholly or partly deductible.

However, the application of goods for business use as samples or as gifts of small value shall not be treated as a supply of goods for consideration.’⁴⁸

The wording and context of Article 16 have thus not changed much since the Second Directive. The literal wording of the article requires that the VAT on the goods in question, or on their component parts, would be wholly or partly deductible. Consequently, if the VAT on those goods is not deductible, taxation would result in double taxation and this would not be in compliance with the principle of fiscal neutrality. It is not entirely clear whether the wording of the current provision allows Member States to disregard deductibility, as was the case under the Second Directive.⁴⁹ However, the literal interpretation of Article 16 seems to exclude this possibility.

It is clear from the wording that this provision is applicable only when no consideration is paid. Following the AG Ruiz-Jarabo Colomer in *Hotel Scandic*⁵⁰, the fact that the price paid for an economic transaction is higher or lower than the cost price is irrelevant to the question whether a transaction is to be regarded as a 'transaction effected for consideration'.⁵¹ The latter concept requires merely a direct link between the supply of goods or the provision of services and the consideration actually received by the taxable person.⁵² The ECJ seemed to permit Member States to disregard symbolic payments only when authorized to do so and not (or no longer)

⁴⁸ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347, 11.12.2006, Article 16.

⁴⁹ B.J.M. Terra and J. Kajus, *Commentary - A Guide to the Recast VAT Directive*, IBFD Publications BV, Amsterdam, 2014, p. 1067.

⁵⁰ Judgment in *Hotel Scandic*, C-412/03, EU:C:2005:47.

⁵¹ Opinion of AG Ruiz-Jarabo Colomer in *Hotel Scandic*, C-412/03, EU:C:2004:746, para 35.

⁵² Judgment in *Hotel Scandic*, C-412/03, EU:C:2005:47, para 22, referring to Judgment in *Apple and Pear Development Council*, C-102/86, EU:C:1988:120, para 12.

based on the approach that no economic activity has taken place.⁵³ However, in *Weald Leasing*, the ECJ referred explicitly to ‘unusually low’ payments as being contrary to the VAT Directive.⁵⁴ Lastly, it seems that just transactions against artificially low payments, which fall outside the scope of VAT⁵⁵, are considered as non-economic and Member States can apply an objective value in order to avoid tax evasion or avoidance.⁵⁶

The wording of the article thus provides that, in order for a supply to be considered as a taxable self-supply under Article 16 of the VAT Directive, several requirements need to be met. Firstly, a person applying, transferring or disposing of the goods should be a taxable person. Secondly, the supplied goods need also to be a part of the business assets. Thirdly, VAT on the goods in question should have been wholly or partly deductible. According to some scholars, the supply should be taxed and not exempt,⁵⁷ however the judgment in *Seeling* proved differently.⁵⁸

3.3. Application of the provision by the ECJ

In order to apply this provision, several cumulative conditions need thus to be satisfied. These conditions have been discussed by the ECJ in its case law and the most relevant cases to this thesis shall be presented below.

The first case which shall be discussed is *De Jong*.⁵⁹ This case dealt with the mixed use of goods by a taxable person and concerned the second condition for the application of Article 16, namely that the supplied goods need to be a part of the business assets.

⁵³ B.J.M. Terra and J. Kajus, *Guide to the European VAT Directives (Introduction to European VAT)*, IBFD Publications BV, Amsterdam, 2015, p. 439-440.

⁵⁴ Judgment in *Weald Leasing*, C-103/09, EU:C:2010:804, para 39.

⁵⁵ Judgment in *Commission v France*, Case 50/87, EU:C:1988:429, para 24.

⁵⁶ B.J.M. Terra and J. Kajus, *Guide to the European VAT Directives (Introduction to European VAT)*, IBFD Publications BV, Amsterdam, 2015, p. 439.

⁵⁷ *Ibid*, p. 394.

⁵⁸ Judgment in *Seeling*, C-269/00, EU:C:2003:254, para 56.

⁵⁹ Judgment in *De Jong*, C-20/91, EU:C:1992:192.

Mr. de Jong was a building contractor who purchased a plot of land VAT free. He built two houses on the land, one of which he sold and another which he kept for his private purposes. When he put one of these dwellings to private use, Mr. de Jong reported on his VAT return as tax payable (output tax), an amount equal to the tax deducted (input tax) in respect of the goods and services used for the construction of the dwelling intended for private purposes. According to the Tax authorities there was a single supply consisting of the land and buildings and the basis of the assessment has to include not just the value of the house, but also the value of the land on which the dwelling was built. Consequently, the Tax authorities charged output tax on the value of the land.⁶⁰

In this case, the ECJ faced the situation when both private and business assets of a taxable person were involved. The Court started analyzing this case with explaining the main goal of Article 16. The purpose of the article is to ensure equality between a taxable person who acquires goods forming part of his business and uses them for private purposes and a non-taxable person who acquires goods of the same type. In order to achieve neutrality in the VAT system, this provision intends to prevent a taxable person who had a right to deduct VAT on his business goods from escaping the payment of VAT when he transfers those goods from his business to his private purposes.⁶¹ As became clear, the article seeks to prevent a taxable person from enjoying advantages to which he is not entitled in comparison with an ordinary customer.

This goal is achieved by the principle of fiscal neutrality as it is the core objective of Article 16 which draws a line on which self-supply of goods provision should be assessed in order to avoid any risky behavior of a taxable person. In pursuit of this goal, the provision must be applicable only if all the conditions are met. When at least one condition is not met, the application of the article is invalid.

In the case at issue, Article 16 could not be applicable, since not all the conditions were satisfied. The second condition, stating that the supplied goods need to be part of business assets, was not fulfilled. As appeared from the facts, Mr. de Jong purchased the land for his private purposes.

⁶⁰ Judgment in *De Jong*, C-20/91, EU:C:1992:192, paras 3-6.

⁶¹ *Ibid*, para 15.

This shows that even though Mr. De Jong built a business dwelling on his private land, the purpose of the purchase of the land did not change and did not become business.

According to Article 74 of the VAT Directive, the taxable amount for self-supply of goods is the purchase price of the goods or of similar goods or, in the absence of a purchase price, the cost price, determined at the time of supply.⁶² In the case at question, the Tax authorities required the value of the land to be included in the taxable amount. The aim of the Tax authorities could in a way be understandable. As the common system of VAT intends to prevent the risk of fraudulent behavior of a taxable person, as well as to simplify the system for charging VAT, the easiest way to calculate VAT in the situation at issue would be to include the value of land and consider the taxable supply to consist of a single supply, taking together the land and two buildings.

However, the ECJ did not agree with the opinion of the Tax authorities and observed that the taxation of the land, which was acquired specifically for private purposes, would not be in conformity with the objective of equal treatment.⁶³ The Court agreed with the opinion of AG Jacobs⁶⁴ and held that, where a taxable person acquired land solely for private use but built a dwelling on that land in the pursuit of his business, only the dwelling is to be regarded as a business asset.⁶⁵ Otherwise, if the value of the land would be included in the taxable amount, the taxable person would face double taxation. Moreover, later in *Gemeente Leusden* and *Holin Groep*, the Court added that a taxable amount must be limited to the expenses in respect of which VAT has been deducted,⁶⁶ what in this situation is not a case, since Mr. De Jong could not deduct VAT on acquired private goods.

The decision in *De Jong* was very unusual, as the ECJ arguably provided with ‘tax advice’. Looking from the perspective of fraud, this tax advice might be used by a taxable person for the purpose of tax evasion or avoidance. If a taxable person allocates goods to his private property, he can sell those goods as a private person and therefore, no VAT on the goods is payable. This

⁶² Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Article 74.

⁶³ Judgment in *De Jong*, C-20/91, EU:C:1992:192, para 18.

⁶⁴ Opinion of AG Jacobs in *De Jong*, C-20/91, EU:C:1992:103.

⁶⁵ Judgment in *De Jong*, C-20/91, EU:C:1992:192, para 17.

⁶⁶ Judgment in Joined cases *Gemeente Leusden*, C-487/01, and *Holin Groep*, C-7/02, EU:C:2004:263, para 93.

scenario would of course raise questions on the compliance with the principle of fiscal neutrality. And, more generally speaking, it is peculiar that the Court provided taxable persons with a hint on how to escape from paying VAT by allocating goods to private use before selling them.

De Jong dealt with the second condition for the application of the article. The next case which shall be discussed, *Slaby and Others*, dealt with the first condition, that the person applying, transferring or disposing of the goods should be a taxable person. Moreover, *Slaby and Others* also slightly touched upon the third condition, regarding the deduction of VAT on acquired goods or the component parts. The latter condition will be discussed more in detail in the next chapter in *Fischer and Brandenstein*⁶⁷, concerning the allocation of goods to private use.

