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The prohibition of deductions of input VAT relating to permanent dwellings
- A standstill legislation in motion?

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Contents

SUMMARY

The area of VAT constitutes an area fully harmonized within the EU, and the framework for the European VAT is established in the VAT Directive and is implemented in Sweden through the Swedish VAT Act. The European VAT is a general tax on consumption with the purpose of only taxing purchases for personal consumption. However, the European VAT cover all stages of production and distribution. To achieve the goal, to only tax private consumption, traders are relieved of the burden of the tax since they are allowed for deductions of input VAT incurred in the business. Therefore, the deduction mechanism is regarded as the essence of the VAT system. The ECJ has also stressed in several of its cases that the right to deduct is an integral part of the VAT system which ensures the neutrality of the tax which must apply in the same manner in all the Member States. Derogations from the fundamental right of deduction are only allowed when expressly permitted in the VAT Directive and must be interpreted strictly.

According to the first subparagraph of Article 176 of the VAT Directive, the Member States were allowed to retain exclusions from the right to deduct input VAT on certain expenditure which was in force under their national provisions, at the time of its accession the EU. The second subparagraph of Article 176 contains a standstill clause prohibiting the Member States from amending their national laws with the effect of extending the scope of retained exclusions.

The objective of this thesis is to examine if the prohibition of deductions of input VAT relating to permanent dwellings in Chapter 8. Section 9 first subparagraph point one of the Swedish VAT Act is in conformity with the VAT Directive, a prohibition which is covered by the standstill clause in the second subparagraph of Article 176. In order to achieve this objective, this thesis begins with examining Article 176 including related case law. This thesis continues by examining the prohibition of deductions of input VAT relating to permanent dwellings and the interpretation of the concept of permanent dwellings by the HFD.

This thesis finds that the prohibition of deductions of input VAT relating to permanent dwellings is in breach of Article 176 since the HFD have been inclined to interpret the concept of permanent dwellings extensively. Not only is the prohibition in breach of the VAT Directive, but the concept of permanent dwellings is also deviating from concepts developed by the ECJ.

SAMMANFATTNING

Mervärdesskatten är ett område som är fullständigt harmoniserat inom EU och ramen för medlemsstaternas regelverk utgörs av mervärdesskattedirektivet. Mervärdesskattedirektivet är i Sverige implementerat genom mervärdesskattelagen. Mervärdesskatten är en allmän och indirekt skatt på konsumtion och syftar till att endast omfatta förvärv för privat konsumtion. Trots detta utgår mervärdeskatt i varje produktions- och distributionsled. För att mervärdesskatten ska uppnå sitt mål, att endast beskatta privat konsumtion, har företagare rätt till avdrag för ingående skatt som hänför sig till förvärv i verksamheten. Avdragsrätten befriar således företagare från att bli belastad av skatten. Därmed utgör avdragsrätten en av de mest centrala funktionerna i mervärdesskattesystemet. EU-domstolen har i flera av sina fall betonat att avdragsrätten utgör en central del av mervärdesskatten som garanterar skattens karaktär och måste därför tillämpas på ett enhetligt sätt i alla medlemsstater. Avvikelser från avdragsrätten måste tolkas strikt och är endast tillåtet när direktivet uttryckligen medger det.

I artikel 176 första stycket mervärdesskattedirektivet anges att medlemsstaterna vid inträdet till EU får behålla begränsningar av avdragsrätten för vissa typer av utgifter som gällde vid tidpunkten för inträdet till EU. Artikel 176 andra stycket innehåller även en så kallad standstillklausul som förbjuder medlemsstaterna att utvidga tillämpningsområdet för de begränsningar av avdragsrätten som gällde vid tidpunkten för inträdet i EU.

Syftet med denna framställning är att undersöka om avdragsförbudet för stadigvarande bostad i 8 kap. 9 § punkt 1 mervärdesskattelagen är förenligt med mervärdesskattedirektivet. Avdragsförbudet utgör en så kallad standstill lagstiftning då förbudet existerade redan vid tidpunkten för Sveriges inträde i EU. För att uppnå detta syfte tar framställningen utgångspunkt i EU-rätten vilket innebär en genomgång av artikel 176 och hur denna har tolkats av EU-domstolen. Detta följs sedan av en genomgång av avdragsförbudet för stadigvarande bostad och hur begreppet stadigvarande bostad har kommit att tolkas av HFD.

I den här framställningen konstateras det att avdragsförbudet för stadigvarande bostad bryter mot artikel 176 då HFD har tolkat begreppet stadigvarande bostad extensivt. Avdragsförbudet är bryter inte enbart mot mervärdesskattedirektivet utan avviker också från andra begrepp som utvecklats i EU-domstolens praxis.

PREFACE

First and foremost, I owe the greatest thanks to my family for supporting me during these five years of studying in Lund.

I would also like to express my sincere gratitude to PwC Malmö, who provided me with valuable experience and input during the writing of this thesis. Especially thanks to, Fredrik Lund and Hanna Jurland. I will forever be grateful for your help and guidance during my internship.

Lastly, I would also like to thank my supervisor Oskar Henkow for the support and for introducing me to the world of VAT.

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Douglas Limnell

ABBREVIATIONS

AG	Advocate General
ECJ	The European Court of Justice
EU	The European Union
HFD	Swedish Supreme Administrative Court
HVB-homes	Residential care homes for children and young persons
ML	The Swedish VAT Act
SOU	Swedish Government Official Reports
STA	Swedish Tax Agency
TFEU	Treaty on the Functioning of the European Union
VAT	Value Added Tax

1 INTRODUCTION

1.1 Background

According to Chapter 3. Section 2 first subparagraph ML[1], the sale, letting or grant of immovable property is exempt from VAT. In other words, VAT is not charged on these transactions and deduction of input VAT relating to these are not allowed. Immovable property constituting permanent dwellings are not subject to VAT according to Chapter 3. Section 3 second subparagraph ML. However, lettings of rooms in the hotel business or similar and camping sites are subject to VAT. Likewise, lettings of immovable property to a taxable person for business premises are subject to VAT provided that the owner applies for voluntary tax liability.

The right to deduct input VAT is regulated in Chapter 8. Section 3 ML. Deductions are allowed in so far as the purchases are for the taxable transactions of a taxable person. Consequently, deductions of input VAT on costs relating to private consumption or exempt transactions are not allowed. Although the general rule prohibits deductions for private consumption, deductions of input VAT relating to permanent dwellings are prohibited according to Chapter 8. Section 9 first subparagraph point one ML.

The prohibition of deductions of input VAT relating to permanent dwellings was introduced in 1968 and only covered dwellings belonging to a taxable person or its employees. The intention of the legislator was to prohibit deductions of input VAT on costs relating to private consumption.[2] Following an editorial change of the provision in 1973, the words taxpayer and employees were removed. However, the purpose of that editorial change was not to extend the scope of the prohibition to cover other dwellings than dwellings belonging to the taxpayer or its employees.[3]

According to the first subparagraph of Article 176 of the VAT Directive[4] the Member States were allowed to retain exclusions from the right to the deduct according to their national laws which were in force on the date of their accession to the EU. The standstill clause in the second subparagraph of Article 176 prohibits the Member States to extend the scope of retained exclusions. The

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[1] Mervärdesskattelag (SFS 1994:200).

[2] Proposition 1968:100, p. 137-138.

[3] Proposition 1973:163, p. 87-93.

[4] Council Directive 2006/112/EC on the common system of value added tax, OJ L 347/1. Hereinafter ”VAT Directive”.

prohibition regarding permanent dwellings was in force at the time of Sweden's accession to the EU and is, therefore, covered by the standstill clause in Article 176.

Through the case law of the HFD, the concept of permanent dwellings has come to include other dwellings than those belonging to the taxpayer or its employees. The concept of permanent dwellings has since 1995 been subject to the interpretation of the HFD in numerous cases illustrating the difficulties when assessing whether a building is considered to be a permanent dwelling. The interpretation of the concept of permanent dwellings in the case law of the HFD, therefore, raises the intriguing question if the prohibition of deductions of input VAT relating to permanent dwellings is in conformity with the VAT Directive.

1.2 Objective and research question

The objective of this thesis is to examine if the prohibition of deductions of input VAT relating to permanent dwellings in ML is in conformity with the VAT Directive.

In order to achieve the objective, this thesis will seek to answer the following question:

Is the prohibition of deductions of input VAT relating to permanent dwellings in the Swedish VAT legislation in conformity with the European VAT Directive?

To achieve this objective, this thesis will primarily examine Article 176 of the VAT Directive and, how the concept of permanent dwelling have been interpreted and applied by the administrative courts. In detail, this thesis examines the interpretation of the concept of permanent dwellings by the HFD to determine if the prohibition is in breach of Article 176 or not. In relation to that, the concept of permanent dwellings will be examined in the light of the fundamental right of deduction, the principle of fiscal neutrality and certain concepts developed in the case law of the ECJ.

1.3 Method, material, and delimitations

In order to achieve the objective and answer the research question, the legal dogmatic method is applied. The legal dogmatic method is used to describe, systemize and interpret the applicable law in force.[5] When applying this method, sources of law are examined according to their status as legal sources.[6] The purpose of this method is to determine the applicable law by legal sources such as law, preparatory works, case law, and doctrine.[7] The legal dogmatic method has been subject to criticism for only taking into account the most authoritative sources and for not considering the effects of the applicable law on society and how the law is applied by the public authorities and lower courts.[8] However, I find this method the most suitable since the objective of this thesis requires that the applicable law is presented and determined. When applying the legal dogmatic method, legal sources are examined according to their legal status. As this thesis concerns a judicial area fully harmonized and since EU law prevails over national legislation in the Member States, the VAT Directive and the case law of the ECJ will be used as primary sources.[9] After the sections examining EU law and the case law of the ECJ, the focus will shift to an examination of the Swedish VAT legislation including preparatory works and the case law of the HFD.

Since the meaning and interpretation of Article 176 of the VAT Directive and the concept of permanent dwellings in ML primarily can be found in the case law, this thesis will be mainly be based on the judgments of the ECJ and the HFD. However, I also have in the analysis included cases from the lower courts and the opinion of the STA to illustrate the application of the concept of permanent dwellings. Lastly, the concept of permanent dwellings will be analyzed in a critical perspective to determine if it gives rise to difficulties in the interpretation and application of the prohibition.

As mentioned above, this thesis will mainly focus on the case law of the ECJ regarding the interpretation of Article 176 of the VAT Directive and the case law of the HFD regarding the interpretation of the concept of permanent dwellings. However, other concepts developed in the case law of the ECJ relating to this topic will be examined and discussed. Lastly, this thesis does not aim to examine the right to option for taxation under the VAT Directive or ML. Nevertheless, a brief discussion will be included regarding the possibility to apply for voluntary

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[5] L. Olsen, *Rättsvetenskapliga perspektiv,* (2004), p. 111.

[6] F. Korling and M. Zamboni, *Juridisk Metodlära,* (2013), p. 21.

[7] N. Jareborg, *Rättsdogmatik som vetenskap,* (2004), p. 8.

[8] F. Korling and M. Zamboni, (2013), p. 24-29.

[9] O. Henkow, *Mervärdesskatt i teori och tillämpning,* (2015), p. 13; F. Korling and M. Zamboni, (2013), p. 111-112.

tax liability according to the Swedish VAT legislation since the concept of permanent dwellings affects this possibility.

1.4 Previous research

During the past three years, the issues surrounding the concept of permanent dwellings have been addressed in a few articles. In the article *"Stadigvarande bostad - ett förlegat begrepp i ML?"*, the prohibition and the concept of permanent dwellings have been criticized by Jan Kleerup and Royne Schiess for being both out of date and incompatible with EU law.[10] Furthermore, a request to abolish the prohibition regarding permanent dwellings has also been sent to the Swedish Ministry of Finance from the Confederation of Swedish Enterprise. In this request, issues both from a Swedish perspective but also in the light of EU law are addressed.[11] Moreover, in the bachelor thesis *"Avdragsbegränsningar - De svenska avdragsbegränsningarnas förenlighet med mervärdesskattedirektivet"* by Linda Erlandsson the prohibition of deductions of input VAT relating to permanent dwellings is briefly examined in relation to Article 176.[12] However, no comprehensive and academic research have been devoted to the topic dealt with in this thesis.