Mr. Słaby and Mr. and Mrs. Kuć carried out agricultural activities on lands which were purchased VAT-free. Following changes to urban management plans, lands were designated for developments. Accordingly, Mr. Słaby and Mr. and Mrs. Kuć began to sell certain parts of their lands to natural persons on an occasional and non-organized basis. The Tax authorities considered those sales as supplies under the VAT Directive and, therefore, subject to VAT.

The main problem in this scenario was whether a flat rate farmer can be considered as a taxable person when he starts selling plots of land, which were reclassified from being used for his agricultural activity to development. Moreover, the Court assessed whether the activities in which the natural persons at question were involved could be considered as economic activities, and thus whether VAT should be paid on those transactions.⁶⁸

In this case, following the opinion of the AG Mazák⁶⁹, the ECJ concluded that a natural person who carries out an agricultural activity on land that was reclassified as land designated for development must not be regarded as a taxable person for VAT purposes when he begins to sell that land, if those sales fall within the scope of the management of the private property of that person.⁷⁰ Although the Court did not explain in its judgment what should be considered as the

⁶⁷ Judgment in Joined cases *Fischer*, C-322/99, and *Brandenstein*, C-323/99, EU:C:2001:280.

⁶⁸ Judgment in *Slaby and Others*, C-180/10, EU:C:2011:589, para 12-26.

⁶⁹ Opinion of AG Mazák in *Slaby and Others*, C-180/10, EU:C:2011:240.

⁷⁰ Judgment in *Slaby and Others*, C-180/10, EU:C:2011:589, para 50.

management of private property, it pointed out that all the relevant circumstances should be taken into consideration. The ECJ did observe that, for that purpose, neither the fact that the party concerned divided the land into plots in order to get a higher overall price from that land, nor the period of time over which those transactions took place, nor the level of income derived from them, are decisive facts.⁷¹ However, the Court added that, if that person takes active steps (such as marketing property by mobilizing resources or making development possible), for the purpose of concluding those sales, that person must be regarded as carrying out an ‘economic activity’ within the meaning of Article 9(1) of the VAT Directive and must, therefore, be regarded as a taxable person for VAT purposes.⁷²

The Court also ruled that the fact that a person is a ‘flat-rate farmer’ is irrelevant in this respect. As regards the whole or partial deduction of VAT on acquired goods, or component parts thereof, this condition was held not to be met, as the applicants acquired the land VAT-free.⁷³ If the conclusion would be different, the taxation on business goods on which tax was not deductible would lead to double taxation, contrary to the principle of fiscal neutrality.⁷⁴ The purchase of land in the case at question could not, therefore, have given rise to any deduction of VAT. Consequently, Article 16 was not applicable in the cases in the main proceedings.⁷⁵

Slaby and Others is an important case, as the ECJ laid down very general criteria for distinguishing an activity of a taxable person from ‘the mere exercise of ownership rights’ by a property owner.⁷⁶ These criteria, especially the one on conducting active steps for concluding specific sales, should be applied carefully when faced with transactions of business assets, certainly in situations of reclassification (of the purpose) of a property. Based on these criteria, Tax authorities in Member States should decide whether a natural person who sells goods can be considered as a taxable person. From the author’s point of view, the guidelines given by the Court on what to consider as an economic activity, as well as when a natural person becomes a taxable person, are too general in order to be functional in practical cases. The decision whether

⁷¹ Judgment in *Slaby and Others*, C-180/10, EU:C:2011:589, para 38.

⁷² *Ibid*, para 51.

⁷³ *Ibid*, para 47.

⁷⁴ Judgment in *Kühne*, C-50/88, EU:C:1989:262, para 10.

⁷⁵ Judgment in *Slaby and Others*, C-180/10, EU:C:2011:589, para 47.

⁷⁶ *Ibid*, para 45, referring to Judgment in *EDM*, C-77/01, EU:C:2004:243, para 58, Judgment in *BBL*, Case C-8/03, EU:C:2004:650, para 39.

a natural person can be considered as taxable merely on the basis of an assessment whether he was taking ‘active steps’ to conclude sales, might be very vague to apply in practice. The ambiguity of ‘active steps’ does not fit the aim of achieving the highest possible simplicity in the common system of VAT and might leave a room for tax evasion or avoidance.

Before moving on to another issue, some words need to be said about the position of flat-rate farmers within the VAT Directive. The VAT Directive suggests a special regime applicable to farmers, meaning that they do not have to account for VAT on the value of their supplies of agricultural goods or services, and they are not entitled to deduct any input VAT.⁷⁷ Following Swinkels, since farmers cannot deduct input tax, they are supposed to reduce that amount of input VAT. Moreover, the customers of farmers, as a compensation for the farmer’s non-deductible input tax, are entitled to a flat-rate input tax deduction. This compensation mechanism is very special in the VAT system, as it is not clear whether the flat-rate farmer’s input VAT, in the end, is non-deductible.⁷⁸

As already all the conditions were introduced (the third condition on the deduction of VAT will be discussed more in depth under the next chapter in *Fischer and Brandenstein*), the next case, *BCR Leasing*,⁷⁹ will deal with the general interpretation of Article 16 of the VAT Directive in terms of the VAT treatment on non-recovered goods.

BCR Leasing was a leasing company which bought cars from various suppliers, fully deducted VAT and leased them to natural or legal persons, remaining the owner of those goods. As regards late or non-payments, BCR Leasing terminated some contracts with defaulting lessees. After termination, leased cars were not returned. Subsequently, BCR Leasing stopped issuing any invoices related to those contracts and collecting VAT. According to the Tax authorities, in this situation of missing goods, the taxable transactions must be classified as self-supplies under Article 16. The question brought before the Court was which taxable transaction is considered to

⁷⁷ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Chapter 2.

⁷⁸ J.P. Swinkels, ‘Scope of the Self-Supply Rule under EU VAT’, *International VAT Monitor*, May/June 2008, IBFD, p. 179-180.

⁷⁹ Judgment in *BCR Leasing*, C-438/13, EU:C:2014:2093.

have taken place if goods were not returned to the lessor after the termination of a leasing agreement.⁸⁰

Not surprisingly, the ECJ did not agree with the opinion of the Tax authorities and delivered a very logical decision. According to the Court, the impossibility to get back the goods from the former lessees, despite the recovery procedures undertaken, in the case where no consideration is received by the lessor following the termination of the lease agreements, may not lead to the treatment as a supply of goods for consideration under Article 16 of the VAT Directive.⁸¹ Firstly, the goods were not in the possession of the taxable person or of his staff. Secondly, there was no disposal free of charge of those goods by the lessor in favor of the lessee. Thirdly, the goods could be considered as being applied just for business purposes, since their business consisted of renting out cars, and therefore, it constituted an economic activity of the lessor.⁸²

The decision in *BCR Leasing* was long awaited for leasing companies which had paid VAT for non-recovered goods as a result of defaulting lessee. After this decision, all companies that had accounted for VAT for non-recovered inventory in this way might be eligible to get their VAT refunded. However, the author believes that the right to get a paid VAT back relying on *BCR Leasing* might cause significant problems to the authorities of each country, if a number of taxable persons requests for VAT refund at the same time. Moreover, this ruling might encourage taxable persons to abuse the refund system and make false registrations of missing goods.

The cumulative conditions as set out in the first sentence of Article 16 have thus provided for quite a variety of cases before the ECJ. The following part of the thesis shall focus more specifically on the exceptions to Article 16 of the VAT Directive.

⁸⁰ Judgment in *BCR Leasing*, C-438/13, EU:C:2014:2093, paras 13-15.

⁸¹ *Ibid*, para 33.

⁸² *Ibid*, para 26.

3.4. Exceptions to the provision

Generally speaking, the first sentence of Article 16 of the VAT Directive focuses on acquired goods used for private purposes by a taxable person or other application free of charge for non-business purposes. In contrast, the second sentence of the provision establishes that the application of business goods as samples or as gifts of small value shall not be treated as a supply of goods for consideration and shall thus not be taxable. Even though the second sentence is not related to private use of goods, it is important to discuss issues related to the exemptions of the provision in the light of the principle of fiscal neutrality. In the following subchapter, the treatment of samples and gifts is discussed.