Moreover, the Swedish Government has recently set up an inquiry to conduct a review of the Swedish VAT legislation with the purpose to propose a new VAT Act. The inquiry will have the objective to improve the VAT legislation by giving it a clearer structure and making it linguistically more modern. A particular objective of the inquiry is also to bring the Swedish VAT legislation more into line with the European VAT Directive, particularly regarding terminology and structure. The inquiry will be presented not later than the 1 April 2019.[13]

1.5 Terminology

The abbreviation *ECJ* or *the Court* with a capital C refers to the European Court of Justice. When referring to national courts, the term *the court* will be used. The Board of Taxation will also be referred to as *the Board*. I have tried to find an appropriate term for the concept *stadigvarande bostad* in the Swedish VAT

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[10] J. Kleerup and R. Schiess, *Stadigvarande bostad ett förlegat begrepp i ML?*, (2014), p. 802.

[11] K. Andersson, A. Sandberg Nilsson, *Svenskt Näringslivs hemställan om slopat avdragsförbud för stadigvarande bostad,* <http://www.svensktnaringsliv.se/migration_catalog/hemstallan-om-slopat-avdragsforbud-for-stadigvarande-bostad-2014_588576.html/BINARY/Hemställan%20om%20slopat%20avdragsförbud%20för%20stadigvarande%20bostad%202014-05-12>,(2014), accessed 2016-07-12. See also A. Sandberg Nilsson, *Dags att slopa avdragsförbudet för stadigvarande bostad!,* (2014), p. 375.

[12] L. Erlandsson, *Avdragsbegränsningar - De svenska avdragsbegränsningarnas förenlighet med mervärdesskattedirektivet",* (2014).

[13] Kommittédirektiv 2016:58.

legislation for which there are plenty of terms. This concept will be referred to as *permanent dwelling*. The prohibition of deductions of input VAT relating to permanent dwellings will occasionally be referred to as *the prohibition*.

1.6 Structure

This thesis is divided into five different chapters. Initially, after a brief introduction in the *first* chapter, the *second* chapter examines the fundamental principles underlying the European VAT and relevant provisions of the VAT Directive including case law of the ECJ. The *third* chapter examines the Swedish VAT legislation and in particular how the concept of permanent dwellings have evolved both through the legislation and the case law of the HFD. The purpose of the *second* and the *third* chapter is to provide a legal framework which will serve as the basis for the analysis carried out in the *fourth* chapter. The *fourth* chapter constitutes the analysis of this thesis in which the prohibition of deductions of input VAT relating to permanent dwellings will be analyzed in the light of EU law. Finally, the *fifth* chapter provides summarizing conclusions based on the analysis carried out in the previous chapters.

2 THE EUROPEAN VAT

2.1 Introduction to the European VAT

The framework for the European VAT is established in the VAT Directive, which replaced the Sixth Directive[14]. A directive is according to Article 288 TFEU, binding upon the Member States and must be implemented. However, the Member States are free to choose the form and method for implementing a directive.[15]

The European VAT is a general and indirect turnover tax on consumption, as opposed to a specific tax such as excises which taxes specific goods (for example tobacco or alcohol). A turnover tax has the purpose of taxing all private expenditure. As the tax is general, in principle, no distinction should be made between goods or services since a good can be a substitute for a service. If services were excluded from the VAT one could, for example, repair his car instead of buying a new. Taxation of goods and not services would stimulate the consumption of the latter and discriminate the purchase of goods. In other words, the generality of the tax implies that it should not affect the choice of traders and consumers. Therefore, generality is an essential part of the VAT. The generality also implies a proportional relationship between the tax and the amount paid for a good or a service. That makes it necessary that the sum of the tax is expressed as a percentage of the retail price and that the amount is equal for identical goods. Through this equal treatment, the system achieves equality and certainty.[16]

Since the European VAT is a tax on consumption, the tax is limited to tax purchases for personal consumption. However, the European VAT covers all stages of production and distribution. By allowing a deduction for businesses on all stages, the burden of the tax is relieved.[17] The European VAT is also an indirect tax meaning that the tax is not imposed directly on the end consumer, who is the one bearing the burden of the tax. Instead, the tax is charged in the form of an increased sales price, and the trader bears the burden of paying in the tax.[18]

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[14] Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the law of the Members States relating to turnover taxed - Common system of value-added tax: uniform basis of assessment, OJ 145/1. Hereinafter ”Sixth Directive”.

[15] B. Terra, J. Kajus, *A Guide to the European VAT Directives - Introduction to European VAT 2014 Volume 1,* (2014), p. 98.

[16] O. Henkow, (2015), p. 22; B. Terra, J. Kajus, (2014), p. 293 and 301.

[17] Article 1(2) of the VAT Directive. See also B. Terra, J. Kajus, (2014), p. 314.

[18] O. Henkow, (2015), p. 22; B. Terra, J. Kajus, (2014), p. 297.

2.2 Neutrality

One of the most fundamental principles underlying the VAT system is the principle of fiscal neutrality which is laid down in Article 1(2) of the VAT Directive and has been applied by the ECJ in numerous cases. The ECJ has held that the principle of fiscal neutrality is intended to reflect the more general principle of equal treatment in secondary EU law. Hence, the principle of fiscal neutrality is not a source of primary law, which it is possible to test the validity of exceptions in the VAT system.[19]

According to Ben Terra and Julie Kajus, it is useful to discern between internal and external neutrality. The internal neutrality can be divided into different aspects such as legal, economic and competition neutrality.[20]

The legal neutrality has the aim of equality. Meaning that equal should be treated equally since the VAT is a general tax on consumption by individuals. To ensure the legal neutrality, the tax has to be measurable so the tax burden can be distributed. That is only achieved when the tax is expressed as a percentage of the retail price and when the amount is equal for identical products.[21]

Furthermore, the VAT must be economically neutral and cannot distort competition. Economic neutrality implies that the tax should not interfere with the market mechanism which allocates the provisions of products and means of productions.[22] As the internal neutrality relates to national aspects, the external neutrality concerns the international aspects of levying a turnover tax. To ensure neutrality, there should not be a different treatment of private expenditure depending on in which country the products will be consumed.[23]

The ECJ has in many of its judgments referred to the principle of fiscal neutrality. In the case C-45/95 Commission v. France, the ECJ considered that double taxation would be contrary to the principle of fiscal neutrality which is inherent in the common system of VAT.[24] In the case C-94/09 Commission v. France, the Court emphasized that it is contrary to the principle of fiscal neutrality to treat

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[19] B. Terra, J. Kajus, (2014), p. 84 and 91.