3.4.1. The treatment of samples of small value for VAT purposes

The case where the ECJ comprehensively discussed the treatment of samples and the notion of ‘small value’ within the VAT Directive was *EMI*.⁸³ EMI was a company engaged in music publishing and in the production and sale of recorded music. In order to promote newly released music, EMI distributed free copies of music recordings to various persons who might influence consumer behavior, and ‘pluggers’, who distributed CDs to their own contacts. EMI accounted for VAT on those recordings and later asked for reimbursement, as it claimed that national law was not compatible with Article 5(6) of the Sixth Directive (current Article 16). The questions raised before the ECJ sought to find out what the essential characteristics of a ‘sample’ are, and whether Member States are allowed to limit the interpretation of ‘sample’ and ‘gifts of small value’.⁸⁴

In its judgment, the ECJ, following the opinion of AG Jääskinen⁸⁵, clarified the definition of a sample as being a specimen of a product that is intended to promote the sale of that product.⁸⁶ The Court pointed out that sometimes it may be necessary for a number of samples to be

⁸³ Judgment in *EMI*, C-581/08, EU:C:2010:559.

⁸⁴ *Ibid*, paras 8-14.

⁸⁵ Opinion of AG Jääskinen in *EMI*, C-581/08, EU:C:2010:194, para 56.

⁸⁶ Judgment in *EMI*, C-581/08, EU:C:2010:559, para 40.

distributed to the same recipient, as it was in *EMI*.⁸⁷ Moreover, the ECJ observed that, to prevent the risk of samples leaking into the market, Member States may require taxpayers distributing samples to take certain precautionary steps, such as mandatory labeling which indicates that the product is a sample.⁸⁸ The Court further concluded that Member States are allowed in their national law to set a ceiling for the value of small value gifts.⁸⁹ It also added that national legislation must not prevent multiple gifts being given to different individuals with the same employer.⁹⁰

The judgment in this case finally clarified what should be considered as a 'sample'. This clarification prevents taxable persons from abusing the system of VAT by avoiding or evading tax when supplied goods are illegally named as samples. Moreover, *EMI* provided Member States with a certain margin of discretion in setting up a ceiling for the meaning of gifts of small value. Even though in 1989 the Commission set up guidelines for the maximum unit value for some Member States, some countries such as Spain, Italy and Luxembourg have no specific monetary limitation for defining gifts of small value. Other countries, such as the United Kingdom and France, find it appropriate to fix specific monetary amounts in the interest of legal certainty.⁹¹

As appears, setting a ceiling for a gift of small value is not as easy as it might look, since it might lead to a leeway for taxable persons to abuse the system of VAT. For instance, by not paying VAT on those goods which should not be considered samples, and seeking to escape the meaning of gifts of small value. Moreover, the lack of guidelines given by the Commission or by the ECJ on how to calculate that ceiling without disregarding the principle of fiscal neutrality does not make the situation easier. AG Jääskinen pointed out that, while fixing the ceiling for small value gifts, Member States need to take into account the general price level, income level and other economic circumstances of that Member State.⁹²

⁸⁷ Judgment in *EMI*, C-581/08, EU:C:2010:559, para 34.

⁸⁸ *Ibid*, para 38.

⁸⁹ *Ibid*, para 44.

⁹⁰ *Ibid*, para 50.

⁹¹ B.J.M. Terra and J. Kajus, *Commentary - A Guide to the Recast VAT Directive*, IBFD Publications BV, Amsterdam, 2014, p. 1067, referring to the answer of the Commission on 18 December 1989 to the question, raised by the Parliament in 1999, O.J. 1999, C039/24.

⁹² Opinion of AG Jääskinen in *EMI*, C-581/08, EU:C:2010:194, para 109.

Although the implementation of a specific amount determining a small value into the VAT Directive would set a harmonized standard for all Member States, regardless of their currency differences, it would not be in line with the principle of fiscal neutrality. The basis for assessment of this amount would likely be very different in each MS (for example in Sweden and in Bulgaria). From the author's point of view, the fairest way to apply the notion of 'gifts of small value' neutrally, is for the legislature to implement a certain formula, which would help Member States to calculate the 'small value' in the specific Member State based on living expenses, average salary etc. Finally, if no harmonized method of the calculation of gifts of small value will be adopted, Member States might be incentivized to have a very low or high national limit of small value. This would either deprive a taxable person from applying the exemption of self-supplies⁹³ or encourage a taxable person to engage in tax avoidance or evasion, or at least very serious tax planning activities.

3.4.2. The treatment of gifts of small value for the VAT purposes

The treatment of gifts of small value is a highly discussed subject, as the Court was not consistent concerning this matter. The ECJ follows the old judgment in *Kuwait Petroleum*⁹⁴ in subsequent case law, which some scholars consider highly questionable. Arguably, the approach in *Kuwait Petroleum* disregards the principle of fiscal neutrality from the perspective of the final consumer. This part of the thesis focuses on the interpretation of gifts of small value in the light of *Kuwait Petroleum*, comparing it to other cases decided by the ECJ before and after.

Kuwait was a company which owned gas stations. In order to promote sales, it offered vouchers to customers on the basis of the amount of fuel purchased at service stations. Vouchers were offered directly or through retailers. Customers of Kuwait were entitled to redeem those vouchers for goods from a catalogue. Kuwait deducted input VAT it paid on the redemption goods but did not account for output VAT. Consequently, the Tax authorities rejected the

⁹³ Opinion of AG Jääskinen in *EMI*, C-581/08, EU:C:2010:194, para 95.

⁹⁴ Judgment in *Kuwait Petroleum*, C- 48/97, EU:C:1999:203.

deduction since the redemption goods were disposed of to customers ‘free of charge’ and should be regarded as supplied for consideration. The question brought before the ECJ was thus whether VAT is due on free goods.⁹⁵

In its judgment, in accordance with the opinion of AG Fennely⁹⁶, the Court concluded that the sale of the fuel and the exchange of goods for vouchers could not be considered as a single transaction, what Kuwait tried to prove. The transactions at issue were two separate transactions with two separate considerations. Subsequently, it observed that an exchange of goods for vouchers is a disposal free of charge and the application of those goods is a supply for zero consideration, and should therefore be taxable.⁹⁷ The Court motivated this standpoint very shortly. First, the redemption goods were described as gifts under a promotion scheme. Second, the retail price remained the same, regardless of whether the customer accepted the vouchers or not.⁹⁸ Finally, the ECJ concluded that the application of goods which are disposed of for vouchers, under a sales promotion scheme and where the goods are not of small value, must be treated as a supply for consideration under Article 5(6) of the Sixth Directive.⁹⁹

The judgment in *Kuwait Petroleum* was very controversial. Following Watson and Garcia, the previous decision in *Elida Gibbs* was the correct way to solve the case, but this approach was not taken by the Court.¹⁰⁰ Although both cases concerned the same issue, namely whether free gifts should be taxed, the decisions in these cases were opposite. In *Elida Gibbs*, coupons, which were distributed free of charge, but over which no VAT was charged, were considered as free gifts.¹⁰¹ On the other hand, in *Kuwait Petroleum*, free gifts were subject to VAT and the principle of fiscal neutrality, according to Watson and Garcia, was completely ignored.¹⁰²

⁹⁵ Judgment in *Kuwait Petroleum*, C- 48/97, EU:C:1999:203, paras 7-13.

⁹⁶ Opinion of AG Fennely in *Kuwait Petroleum*, C-48/97, EU:C:1998:342.

⁹⁷ Judgment in *Kuwait Petroleum*, C- 48/97, EU:C:1999:203, paras 28-29.

⁹⁸ *Ibid*, paras 30-31.

⁹⁹ *Ibid*, para 32.

¹⁰⁰ J. Watson and K. Garcia, ‘EU VAT and the Rule of Economics’, *International VAT Monitor*, 2009(3), p. 197.

¹⁰¹ Judgment in *Elida Gibbs*, C-317/94, EU:C:1996:400, para 35.

¹⁰² J. Watson and K. Garcia, ‘EU VAT and the Rule of Economics’, *International VAT Monitor*, 2009(3), p. 197, and J. Watson and K. Garcia, ‘Babylonian Confusion Following the ECJ’s Decision on Loyalty Rewards’, *International VAT Monitor*, 2011(1), p. 15.

As was stated in the Introduction, the principle of fiscal neutrality should be assessed so as to benefit the taxable person, or at least so as to facilitate maximally the business undertaken by a taxable person. The approach taken in *Kuwait Petroleum* satisfies the principle of fiscal neutrality, which stipulates that a taxable person cannot bear the final burden of VAT. If an ‘*Elida Gibbs*-approach’ would have been taken in *Kuwait Petroleum*, it would lead to Kuwait paying VAT on free goods (since the consumer did not pay for them) without any right to deduct input VAT.

In respect of *Commission v. Germany*¹⁰³, which was the first case after *Kuwait Petroleum* brought before the ECJ concerning the same issue, the Court differentiated the free gifts and money-off coupon schemes. Thereby, it followed AG Jacobs, who stated that ‘*the two types of scheme fall under different provisions, which explains the difference in treatment. As the Commission pointed out at the hearing, one scheme involves supplying more goods at the same price and the other involves supplying the same goods at a lower price*’.¹⁰⁴ The Court accordingly concluded that ‘*although the two types of promotional scheme, namely the issue of money-off coupons and the offer of advertising gifts, come under two distinct sets of rules, that difference in tax treatment is inherent in the structure of the Sixth Directive and cannot cause distortion of competition...*’¹⁰⁵

The Court has not changed its approach since *Kuwait Petroleum*, meaning that the decision remains legally binding. It also shows that the ECJ itself does not question the effect the outcome of the case arguably has on the principle of fiscal neutrality, following Watson and Garcia.¹⁰⁶ This approach of the Court is understandable when looking at the principle of fiscal neutrality from the perspective of the taxable person, contrary to the consumer perspective that Watson and Garcia use. As stated, if the free goods in *Kuwait Petroleum* were to be exempt of taxation, the taxable person would be held to bear the (input) costs without a possibility to deduct.

¹⁰³ Judgment in *Commission v. Germany*, C-427/98, EU:C:2002:581.

¹⁰⁴ Opinion of AG Jacobs in *Commission v. Germany*, C-427/98, EU:C:2001:457, para 106.

¹⁰⁵ Judgment in *Commission v. Germany*, C-427/98, EU:C:2002:581, para 77.

¹⁰⁶ J. Watson and K. Garcia, ‘EU VAT and the Rule of Economics’, *International VAT Monitor*, 2009(3), p. 197, and J. Watson and K. Garcia, ‘Babylonian Confusion Following the ECJ’s Decision on Loyalty Rewards’, *International VAT Monitor*, 2011(1), p. 15.

It is true that principles on which the VAT system is based should prevail over the legal provisions by which those principles have been implemented into Community law.¹⁰⁷ In situations where the detailed provisions of the Directives do not follow the principles of the First Directive, they should be corrected by the ECJ.¹⁰⁸ Moreover, the main principles of the common VAT system, such as the principle of fiscal neutrality, should not be assessed only in respect of a consumer. Since the whole VAT system is structured in a way to entirely relieve a taxable person from paying VAT, the principle of fiscal neutrality should be assessed more from the perspective of a taxable person.

3.5. Final remarks

The application of Article 16 of the VAT Directive has shown to be very complicated, as the provision concerns taxation on business goods used for private purposes. The main goal of the article is to hinder a taxable person from achieving advantages, to which he is not entitled in comparison with an ordinary consumer. Although there are cumulative conditions which need to be met for the application of the article, a leeway for a fraudulent behavior of a taxable person still exists.

Bearing these remaining issues of the application of the provision, the following chapter analyzes the allocation of assets and private use of goods, followed by the ECJ's developments.

¹⁰⁷ J. Watson and K. Garcia, 'EU VAT and the Rule of Economics', *International VAT Monitor*, 2009(3), p. 190.

¹⁰⁸ *Ibid*, p. 191.

4. PRIVATE USE OF GOODS AND ALLOCATION OF ASSETS

4.1. Introductory remarks

The private use and the application of Article 16 of the VAT Directive proved to be complicated when it turns to the compulsory conditions for the application of the article and exemptions from the general rule. Another difficult aspect of the application of the article is related to mixed use of goods and allocation of assets. The ECJ has, for the purposes of VAT, developed in its case law the doctrine of ‘Asset labelling’ which aims to simplify the procedure for a taxable person to deduct input VAT and account for output VAT on his capital goods.

Under this doctrine, a taxable person who purchases a capital item, such as residential property or passenger cars, and wants to use it for mixed purposes (both for business and private purposes), has three options at the time of the purchase. Firstly, he is entitled to allocate those goods wholly to the assets of his business. Secondly, a taxable person can integrate capital goods partly into his private and partly into his business assets. Thirdly, a taxable person can allocate goods entirely to his private assets.¹⁰⁹

The assessment of these types of allocation of capital goods, following the developments of the doctrine by the ECJ, forms the basis of this chapter. Thereafter, the Commission’s proposal and the current Article 168a of the VAT Directive, eliminating the doctrine, are discussed.

4.2. Options of allocation

As introduced above, there are three different types of allocation of capital goods. The specific choice of allocation is important not only for determining the deductible VAT, but also for ascertaining whether the subsequent supply of those goods shall be subject to VAT. Below, the

¹⁰⁹ J.P. Swinkels, ‘Limitations and Justification of the European Court of Justice’s Doctrine of Asset Labelling’, *International VAT Monitor*, July/August 2009, p. 285.

types of allocation are introduced, following the developments of the doctrine in the ECJ's case law.

4.2.1. Allocation wholly to business assets

The first option which a taxable person is entitled to, according to the doctrine of 'Asset labelling', is allocation of capital goods wholly to his business assets. When a taxable person allocates capital goods to his business assets, those goods become business goods and are treated under Article 26 of the VAT Directive (which regulates the self-supply of services).¹¹⁰ With this type of allocation of goods, a taxable person is entitled to a full and immediate input VAT deduction. However, the right to immediately and fully deduct VAT paid at the time of the purchase leads to the corresponding obligation to account for VAT on the subsequent supply of goods, as well as pay VAT on private use of the business assets.¹¹¹

A case which had a big impact on allocation of capital items wholly to business assets, was *Lennartz*.¹¹² In this case, the ECJ for the first time examined the right of a taxable person to deduct input VAT in respect of goods used for mixed purposes and allocated entirely to business assets. Later in *P. Charles and T. S. Charles-Tijmens* it was observed that national legislation which forbids this right is not compatible with Community law.¹¹³ The judgment in *Lennartz* was of the biggest importance, since even in the case of a very small percentage of business use (in *Lennartz* the business use consisted just of 8%), a taxable person is still allowed to allocate goods to his business use and to deduct VAT fully on the purchase of goods even on that part which had been used for private purposes before.¹¹⁴ Moreover, in *Lennartz* the ECJ concluded that there is no direct link between actual use of capital goods and their label and, therefore, the right to deduct input tax.¹¹⁵ The latter issue was changed by the adoption of Article 168a of the

¹¹⁰ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Article 26.

¹¹¹ Judgment in *P. Charles and T. S. Charles-Tijmens*, C-434/03, EU:C:2005:463, para 30, Judgment in *Wollny*, C-72/05, EU:C:2006:573, para 24, Judgment in *Seeling*, C-269/00, EU:C:2003:254, para 40.

¹¹² Judgment in *Lennartz*, C-97/90, EU:C:1991:315.

¹¹³ Judgment in *P. Charles and T. S. Charles-Tijmens*, C-434/03, EU:C:2005:463, para 36.

¹¹⁴ Judgment in *Lennartz*, C-97/90, EU:C:1991:315, para 29.

¹¹⁵ *Ibid*, para 26.

VAT Directive, according to which the initial deduction is limited to the actual use of the goods for taxable transactions and is no longer based on its labelling.¹¹⁶

This allocation of capital goods wholly to business assets obviously provides for a simplification of the VAT system. With this choice of allocation, there is no risk that a taxable person evades or avoids tax, since he is entitled to deduct input VAT on his business goods in full. According to AG Jacobs, another advantage of allocation of capital items entirely to business goods is that *'account will be taken of any reduction in the proportion of private use in later years'*.¹¹⁷

One might argue that this type of allocation, especially when the percentage of business use is so low and it still entitles a full VAT deduction on acquired goods, might not be in line with the principle of fiscal neutrality, even though the private use is taxed. Moreover, a taxable person is deprived of adjustment of input VAT, when an asset prior belonged to private assets and later was transferred to business sphere.¹¹⁸ In accordance with Opreel, although a taxable person corrects the deduction of input VAT on the basis of a deemed taxable supplies, the doctrine creates cash flow advantages.¹¹⁹ Finally, a taxable person must in the end pay VAT only on goods and services which have been used for private purposes¹²⁰, since he is entitled to deduct input VAT paid on the taxable transactions.

Although the findings show that allocation of capital goods entirely to business assets might not be in conformity with the main principles of the VAT system, it is likely to be justified by the need to ensure simplification of the VAT system. This type of allocation of capital goods to business assets makes it easier to exercise the right to deduct input VAT and corresponding obligation to account for VAT on subsequent supplies. Besides, it precludes a taxable person from behaving fraudulently.

¹¹⁶ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Article 168a.

¹¹⁷ Opinion of AG Jacobs in *Armbrrecht*, C-291/92, EU:C:1993:359, para 49.