[20] B. Terra, J. Kajus, (2014), p. 300-301.

[21] B. Terra, J. Kajus, (2014), p. 301.

[22] B. Terra, J. Kajus, (2014), p. 301-302.

[23] B. Terra, J. Kajus, (2014) p. 303-304.

[24] C-45/95, *Commission v. France*, EU:C:1997:315, para 15. See also C-155/01 *Cookies World,* EU:C:2003:449, para 60.

similar goods and services differently for VAT purposes which are in competition with each other.[25]

2.3 The right of deduction

As mentioned above, to achieve a general indirect tax on consumption the VAT system includes a deduction mechanism, and could be considered as the essence of the VAT system.[26] According to Article 168 of the VAT Directive, in so far as the goods or services are used for taxed transactions of a taxable person, the taxable person shall have the right to deduct VAT due in respect of supplies to him of goods and services.

Supplies of goods or service that are exempt according to Article 132 or goods or services used for non-business purposes does not give rise to a deduction.[27] Hence, goods that are not used for taxable activities or used for private consumption gives no right to deduction.[28] In the case where a trader is using goods or services for both taxed and exempt transactions, he or she may only deduct the proportion that is attributable to taxed transactions according to Article 173. If attribution is not possible Article 174 of the VAT Directive provides for apportionment or the so-called pro-rata calculation.

The importance of the deduction mechanism has also been expressed in several cases of the ECJ. In the case 268/83 Rompelman, the Court pointed out that the deduction system is meant to relieve a trader entirely from the burden of VAT in the course of his economic activities. The system of VAT thereby ensures that all economic activities, provided that they are subject to VAT, are taxed in a neutral way.[29] The ECJ has also held that in the absence of provisions giving the Member States the right to limit the right of deduction, that right must be exercised immediately. The right to deduct must also be applied in a similar manner in all Member States, and derogations are only permitted when expressly provided in the VAT Directive.[30]

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[25] C-94/09, *Commission v. France,* EU:C:2010:253, para 40.

[26] B. Terra, J. Kajus, (2014) p. 1191.

[27] B. Terra, J. Kajus, (2014), p. 1191.

[28] C-97/90, *Lennartz,* EU:C:1991:315, para 9.

[29] 268/83, *Rompelman*, EU:C:1985:74, para 19.

[30] C-50/87, *Commission v. France,* EU:C:1988:429, paras 16-17.

2.4 The standstill clause in Article 176

According to the first subparagraph of Article 176 (ex 17(6)) of the VAT Directive, the Council, acting unanimously on a proposal from the Commission, shall determine the expenditure in respect of which VAT shall not be deductible. VAT shall in no circumstances be deductible in respect of expenditure which is not strictly business expenditure, such as that on luxuries, amusement or entertainment. Moreover, the provision of Article 17(6) of the Sixth Directive is to be considered in essence the same as Article 176 of the current VAT Directive[31].

The second subparagraph of Article 176 stipulates a so-called standstill clause which allows the Member States to retain all the exclusions provided under their national laws on 1 January 1979 or, in the case of the Member States which acceded to the Community after that date, on the date of their accession.[32] Article 176 and retained exclusions from the right to deduct VAT has been subject to the interpretation of the ECJ numerous times. The following chapters examine the case law of the ECJ relating to Article 176.

2.4.1 Expenditure in the course of the business

In the case C-43/96 Commission v. France, the Commission applied to the ECJ for a declaration that the French Republic had failed to fulfill its obligation under Article 17 of the Sixth Directive. The reason was that French law from 1967 did not allow deductions for input tax relating to vehicles or machines whatever their nature, designed for the transport of persons. The law included bicycles, motorcycles, private motor cars, boats, airplanes, and helicopters. The Commission argued that the denial of the right to deduct VAT on goods which constitute the very tool of a taxable person's trade was contrary to Article 17(2) (now Article 168). And that the exclusions of the right to deduct authorized under Article 17(6) (now Article 176) only relates to expenditure which is not strictly business expenditure.[33]

The Court dismissed the application and noted that it follows from the wording of the second sentence in the first subparagraph of Article 17(6) (now Article 176), that the rules which the Council shall adopt are not automatically limited to expenditure which is not strictly related to a business. Furthermore, the Court pointed out that the expression "all the exclusions" in the second subparagraph of Article 17(6) clearly covers expenditure strictly related to a business.

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[31] C-395/09, *Oasis East,* EU:C:2010:570, para 32.

[32] C-409/99, *Metropol Treuhand*, EU:C:2002:2, para 48.

[33] C-43/96, *Commission v. France,* EU:C:1998:304, paras 13-15.