¹¹⁸ Judgment in *Lennartz*, C-97/90, EU:C:1991:315, paras 8-12.

¹¹⁹ J. Opreel, 'Termination of the European Court of Justice's Optimization Scheme', *International VAT Monitor*, July/August 2008, IBFD, p. 264.

¹²⁰ Judgment in *Seeling*, C-269/00, EU:C:2003:254, para 40.

4.2.2. Allocation partly to business, partly to private assets

It is clear that in some cases the *Lennartz* method may allow private use to be accounted more precisely. However, it does not do so in all circumstances, particularly in the form in which it is applied to immovable property by national laws in some Member States.¹²¹

Another alternative for a taxable person is to allocate capital goods partly to his business assets. In this case a taxable person is entitled to deduct input VAT paid just on business goods, excluding the goods which are allocated to private assets. In this situation a taxable person is obliged to account for VAT just on the part of the goods which is allocated to business assets. For the part of goods which a taxable person decides to keep in his private assets, the VAT Directive is not applicable, as the supply is out of the scope of the Directive. This situation is best described in *Armbrecht*¹²², which dealt with capital goods partly allocated to private and partly to business assets.

Mr. Armbrecht, a hotelier, owned a property, consisting of a guesthouse, a restaurant and a private dwelling. He sold the whole property inclusive VAT, but did not charge VAT on his private dwelling. In the VAT declaration Mr. Armbrecht treated the sale of the business parts as taxable and the private dwelling as tax-free, as it constituted his private assets. According to the Tax authorities, Mr. Armbrecht should have also accounted for VAT on the sale of the private dwelling, as under national legislation the whole property is considered as one inseparable unit.¹²³

In principle the ECJ was asked whether a taxable person can exclude the parts of an immovable property from his business assets, regardless the fact that the immovable property constitutes a single asset under the national law.¹²⁴ Both AGs Gerven¹²⁵ and Jacobs¹²⁶ concluded that a taxable person is entitled to allocate just part of his capital goods to his business assets and

¹²¹ Opinion of AG Jacobs in *Armbrecht*, C-291/92, EU:C:1993:359, para 48.

¹²² Judgment in *Armbrecht*, C-291/92, EU:C:1995:304.

¹²³ *Ibid*, paras 3-6.

¹²⁴ *Ibid*, para 7.

¹²⁵ Opinion of AG Van Gerven in *Armbrecht*, C-291/92, EU:C:1993:359, para 14.

¹²⁶ Opinion of AG Jacobs in *Armbrecht*, C-291/92, EU:C:1993:359, para 49.

exclude the part which is retained to private assets. Consequently, the taxable person, in this scenario, would be obliged to account for VAT just on those capital goods which form his business assets, excluding capital goods which are allocated specifically to private assets, like the private dwelling in the case at question.¹²⁷

The ECJ, following the opinions of the AGs, pointed out that the Sixth Directive does not preclude a taxable person to allocate a part of the capital goods to his private assets and therefore exclude them from the VAT system.¹²⁸ Moreover, the apportionment between the part allocated to private assets and a part integrated to business use ‘*must be based on the proportions of private and business use in the year of acquisition and not on a geographical division*’.¹²⁹ Only ‘*the apportionment based on the percentage of private use can achieve a rational result*’.¹³⁰ Moreover, this method of apportionment could also be applied to other categories of assets, such as motor cars, as it is based on the use of assets but not on the kind of the asset.¹³¹ Following AG Jacobs, a fixed geographical division of an immovable property partly to business and partly to private use would lead to double taxation.¹³² Accordingly, double taxation would be contrary to the principle of fiscal neutrality, as the taxable person would be in the less advantageous situation than an ordinary consumer or the taxable person who used such goods only for business purposes.

The Court concluded that where a taxable person sells property of which a part was reserved for his private use, with respect to the sale of that part he does not act as a taxable person within the VAT Directive.¹³³ This shows that national provisions, which stated that a taxable person when disposing of the entire property should account for VAT even on those parts which are labeled as private assets, were in violation of the principle of fiscal neutrality. Moreover, following AG Jacobs, this choice of allocation will not lead to tax avoidance. On the contrary, it guarantees that private use is accounted for in accordance with the principle that ‘*the tax burden should resemble*

¹²⁷ Opinion of AG Van Gerven in *Armbrecht*, C-291/92, EU:C:1993:359, para 19, and Opinion of AG Jacobs in *Armbrecht*, C-291/92, EU:C:1993:359, para 52.

¹²⁸ Judgment in *Armbrecht*, C-291/92, EU:C:1995:304, para 19.

¹²⁹ *Ibid.*, para 21, referring to Opinion of AG Jacobs in *Armbrecht*, C-291/92, EU:C:1993:359, para 50.

¹³⁰ Opinion of AG Jacobs in *Armbrecht*, C-291/92, EU:C:1993:359, para 50.

¹³¹ *Ibid.*

¹³² *Ibid.*

¹³³ Judgment in *Armbrecht*, C-291/92, EU:C:1995:304, para 17.

as closely as possible that which would have been borne if the goods had remained in the taxable person's private domain.'¹³⁴

The conclusion which emerges from the case is that the supply can only be subject to VAT if a taxable person did not retain the property, or part of it, in his private assets. Accordingly, if a taxable person allocates his capital goods or part of them to his private assets, the right to deduct input tax applies only to the part assigned to the business and the adjustment of that deduction is also limited to the same part.¹³⁵ In the case where inputs are used for both taxed and non-taxed purposes (private), 'a taxable person must attribute the costs of the inputs to both categories of transactions either by directly attributing the inputs to specific output transactions or by attributing them to their total economic activities by reference to turnover derived from the two categories of transactions.'¹³⁶ In the latter case, the method for calculation of that proportion is called 'pro-rata' and is established in Article 174 of the VAT Directive.¹³⁷

It is clear that pro-rata can be applied only in respect of economic activities of a taxable person. For the purpose of achieving complete neutrality within the common VAT system, both turnover from transactions falling outside the scope of VAT (made for private purposes) and incidental (exempt) financial transactions, are excluded from the calculation of pro-rata.¹³⁸ The VAT Directive does not entail a mechanism to establish a deductible proportion where the taxable person's output consists of both economic and non-economic activities. The latter situation was discussed in *Securenta*.¹³⁹

In *Securenta*, a taxpayer carried out three types of activities: non-economic activities, which do not fall within the scope of VAT Directive, economic activities, which fall within the scope of VAT Directive but are exempt and taxed economic activities.¹⁴⁰ The question in this case was

¹³⁴ Opinion of AG Jacobs in *Armbrecht*, C-291/92, EU:C:1993:359, para 49.

¹³⁵ Judgment in *Armbrecht*, C-291/92, EU:C:1995:304, para 32.

¹³⁶ M. Gabriël and H. van Kesteren, 'Calculation of the (Pre-) Pro Rata under EU VAT Law', *International VAT Monitor*, September/October, 2011, IBFD, p. 332.

¹³⁷ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Article 174.

¹³⁸ Judgment in *EDM*, C-77/01, EU:C:2004:243, para 55.

¹³⁹ Judgment in *Securenta*, C-437/07, EU:C:2008:166.

¹⁴⁰ *Ibid*, para 11.

how the right to deduct input VAT is to be determined when a taxpayer carries out both economic and non-economic activities.¹⁴¹

The ECJ pointed out that when input VAT relating to expenditure incurred by a taxpayer is connected with activities which do not fall within the scope of VAT, it cannot give rise to a right to deduct.¹⁴² Following *Henkow*, this answer of the Court established a requirement for deduction that the exclusive reason for incurring costs needs to be related to economic activities.¹⁴³ This is a change in relation to previous case law, according to which it was enough to establish a link with transactions entailing the right to deduct.¹⁴⁴ Furthermore, later in *VNLTO*¹⁴⁵, the Court, following findings in *Securenta*, added that ‘*where a taxable person simultaneously carries out economic activities, whether taxed or exempt, and non-economic activities outside the scope of the directive, deduction of the input VAT relating to expenditure is allowed only to the extent to which that expenditure may be attributed as an output to the economic activity of the taxable person.*’¹⁴⁶

Moreover, the ECJ pointed out that there are no rules in the EU VAT system, stating what methods or criteria should be used for the calculation of the deduction of VAT. It is up to Member States to choose methods or criteria that are in line with the principles of VAT system.¹⁴⁷ Although the Court states that the situation is unregulated in the common system of VAT, the VAT Directive contains provisions on private use, following the doctrine of ‘Asset labelling.’¹⁴⁸

Finally, although the allocation of goods partly to business and partly to private assets brings fairness for the calculation of VAT, and can be considered as being in accordance with fiscal neutrality, it does not serve the requirement of simplicity for the VAT Directive. To calculate

¹⁴¹ Judgment in *Securenta*, C-437/07, EU:C:2008:166, para 17.