Hence, Article 176 authorizes the Member States to keep national rules which limit the right to deduction input VAT on means of transport constituting the very tool of their trade. The Court pointed out that this interpretation was also confirmed by the explanatory memorandum accompanying its proposal for the Sixth Directive in which the Commission stated that certain expenditure, even though incurred in a business would be difficult to apportion the use between private and business.[34]

In the case C-305/97 Royscot Leasing, two leasing companies claimed for a deduction of input VAT on the purchase of motor cars, which was prohibited in the United Kingdom. The companies argued on the ground, that Article 11(4) of the Second Directive, which predated the Sixth Directive and Article 17(6) of the Sixth Directive did not permit the United Kingdom to introduce and retain an exclusion of input VAT on the costs of motor cars. The companies pointed out that Article 17(6) (now Article 176) did not authorize the retention of such an exclusion which was not justified by Article 11(4) of the Second Directive. The question referred to ECJ was whether Article 11(4) of the Second Directive authorized the Member States to introduce or retain, and whether 17(6) (now Article 176) authorized the Member States to retain, general exclusions from the right to deduct the VAT on the purchase of cars by a taxable person for his taxable transactions. Even though the cars were essential tools for the business or those cars could not, in a particular case, be used for privately by the taxable person.[35]

According to the Court, Article 11(1) of the Second Directive introduced a right of deduction and Article 11(4) allowed the Member States to exclude the right to deduct input VAT for certain goods and services. The Court admitted that Article 17(6) (now Article 176) presupposed that the exclusions which Member State may retain were lawful under the Second Directive.[36] Furthermore, the Court held, referring to C-43/96 Commission v. France, that according to Article 17(6) Member States may retain exclusions with denies taxable persons the right to deduct both VAT on means of transport which constitute the very tool of their trade and also VAT relating to the motor vehicles which are not possible to use privately.[37] The Court also pointed out that Article 11(4) of the Second Directive allowed the Member States to exclude the right to deduct VAT on expenditure which is strictly related to the business and not limited to goods and services that could be used privately. However, Article 11(4) did not give the Member States an unlimited discretion to exclude all goods and service which would negate the right to deduct. Therefore, Article 11(4) and 17(6) (now Article 176) allows the

[34] C-43/96, *Commission v. France*, EU:C:1998:304, paras 16-20.

[35] C-305/97, *Royscot Leasing*, EU:C:1999:481, paras 15-17.

[36] C-305/97, *Royscot Leasing*, EU:C:1999:481, paras 21-23.

[37] C-305/97, *Royscot Leasing*, EU:C:1999:481, paras 19-20.

Member States to retain general exclusions from the right to deduct input VAT relating to the purchases of cars solely used in a taxable activity. According to the Court, the United Kingdom did use an authorization under Article 11(4) rather than impairing the general system of the right to deduction.[38]

In the case C-434/03 P. Charles and T.S. Charles-Tijmens, the ECJ noted that Article 17(6) (now Article 176) presupposes that the exclusions which the Member States may retain exclusions were lawful according to the Second Directive, which predated the Sixth Directive. The Court stated that the derogation allowed the Member States to exclude deductions of certain goods and services, in particular, goods and services which could be used exclusively or partially for private purposes by the taxable person or his staff. However, the provisions did not give the Member States an unfettered discretion to exclude all and any goods and services from the right to deduction. It allowed the Member States to exclude certain goods, such as motor vehicles. The provision did not allow the Member States to exclude all goods in so far they are used privately by the taxable person.[39]

2.4.2 Amendments reducing the scope of a retained exclusion

In the case C-345/99 Commission v. France, infringement proceedings was lodged by the Commission against France for failing to fulfill its obligations under 17(2) of the Sixth Directive (now Article 168). From 1 January 1979, which was the date the Sixth Directive came into force, all private vehicles were generally excluded from the right to deduct according to the French law. From 1 January 1993, the French VAT legislation was amended granting a right to deductions of VAT on costs for certain vehicles. VAT charged on purchases, imports, intra-community acquisitions, supplies and services for vehicles or machines used exclusively for driving instructions was no longer excluded from the right to deduct.[40] The Commission argued that Article 17(6) (now Article 176) did not authorize amendments introducing a right of deduction subject to certain conditions, such as in this case. The Member States can only amend its legislation in accordance with Article 17(2) (now Article 168). The only condition for the right to deduct is that the goods and services are used for the taxable transactions carried out by a taxable person.[41]

The ECJ disagreed with the Commission and stated that in cases where the legislation of a Member State is amended to reduce the scope of an existing

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[38] C-305/97, *Royscot Leasing*, EU:C:1999:481, paras 22-25.

[39] C-434/03, *P. Charles, T.S. Charles-Tijmens*, EU:C:2005:463, paras 31-34.

[40] C-345/99, *Commission v. France*, EU:C:2001:334, paras 6-8.

[41] C-345/99, *Commission v. France*, EU:C:2001:334, para 15.

exclusion and bringing its legislation into line with the objective of the VAT Directive, that legislation is covered by Article 17(6) and is not in breach of Article 17(2) (now Article 168). The amendment of the French legislation had the effect of reducing the scope of an existing exclusions from the right to deduct and the action by the Commission was dismissed.[42]

2.4.3 Amendments extending the scope of a retained exclusion

The case C-40/00 Commission v. France concerned a prohibition in the French legislation under which no deductions of input VAT on diesel used for fuel for the operation vehicles or machines was allowed. In 1982, the French legislation was amended, and the prohibition on the deduction was changed several times between 1982 and 1991. The rate of deduction was increased from 10% in 1982 to 90% in 1991 and was reduced to 50% during the same year. The right to deduct input VAT was in 1998, completely abolished.[43] The Commission contended that the reintroduction of the prohibition of deduction in 1998 was prohibited under Article 17(6) (now Article 176) and was therefore in breach of Article 17(2) (now Article 168).[44]

The Court held that Article 17(6) (now Article 176) covers the situation when a legislation of a Member State is amended with the effect of reducing the scope of existing exclusions and bringing itself into line with the objective of the VAT Directive. However, amendments of national legislation which has the effect of increasing the scope existing exclusions is not covered by Article 17(6) (now Article 176) and is diverging from the objectives of the VAT Directive.[45] The Court found that France had failed to fulfill its obligations and rejected the argument of the French Government that the legislation was adopted for environmental reasons.[46]

The ECJ also held in the joined Cases C-538/08 Holding and C-33/09 Oracle Nederland that Article 17(6) (now Article 176) does not preclude an amendment of national provisions, intended to restrict the scope of an exclusion, where it cannot be ruled out the, in an individual case, that the scope of the exclusions might be extended because of the flat rate nature of the amendment.[47]

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[42] C-345/99, *Commission v. France*, EU:C:2001:334, paras 21-25.