¹⁴² *Ibid*, para 30.

¹⁴³ O. Henkow, ‘Neutrality of VAT for taxable persons: a new approach in European VAT?’, *EC Tax Review*, 2008-5, p. 237.

¹⁴⁴ *Ibid*.

¹⁴⁵ Judgment in *VNLTO*, C-515/07, EU:C:2009:88.

¹⁴⁶ *Ibid*, para 37.

¹⁴⁷ Judgment in *Securenta*, C-437/07, EU:C:2008:166, paras 33-36.

¹⁴⁸ O. Henkow, ‘Neutrality of VAT for taxable persons: a new approach in European VAT?’, *EC Tax Review*, 2008-5, p. 238-239.

pro-rata is very complicated as it requires the exact percentage of business use of goods to be determined. Moreover, regardless of the difficulties of calculation of deductible VAT, this type of allocation bears with it the highest risk of fraudulent behavior of a taxable person among the three types of allocation.¹⁴⁹

4.2.3. Allocation wholly to private assets

The last alternative which can be chosen by a taxable person is to allocate capital goods entirely to his private assets. This option does not entitle a taxable person to any deduction of VAT on the goods acquired and does not oblige to account for VAT on the subsequent supply. In this scenario, the position of the taxable person is exactly the same compared to a non-taxable person, who buys goods of the same type and is not allowed to deduct any input VAT. The case where a taxable person used goods for mixed purposes and allocated them wholly to private assets was *Bakcsi*.¹⁵⁰

Mr. Bakcsi was a self-employed haulage contractor and purchased a car from a private individual without being able to deduct input VAT. The car was used to the extent of 70% for business purposes. When Bakcsi sold the car, the Tax authorities stated that the sale was subject to VAT, as Bakcsi deducted input VAT paid on its repair and maintenance costs, indicating that he allocated the car to his business assets.¹⁵¹

In this case, the ECJ, following the decision in *Armbrecht*, firstly observed that the provisions established in the Sixth Directive do not preclude a taxable person from labelling his acquired goods wholly to his private assets.¹⁵² This means that a taxable person, who purchases capital goods in order to use them for mixed purposes, has a right to label them as his private goods and

¹⁴⁹ There exists a motive to come up with an incorrect pro-rata, but it is unlikely that a taxable person would choose this allocation explicitly and subsequently provide with a fake calculation.

¹⁵⁰ Judgment in *Bakcsi*, C-415/98, EU:C:2001:136.

¹⁵¹ *Ibid*, paras 9-12.

¹⁵² *Ibid*, para 26.

thus wholly exclude them from the system of VAT, regardless of the way they had been used before. Therefore, no VAT is due on those goods and no deductions are possible.¹⁵³

Moreover, following *Lennartz*, the Court pointed out that the use of capital goods and the allocation of those goods either to business or to private purposes should be taken into account just when a taxable person seeks the right to deduct input VAT on the acquired goods.¹⁵⁴ In such a situation, it is necessary to determine whether the goods have been acquired by the taxable person acting in respect of his economic activities.¹⁵⁵ Usually, the authorities are of the opinion that if a taxable person requests a right to deduct input VAT, this shows that a taxable person considers his capital goods being a part of his business assets and the taxable person is entitled to the deduction of input VAT, and therefore he must account for the output VAT. According to the ECJ in *Bakcsi*, the fact that a taxpayer deducts VAT on the costs of using a capital item does not necessarily mean that the item is wholly allocated to business use.¹⁵⁶ On the other hand, if no such request of the deduction of VAT arises by a taxable person, capital goods are deemed to be within his private assets and there is no need to assess the allocation of those goods.

However, where a taxable person withdraws a capital item from his business assets and allocates it to his private use, that withdrawal is treated as a self-supply under Article 16 of the VAT Directive. In order to apply this provision, the mentioned conditions need to be met, namely there should be a taxable person, supplied goods need to be a part of his business assets and VAT on those goods should have been wholly or partly deductible.¹⁵⁷

As regards the compliance with the conditions, the requirement which relates to the full or partial deduction of VAT on purchased goods, is not fulfilled if, as in *Bakcsi* or *Lennartz*, a taxable person who purchased the item from a non-taxable person was not allowed to deduct any input tax. If the taxable person has chosen to retain a capital item wholly within his private assets and

¹⁵³ Judgment in *Bakcsi*, C-415/98, EU:C:2001:136, para 27.

¹⁵⁴ *Ibid*, para 29.

¹⁵⁵ Judgment in *Lennartz*, C-97/90, EU:C:1991:315, paras 21, 35.

¹⁵⁶ Judgment in *Bakcsi*, C-415/98, EU:C:2001:136, para 33.

¹⁵⁷ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Article 16.

was therefore not entitled to deduct the input VAT paid on the acquisition, the use of capital goods cannot be subject to VAT.¹⁵⁸

Following *Terra* and *Kajus*, the decision in this case followed the principles already established in the previous judgments of *Armbrecht* and *Lennartz*. In the latter cases, the same as in *Bakcsi*, where no VAT deduction was possible at the moment of the acquisition of goods, a flexible regime was suggested under the Sixth Directive,¹⁵⁹ meaning that the taxable person could allocate goods partly or wholly to business or private assets and based on a specific type of allocation enjoy the advantages of the provisions of the VAT Directive.

Other cases, where facts were similar to *Bakcsi*, were *Fischer* and *Brandenstein*.¹⁶⁰ These joined cases also dealt with a transfer of business goods to private assets, on the acquisition of which VAT was not deductible. Mr. Fischer and Mr. Brandenstein were taxable persons who purchased cars from private persons with no right to deduct input VAT. After the purchases, some maintenance work on which VAT was deducted was used for both cars. Both taxable persons allocated the cars to private use.¹⁶¹

According to the Tax authorities, the allocation of assets to private use were considered deemed self-supplies.¹⁶² The questions brought before the ECJ were whether VAT is due when a taxable person allocates a capital good to private assets which was purchased with no right to deduct VAT and which, after its acquisition, had work done to it on which VAT was deducted.¹⁶³ Moreover, the national court in *Fischer* also asked whether Article 5(6) is to be interpreted as meaning that the tax must be paid on the goods and their component parts or only on the components subsequently incorporated in the goods.¹⁶⁴

¹⁵⁸ Judgment in *Bakcsi*, C-415/98, EU:C:2001:136, para 31.

¹⁵⁹ B.J.M. Terra and J. Kajus, *Guide to the European VAT Directives (Introduction to European VAT)*, IBFD Publications BV, Amsterdam, 2015, p. 443.

¹⁶⁰ Judgment in Joined cases *Fischer*, C-322/99, and *Brandenstein*, C-323/99, EU:C:2001:280.

¹⁶¹ Judgment in Joined cases *Fischer*, C-322/99, paras 14-16, and *Brandenstein*, C-323/99, EU:C:2001:280, paras 22-23.

¹⁶² Judgment in Joined cases *Fischer*, C-322/99, para 17, and *Brandenstein*, C-323/99, EU:C:2001:280, para 24.

¹⁶³ Judgment in Joined cases *Fischer*, C-322/99, and *Brandenstein*, C-323/99, EU:C:2001:280, paras 37-38.

¹⁶⁴ *Ibid*, para 37.

As was stated previously in *Bakcsi*, the purpose of the provision is to maintain equal treatment between a taxable person who withdraws goods from his business and an ordinary consumer who buys goods of the same type. In order to obtain equal treatment, namely the fiscal neutrality, the provision should be interpreted as there is no difference between the component parts already existing when the goods are acquired and the components incorporated after the acquisition.¹⁶⁵ In both scenarios, if a taxable person has deducted the VAT on the component parts of the goods, he must, when he allocates the goods for his private use, be prevented from enjoying advantages to which he is not entitled by comparison with an ordinary consumer.¹⁶⁶

According to AG Jacobs, it is necessary to assess whether the goods incorporated in the vehicle are not separable or independent. Where such goods are physically and economically distinctive, they must not be regarded as component parts of the vehicle.¹⁶⁷ On the contrary, these goods need to be considered as independent taxable supplies.