[43] C-40/00, *Commission v. France*, EU:C:2001:338, paras 5-7.

[44] C-40/00, *Commission v. France*, EU:C:2001:338, para 13.

[45] C-40/00, *Commission v. France*, EU:C:2001:338, paras 16-17.

[46] C-40/00, *Commission v. France*, EU:C:2001:338, paras 20-24.

[47] Joined cases C-538/08, *X Holding BV* and C-33/09, *Oracle Nederland BV,* EU:C:2010:192*,* paras 70-71.

The case C-414/07 Magoora concerned the right for the Polish company Magoora to deduct input VAT relating to the purchase of fuel for a vehicle used for the companies activities under a leasing contract. On 25 March 2005, Magoora entered a leasing contract for a car and the Law on VAT in force in Poland on that day was not applicable to Magoora's purchase. The law was instead amended on 22 August 2005 and applied to Magoora's purchase which restricted the right to deduct because the vehicle of Magoora did not exceed 3.5 tons according to a new formula. Magoora applied for interpretation of the national legislation to Head of the Cracow-Prądnik Tax Office and took the view that it should retain the right to deduct input VAT on the purchases of fuel pursuant to Article 17(6) (now Article 176). The Head of the Cracow-Prądnik found Magoora's submissions unfound arguing that Article 17(6) could not constitute a source of national law in Poland. Magoora appealed and the question was referred to the ECJ whether 17(2) and 17(6) (now Article 168 and 176) precludes Member States from entirely revoking, from the date of when the VAT Directive came into force, national provisions limiting the right to deductions of input VAT on fuel for vehicles and replacing them with new a criteria and amending those with the effect of extending the restrictions.[48]

The Court held in its judgment that Article 17(6) (now Article 176) is a standstill clause and does not allow a new Member State to amend its legislation on its accession to the European Union, which diverts from the objectives of the VAT Directive. An amendment with that effect would be contrary to the spirit of the standstill clause.[49]

2.4.4 Option for taxation

In the case C-184/04 Uudenkaupungin kaupunki, one of the questions referred was if Article 17(6) (now Article 176) must be interpreted as meaning that a Member State which allows its taxable persons to opt for taxation of the letting of a property is allowed to deny deductions of VAT on immovable property investments made before the right to opt is exercised. If the application to opt is not done within six months from the day the property was brought into use. The ECJ held that the origin of Article 17(6) (now Article 176) implies that the possibility given to the Member States in the second subparagraph only applies to limitations of the right to deduct with regard to categories of expenditure defined by reference to the nature of the goods or services and not by reference to the use to which they are put or to how they are used. According to the Court, it was apparent that the Finnish VAT legislation provided a possibility to deduct VAT on immovable property investments. The exclusions in this case related to costs

[48] C-414/07, *Magoora*, EU:C:2008:766, paras 13-20.

[49] C-414/07, *Magoora*, EU:C:2008:766, para 39. See also C-124/12, *AES*, EU:C:2013:488, para 43.

incurred before the option to become liable to VAT and did not fall within the second subparagraph of Article 17(6). Moreover, the Court concluded that Article 17(6) (now Article 176) must be interpreted as not allowing the Member States to exclude the deduction of input VAT relating to immovable property investments incurred before the right to opt for taxation is exercised, when the application to opt have not been made within six months after the property was brought into use.[50]

2.4.5 Administrative measures or practices by the public authorities

In the case C-371/07 Danfoss AstraZeneca the question referred to the ECJ concerned the VAT treatment of meals provided free of charge by the companies canteens for business contacts and staff during work meetings. According to the Danish VAT legislation, these types of meals were subject to VAT, but no deduction of input VAT was allowed. However, the companies deducted all the input VAT from the canteens according to an administrative practice which had applied since 1978. The administrative practice meant that the VAT was assessed on the cost price for the provision of the meals. All the purchases for the canteens were also regarded as attributable to the taxable transactions, and the VAT was fully deductible. In 1999, the Landskatteret disallowed the application of the administrative practice and considered that the VAT had to be assessed on the actual payment received instead of the cost price. Therefore, the companies claimed for a refund of VAT, which had been calculated on the costs price of the meals. The tax authorities refused the claim for a refund on the ground that the meals had been used for private purposes and should be subject to VAT.[51]

The companies appealed and the national court decided to refer to the ECJ the question whether Article 17(6) (now Article 176) allows authorities to deny the right to deduct according to retained exclusions from the right to deduct which existed under the national law before the Sixth Directive came into force but was not in practice applicable.[52]

The Court recalled the fundamental principle underlying the common system of VAT, that VAT should apply to each transaction by way of production or distribution, and that deductions must be allowed for all input VAT relating to those transactions. Furthermore, the Court stated that it is settled in the case law that the right to deduct VAT is an integral part of the VAT scheme and in principle may not be limited. Limitations of the right to deduct must be applied in a similar manner in all the Member States, and derogations are only permitted in cases

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[50] C-184/04, *Uudenkaupungin kaupunki*, EU:C:2006:214, paras 48-51.

[51] C-371/07, *Danfoss A/S AstraZeneca,* EU:C:2008:711, paras 17-23.