Furthermore, the Court concluded that if a taxable person acquires goods without a right to deduct input VAT, it would be in breach of the principle of fiscal neutrality, if the allocation of those goods to private assets would be subject to VAT, where post-acquisition supplies of goods do not increase their value and have been consumed when the allocation was affected.¹⁶⁸ The ECJ observed that in the situation at issue, VAT should be payable under Article 5(6) of the Sixth Directive (current Article 16 of the VAT Directive), if the work done after the acquisition of goods, resulted in the incorporation of component parts within the meaning of that provision.¹⁶⁹

Finally the Court pointed out that VAT is not due on goods allocated by a taxable person to his private assets where the taxable person has no right to deduct input VAT on acquired goods, even if expenditure, in respect of which input VAT was deductible, has subsequently been incurred in connection with those goods.¹⁷⁰ Moreover, where work on which input VAT was

¹⁶⁵ Judgment in *Bakcsi*, C-415/98, EU:C:2001:136, para 42.

¹⁶⁶ Judgment in Joined cases *Fischer*, C-322/99, and *Brandenstein*, C-323/99, EU:C:2001:280, para 57.

¹⁶⁷ Opinion of AG Jacobs in Joined cases *Fischer*, C-322/99, and *Brandenstein*, C-323/99, EU:C:2000:700, para 72.

¹⁶⁸ Judgment in Joined cases *Fischer*, C-322/99, and *Brandenstein*, C-323/99, EU:C:2001:280, para 67.

¹⁶⁹ *Ibid*, para 51.

¹⁷⁰ *Ibid*, para 53.

deductible has been carried out on the goods after they were acquired, and that work resulted in the incorporation of component parts in the goods, the VAT is payable under Article 5(6) of the Sixth Directive only on those component parts.¹⁷¹ Although the AG observed that VAT in this scenario should be payable on the goods and component parts taken together¹⁷², the author tends to agree with the opposite opinion of the Court. If a taxable person cannot deduct input VAT on the acquired goods at the moment of the purchase, it would run counter to the principle of fiscal neutrality for that allocation to be subject to VAT and thus a double taxation would occur.

The judgments in *Bakcsi* as well as in *Fischer* and *Brandenstein* once again clarified that the treatment of the VAT on acquired goods is based on the alternative chosen by a taxable person. If a taxable person chooses to retain the goods or part of them as private assets, he is deprived of the right of deduction of input tax relating to the acquisition of the goods or the part of them. Consequently, the main purpose of Article 16 of the VAT Directive, in particular, to ensure equal treatment between a taxable person who withdraws goods from his business and an ordinary consumer¹⁷³, is in compliance with the principle of fiscal neutrality, as none of the parties would be able to benefit from the VAT regime.

However, in accordance with Swinkels, the decisions in *Bakcsi*, *Fischer* and *Brandenstein* provided a taxable person with a tax advice. If a taxable person acquired capital goods from a non-taxable person, he may avoid taxation of the subsequent supply by first withdrawing items from business assets to private assets, and then supplying the items to the final consumer as a non-taxable person.¹⁷⁴

As appears the doctrine of ‘Assets labelling’ is highly criticized as being arguably not in line with the main principles of the common system of VAT and in some cases leaving a room for a fraudulent behavior of a taxable person. The Commission came up with a proposal¹⁷⁵ which intended to eliminate the doctrine of ‘Asset labelling’ and solve remaining issues related to the

¹⁷¹ Judgment in Joined cases *Fischer*, C-322/99, and *Brandenstein*, C-323/99, EU:C:2001:280, para 78.

¹⁷² Opinion of AG Jacobs in Joined cases *Fischer*, C-322/99, and *Brandenstein*, C-323/99, EU:C:2000:700, para 72.

¹⁷³ Judgment in *Bakcsi*, C-415/98, EU:C:2001:136, para 42.

¹⁷⁴ J.P. Swinkels, ‘Asset labelling for VAT purposes’, *International VAT Monitor*, January/February 2006, IBFD, p. 10.

¹⁷⁵ Proposal for a Council Directive amending VAT Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Brussels, 7.11.2007, COM(2007) 677 final, 2007/0238 (CNS).

application of the doctrine. In the following subchapter the latter proposal and a new article is discussed.

4.3. Commission's proposal and Article 168a of the VAT Directive

Before the 1st of January 2011, the rules for deduction of immovable property differed from the current legislation. Those rules were based on the ECJ's developed doctrine of 'Asset labelling'. The doctrine is considered as being very controversial as regards the right to deduct input VAT but also as regards a taxable person's liability to account for VAT on the disposal of capital goods purchased without incurring a separate charge of VAT.¹⁷⁶

Despite the efforts of the Court to convince Member States that the doctrine works perfectly¹⁷⁷, in 2007 the Commission proposed a new provision¹⁷⁸ to the VAT Directive which restricts the application of the doctrine of 'Asset labelling'. The new Article 168a of the VAT Directive was adopted on the 1st of January 2011.

According to Article 168a, in the case of immovable property forming part of the business assets of a taxable person and used both for purposes of the taxable person's business and for his private use (or for purposes other than those of his business), the initial deduction of input VAT is limited to the actual use of the property for taxable transactions and is no longer based on its labelling. Accordingly, the immediate deduction of input VAT on immovable property used for mixed purposes is no longer possible.

Moreover, the new provision established that the limited initial deduction must be adjusted in the following years of the adjustment period¹⁷⁹ in the same manner as changes in the use of capital

¹⁷⁶ J.P. Swinkels, 'Elimination of the Doctrine of Asset Labelling', *International VAT Monitor*, 2010 (Volume 21), No 3, Published 14 May 2010, IBFD, p. 195, referred to Judgment in *Bakcsi*, C-415/98, EU:C:2001:136, Judgment in Joined cases *Fischer*, C-322/99, and *Brandenstein*, C-323/99, EU:C:2001:280.

¹⁷⁷ Judgment in *Puffer*, C-460/07, EU:C:2009:254.

¹⁷⁸ Proposal for a Council Directive amending VAT Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Brussels, 7.11.2007, COM(2007) 677 final, 2007/0238 (CNS), p. 13, Article 168a.

¹⁷⁹ The 'adjustment period' is the period laid down by Article 187(1) of the VAT Directive during which the initial deduction of VAT on capital goods must be adjusted in accordance with the use of the goods for both taxed and

goods for taxable and exempt purposes give rise to adjustment of the initial input tax deduction.¹⁸⁰ Following Terra and Kajus, the amending Directive¹⁸¹ did not provide with any transitional measures. When the rules became effective in Member States (from the 1st of January 2011) *‘the VAT on immovable property to which the adjustment rules still apply, has to be readjusted based on the use at that moment giving rise to deduction and subsequently on a yearly basis reflecting the effective non-business use.’*¹⁸²

The insight of the newly adopted provision is similar to the findings of the ECJ in *Wollny*.¹⁸³ In this case the Court held that the VAT Directive *‘does not preclude the taxable amount for VAT in respect of the private use of part of a building treated by a taxable person as forming, in its entirety, part of the assets of his business from being fixed at a portion of the acquisition or construction costs of the building, established in accordance with the length of the period for adjustment of deductions concerning VAT.’*¹⁸⁴ Under Article 168a of the VAT Directive it is not a matter of the taxable amount for a self-supply but of repayable VAT on the occasion of non-business use.

According to Terra and Kajus, as regards amendments in the self-supply rules, the changes established in Article 168a of the VAT Directive are more than just technical. During the adjustment period, the self-supply rules are postponed and private use is equalized to the treatment of exemptions without the right of deduction. Changes in private use result in adjustments of the deducted input tax.¹⁸⁵ When the adjustment period no longer applies, the self-supply rules are restored. Such changes are certainly technical, but also very important.¹⁸⁶

exempt purposes. As regards movable capital goods, the adjustment period is 5 years and, as regards immovable capital goods, 5 to 20 years, including the year of purchase.

¹⁸⁰ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L 347, 11.12.2006, Articles 187, 188, 190 and 192.

¹⁸¹ Council Directive 2009/162/EU of 22 December 2009 amending various provisions of Directive 2006/112/EC on the common system of value added tax, L 10/14, 15.1.2010.

¹⁸² B.J.M. Terra and J. Kajus, *Commentary - A Guide to the Recast VAT Directive*, IBFD Publications BV, Amsterdam, 2014, p. 4120.

¹⁸³ Judgment in *Wollny*, C-72/05, EU:C:2006:573.

¹⁸⁴ *Ibid*, para 53.

¹⁸⁵ B.J.M. Terra and J. Kajus, *Commentary - A Guide to the Recast VAT Directive*, IBFD Publications BV, Amsterdam, 2014, p. 4120.

¹⁸⁶ *Ibid*.