[52] C-371/07, *Danfoss A/S AstraZeneca,* EU:C:2008:711, paras 23-24.

where the directive expressly allows it. Provisions derogating from the principle of the right to deduct, ensuring the neutrality of the VAT, must be interpreted strictly. Article 17(2) (now Article 168) stipulates the principle of the right to deduct and deductions are allowed as long as the input VAT relates to goods and services used for the purposes of taxable transactions. This principle is subject to a derogation in Article 17(6) (now Article 176).[53]

Lastly, the Court stated that, by introducing an administrative practice granting a full right to deduct input VAT relating to the provision of food, the Danish administration precluded itself from limiting the right to deduct according to the exclusions in force before the Sixth Directive came into force. The Court pointed out that in the context of the standstill clause in the second subparagraph of Article 17(6) (now Article 176), both legislative acts in the strict sense and administrative measures and practices of the public authorities must be taken into account.[54]

2.4.6 The right to deduct and the strict interpretation of Article 176

In case C-74/08 PARAT Automotive Cabrio a company under a subsidy contract concluded with the Hungarian Development Bank, PARAT made an investment for the purpose of expanding its production capacity for convertible tops. The contract granted PARAT a subsidy covering 47% of the investment costs. PARAT entered four invoices issued for machinery and deducted all VAT on those invoices. The authorities carried out an audit and PARAT was obliged to reduce its amount of deducted input VAT because of the subsidy received. The authorities calculated the amount deductible on the basis of the proportion of the subsidy (47%). PARAT was also subject to a fine and penalty for delay. PARAT brought an action against that decision which resulted in questions referred to the ECJ. The first question was whether it was contrary to Article 17(2) (now Article 168) to exclude the right to deduct because a part of the price of the investment costs came from a subsidy.[55]

The ECJ held, recalling previous case law, that the right to deduct is an integral part of the VAT and a fundamental principle underlying the system of VAT and may not in principle be limited. Article 17(2) (now Article 168) specifies the condition giving a right to deduction and the extent of that right. Derogation from this are only permitted in cases expressly provided in the directive, such as in

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[53] C-371/07, *Danfoss A/S AstraZeneca*, EU:C:2008:711, paras 26-29.

[54] C-371/07, *Danfoss A/S AstraZeneca*, EU:C:2008:711, paras 42-44. See also C-409/99, *Metropol Treuhand*, EU:C:2002:2, para 49.

[55] C-74/08, *PARAT,* EU:C:2009:261, paras 6-13.

Article 17(6) (now Article 176) and should be interpreted strictly.[56] The Court held that the derogation made in the Hungarian VAT legislation constituted a measure of a general nature restricting the right to full deduction of input VAT relating to acquisitions of goods financed by subsidies. The legislation, therefore, constituted a restriction going beyond what is authorized by Article 17(6) (now Article 176).[57]

2.4.7 Summary

In summary, Article 176 only allow the Member States to retain exclusions from the right to deduct which was in force at the time of its accession to the European Union. Article 176 authorizes the Member States to retain limitations of deduction of input tax relating to expenditure which is not strictly the related to a business. Consequently, a Member State can retain national rules which exclude deduction of input VAT relating to goods or services, which constitute the very tool of their trade, such as cars or other vehicles. Even though the good or service is essential for the business and could not in a specific case, be used for private purposes by the taxable person.

The standstill clause in the second subparagraph of Article 176 covers the situation when a Member State amend its law with the effect of extending the scope of retained exclusions. However, the standstill clause does not preclude an amendment of a national provision which is intended to narrow the scope of a retained exclusion.

Moreover, the ECJ has pointed out that it is not only legislative acts that must be taken into account when determining if a Member State is in breach of the standstill clause, but also administrative measures and practices of the public authorities. A Member State can, therefore, through administrative measures and practices of its public authorities either limit or extend the scope of a retained exclusions from the right to deduct. If a Member State through administrative measures or practices limits the scope of a retained exclusion, it has precluded itself from either extend it or in the future apply the exclusion again as it applied before the administrative practice or measure came into force.

The ECJ has also stressed that the right to deduct is an integral part of the VAT scheme which ensuring that economic activities are taxed in a neutral and must be applied in the same manner in all Member States. Derogation from this is only allowed when expressly permitted in the VAT Directive and must be interpreted strictly.

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[56] C-74/08, *PARAT,* EU:C:2009:261, paras 15-18.

[57] C-74/08, *PARAT,* EU:C:2009:261, paras 28-30.

3 THE SWEDISH VAT LEGISLATION

The European VAT Directive is implemented into Swedish law through ML. According to Chapter 1. Section 1 ML, the supply of goods or services by a taxable person shall be subject to VAT. The right to deduct input VAT is regulated in Chapter 8. Section 3 ML and deductions are allowed in so far as the purchases are for the taxable transactions of a taxable person (implementing Article 168 of the VAT Directive).

3.1 Immovable property

According to Chapter 3. Section 2 ML, the supply of immovable property are exempt from VAT, meaning that VAT is not charged on the sale, letting or the grant of immovable property. From this exemption, exceptions are made. For example, rooms of hotel businesses or similar and camping sites in campsite businesses are subject to VAT according to Chapter 3. Section 3 first subparagraph point four ML. Likewise, lettings of immovable property to a taxable person for business premises are subject to VAT according to Chapter 3. Section 3 second subparagraph ML. However, lettings for business premises requires that the owner of immovable property applies for voluntary tax liability according to Chapter 9. Section 1 and 2 ML. By becoming voluntarily liable to tax, the owner must charge VAT on the transactions but obtains the right to deduct input VAT relating to the property. Lastly, lettings of immovable property for permanent dwellings are not subject to VAT according to Chapter 3. Section 3 second subparagraph ML and the owner of the property can not apply for voluntarily tax liability.

Moreover, lettings of immovable property to a municipality are subject to VAT even though it is let for an activity which is not taxed according to Chapter. 3 Section 3 second subparagraph ML. Therefore, a property owner can, in this particular situation, obtain the right to deduct input VAT even though the activity carried out in the building is exempt.

3.2 Permanent dwellings

As mentioned above, lettings of immovable property for the use of permanent dwellings are not liable to VAT according to Chapter 3. Section 3 second paragraph ML and deductions of input VAT relating to permanent dwellings are prohibited according to Chapter 8. Section 9 first subparagraph point one ML. The concept of permanent dwellings in Chapter 3. Section 3 second subparagraph and Chapter 8. Section 9 first subparagraph point one ML is given the same

meaning[58]. Consequently, property owners letting immovable property for the use of permanent dwellings cannot be liable to tax and are not allowed for a deduction of input VAT relating to the property. The scope of the prohibition also covers VAT on costs for inventory, repair work, operational costs and maintenance[59].

The following chapters will examine the introduction of the prohibition of deductions of input VAT relating to permanent dwellings into the Swedish VAT legislation and how the HFD has interpreted the concept of permanent dwellings.