According to the Commission, the new provision more closely reflects the main principles of the EU VAT system, by taking into account changes between business and non-business use of the immovable property acquired as capital goods.¹⁸⁷ However, the reality is different. In accordance with Henkow, Article 168a makes the principle of fiscal neutrality be dependent on the proper functioning of the new adjustment system. This does not guarantee neutrality, as a taxable person might not be relieved of the burden of VAT and because after the adjustment period an increase in business use of the asset will not be reflected in any increase in the right to deduct input VAT. Moreover, the increase in private use is likely to be taxed, since the private use provisions do apply after the expiry of the adjustment period.¹⁸⁸

Following Henkow, the new Article 168a leads to a stepping away from the principle of fiscal neutrality towards a more revenue secure system.¹⁸⁹ In order to justify the moving away from neutrality, the interpretation of the article should be limited to what is absolutely necessary in order to protect VAT revenue.¹⁹⁰

4.4. Final remarks

The objective of the doctrine of ‘Asset labelling’ was to bring the self-supply rules in VAT to perfection in light of the principle of fiscal neutrality and to simplify the right of a taxable person to deduct input VAT and the obligation to account for output VAT. As became clear, the doctrine of ‘Asset labelling’ has been very controversial.

One might argue that this allocation of assets is very likely to not be in perfect accordance with the principle of fiscal neutrality. The two ways of complete allocation, either to business or private assets, inherently do not reflect the actual use of mixed goods and the most fair type, partial allocation, is least used due to its complexity. Moreover, allowing full and immediate

¹⁸⁷ Proposal for a Council Directive amending VAT Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, Brussels, 7.11.2007, COM(2007) 677 final, 2007/0238 (CNS), p. 3.

¹⁸⁸ O. Henkow, ‘Neutrality of VAT for taxable persons: a new approach in European VAT?’, *EC Tax Review*, 2008-5, p. 236.

¹⁸⁹ *Ibid.*

¹⁹⁰ *Ibid.*

deduction to a taxable person and taxing his private use, might create some difficulties in practice. It is close to impossible to detect when a taxable person uses business assets privately, and accordingly when he needs to pay VAT on his privately used goods. In order to handle this situation, it might be easier to simply not allow the deduction, which is essentially what the new article aims to do.

However, although the Commission believes that the new Article 168a of the VAT Directive solves these problems, the provision has its own peculiarities, which might also not always be in line with the principle of fiscal neutrality either. Besides, the practical application of Article 168a has the same issue of complex pro-rata calculation as the partial allocation.

5. CONCLUSION

5.1. Summarizing view

The chapters above have shown that the current system of VAT, concerning the provision of self-supply of goods, is far from being perfect. This chapter concludes the thesis by interpreting the findings in the perspective of the research question. Finally, the final remarks on the research outcome are delivered.

As appears, to ensure a complete compliance with the principle of neutrality is a difficult task both for the ECJ and for tax authorities. The application of self-supply of goods by national tax authorities has not always produced fair results, since the rule itself is dependent on three cumulative conditions, which bring complexity. Although the purpose of the provision is to maintain equality between taxable and non-taxable persons in case of using goods for private purposes, the strict application still leaves a margin for possible fraudulent behavior of a taxable person, as in *De Jong* or *Slaby and Others*.

The development of the doctrine of ‘Asset labelling’ by the ECJ aimed at supplementing the current complex VAT system as regards the goods used for both private and business purposes.¹⁹¹ The purpose of this doctrine was to bring VAT to perfection in light of the principle of fiscal neutrality¹⁹² and to obtain the most possible simplification within the VAT system. Undoubtedly, the doctrine provides for an easier deduction mechanism and prohibits double taxation, but it also has specific nuances.

Unfortunately, the EU legislature did not see the advantages stemming from asset labelling and restricted the doctrine by implementing the new Article 168a of the VAT Directive, which aims at limiting deduction in case of immovable property, to actual use. This has not necessarily had a

¹⁹¹ J.P. Swinkels, ‘Asset labelling for VAT purposes’, *International VAT Monitor*, January/February 2006, IBFD, p. 8.

¹⁹² *Ibid*, p. 16.

positive influence on the balance with the principle of fiscal neutrality or on the fraud resistance of the system.

5.2. Research outcome

These summarized findings provide for a clear overview of the current difficulties in the field. Bearing those in mind, an answer to the research question can be formulated. That question, as presented in the Introduction, is the following:

To what extent does Article 16 of the VAT Directive, on the self-supply of goods, comply with the necessity to be fraud proof, bearing in mind the principle of fiscal neutrality?

With the two main aspects of this question, neutrality and fraud resistance, the different theories as seen throughout this research can be assessed. When looking at the recently limited doctrine of ‘Asset labelling’, it is true that a strict interpreter of the principle of fiscal neutrality would not easily be satisfied. By presenting the taxable person with a choice of allocation of assets, it is almost certain that the result is not a perfect representation of the balance between taxable and non-taxable activities. However, the fact that the taxable person is provided with the autonomy of choosing his own tax treatment might be a very effective tool in the prevention of fraud. As he decides for himself, no incentive appears to exist to come up with fraudulent behavior. It is up to the taxable person to decide what fits his business best. And, although this might thus not fully be in line with neutrality, it did provide with a clear, simplified and secure scheme that established equal treatment in a way where each taxable person is responsible for his own tax treatment.

Bearing that view in mind, the inconsistencies and uncertainties existing in the described case law are unsatisfying. In the application of Article 16, the Court has faced many difficulties in determining a straightforward interpretation. As discussed, the conditions for the existence of an economic (business) activity in *Slaby and Others*, and subsequently developed requirements in

determining the applicability of Article 16, are not seamless and thereby provide with opportunity and incentive to avoid or evade paying VAT.

However, the intention of the ECJ and national authorities to apply a pro-rata for every specific case is a more serious pursuit of strict neutrality. Whether that is realistic is another question, as the calculation and monitoring in practice is uncertain. Moreover, that uncertainty and lack of monitoring possibility is again an incentive for taxpayers to provide with a false calculation of their pro-rata.

Although this view at the current situation of the ECJ's case law is very critical, the author is of the opinion that by the change of approach from *Elida Gibbs* to *Kuwait Petroleum*, the ECJ has taken a step in the right direction. This has to do with the different possibilities of interpreting the principle of fiscal neutrality. *Elida Gibbs* provided for a well respected approach, as it established neutrality from the perspective of the consumer. A taxable amount can never exceed the amount paid by the consumer. However, in *Kuwait Petroleum*, the Court chose a different path, which from an entrepreneurial perspective is more understandable. By not accepting the exemption of taxation of redemption goods, the Court implicitly made the costs on those goods deductible for the taxable person. This perfectly meets the above presented perception of the principle of fiscal neutrality, which essentially held that the final burden of VAT can never be borne by the taxable person. In contrast, an '*Elida Gibbs*-approach' in *Kuwait Petroleum* would have led for Kuwait to bear the costs of free goods, because the consumer did not pay for them, without income and without the possibility to deduct.

Whether the new Article 168a is the solution, is another question. Although the Commission is of that opinion, doctrinal debate gives a room for discussion. The difficult balance between the principle of fiscal neutrality and the restriction of adjustment for changes in use from business to private, and not the other way around, is certainly questionable.

Besides, another viewpoint on the principle might be relevant as well. Coming back to the 'Asset labelling' doctrine, the simplicity of the VAT system is another important principle. From an institutional-, or Member State-perspective, the burden of case-by-case pro-rata calculation is

very high. In the application of the doctrine, the burden for the responsible authorities would be considerably lower, which usually also means a reduction of costs. Taking this into account, as also the extra effort Member States presumably need to prevent fraud, it is questionable that the EU legislature has chosen the strict neutrality approach. On the other hand, the security of revenues after the end of the adjustment period might be an equally good idea of those benefits for Member States.

5.3. Final remarks

Although the new Article 168a of the VAT Directive is more ‘fair’ than the previous ‘Asset labelling’ doctrine, concerning the deduction based on actual use of goods, it also expresses the approach that a revenue secure system prevails over the principle of fiscal neutrality. It is considered to be a big step away from the core principle on which the whole VAT system is based.¹⁹³

The author is of the opinion that the new provision, although it is considered to be more ‘suitable’ for the VAT system, disregards the principle of fiscal neutrality by the specific consequences of the limited adjustment period. The author believes that the previous mechanism, based on the doctrine of ‘Asset labelling’ to a more satisfactory extent guaranteed neutrality, served the requirement of simplification and most importantly, provided with barely any risk for fraudulent behavior of a taxable person. These achievements are trusted to be more desired than just a blunt compliance with the literal wording of the VAT directive.

¹⁹³ O. Henkow, ‘Neutrality of VAT for taxable persons: a new approach in European VAT?’, *EC Tax Review*, 2008-5, p. 236.

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