3.2.1 The intention of the legislator

In 1968, the prohibition to deduct input VAT relating to permanent dwellings was introduced into the Swedish VAT legislation. At first, the prohibition only applied to permanent dwellings belonging to the taxpayer himself or his employees.[60] The intention of the legislator was only to prohibit deductions of VAT on costs relating to permanent dwellings owned by the taxpayer or his employees. The legislator expressed that all other input tax relating to purchases for the business which could also be used for private purposes was to be fully deductible, despite the fact that it could relate to private consumption.[61]

In 1973, this provision was amended by a change of the wording. The words taxpayer and employee was removed from the provision and the wording only stated a prohibition of deductions of input VAT relating to permanent dwellings. This amendment was a part of a step in removing the exemption for agricultural tenancy. The purpose of the editorial change of the provision was to clarify that deduction of input tax relating to permanent dwellings such as manor houses or other dwellings on an agricultural property was to be prohibited.[62] The amendment only related to dwellings on agricultural property and not other lettings of immovable property for permanent dwellings.[63]

In connection to Sweden's accession to the European Union, a Government Committee was appointed to submit proposals with the purpose of bringing the Swedish VAT legislation in conformity with the Sixth Directive, which was the directive in force at the time. Regarding the prohibition of deductions of input VAT relating to permanent dwellings the Government Committee found it to be in conformity with the Sixth Directive since it allowed for retention of a restriction

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[58] J. Kleerup and R. Schiess, (2014), p. 810; HFD 2015 not. 56.

[59] SOU 1994:88, p. 241-242.

[60] Lag om mervärdesskatt (SFS 1968:430), Section 18.

[61] Proposition 1968:100, p. 137-138.

[62] Proposition 1973:163, p. 87 and 93. See also RÅ 2003 ref. 100 I.

[63] Proposition 1973:163, p. 92; RÅ 2003 ref. 100 I.

of the right deduction for expenditure which was not strictly business expenditure, such as that on luxuries, amusement or entertainment. The Government Committee pointed out that the prohibition in the Swedish legislation was only intended to target private consumption, and that deductions of input tax which was not strictly business expenditure were prohibited. The Government Committee pointed out that private consumption cannot give rise to the right of deduction according to the more general provision in Chapter 8. Section 3 ML and that the essence of the VAT is to tax goods or services for private consumption. The Government Committee questioned the prohibition since it is clear from the general provision and the concept of VAT that deduction of VAT on costs for private consumption are not allowed.[64]

3.3 Case law on the interpretation of the concept of permanent dwellings

In the early case RÅ84 1:69, a private individual carried out reindeer husbandry. A smaller and simple cottage was built as a dwelling for P and his family to live in during the summer when carrying out the reindeer husbandry. The HFD considered the building to be attributable to the business and did not constitute a permanent dwelling. The court based the assessment mainly on the nature of the cottage and considered it to be of a more simple nature. P was therefore entitled to a full deduction of input VAT relating to the cottage.[65]

3.3.1 Short-term lettings similar to the hotel business

In RÅ 1988 not. 642 a company applied for a preliminary ruling to the National Tax Administration. The company had pursued recreational and outdoor activities by renting out cabins. The cabins were located in an area with good fishing and wildlife opportunities. The complex consisted of 30 houses equipped with TVs, telephones, showers and toilets. The facility also included a restaurant and a conference room. Due to lack of profitability, the company let the cabins to the Swedish Migration Board for temporary accommodation for asylum seekers. The asylum seeking guests stayed for a minimum period of one month. Both the National Tax Administration and the HFD considered the lettings to be temporary and similar to the hotel business and therefore liable to 12% VAT.[66]

In RÅ 1991 not. 82 the same company as in RÅ 1988 not. 642, applied for a new preliminary ruling regarding the same property. The reason for the new application was that the stay of the asylum seekers had been extended. The stay of

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[64] SOU 1994:88, p. 254-255; Proposition 1994/95:57, p. 130.

[65] RÅ84 1:69.

[66] RÅ 1988 not. 642.

the asylum seekers now amounted from four up to nine months, with an average stay of six months. The National Tax Administration considered the letting to be short-term and temporary similar to the hotel business. The National Tax Administration stated that the assessment of whether the letting is temporary and short-term should be based on the purposes of the business. The National Tax Administration concluded that the purpose of the company's business was to provide temporary dwellings for asylum seekers and therefore subject to VAT, such as businesses similar to hotels. The fact that the duration of the stay could be longer than in the previous case did not change the fact that it was let for temporary and short-term accommodation. The HFD agreed and settled the case.[67]

In the case RÅ 2002 ref. 67 a partnership applied for a preliminary ruling to the Board of Taxation. The partnership intended to rebuild all apartments in a building which would, after the rebuilding, be used in a business similar to a hotel in the form of short-term lettings of so-called company housing. Therefore, the partnership raised the question about voluntary tax liability and the right to deduct input VAT on costs relating to the investment. The Board considered that the apartments, after the rebuilding, which was let out for the purpose of a hotel business or similar was not used as permanent dwellings. Regardless of the character and layout of the apartments, they could not be considered to be used as permanent dwellings. The Board allowed for a deduction according to the general rule in Chapter 8. Section 3 ML.

The National Tax Administration appealed against the ruling of the Board. The HFD reached the same conclusion. Unlike the board, the court considered the supply of the short-term lettings to be taxed according to Chapter 3. Section 2 and 3 first subparagraph ML as provision of accommodation in the hotel business or similar. The court stated it constituted a taxable activity which gave rise to a deduction according to Chapter 8. Section 3 first subparagraph ML.[68] The HFD also held in the case RÅ 2002 not. 174 that the letting of apartments for a hotel business was not used as a permanent dwelling and consequently allowed for a deduction of input VAT provided that the company applied for voluntary tax liability.[69]

In the case RÅ 2005 ref. 34 a company applied for a preliminary ruling to the Board of Taxation asking whether a building leased by the company for providing temporary housing for its employees during in-service training constituted a permanent dwelling or not. The leased building consisted of 18 apartments, corridors, laundry, dining hall and other common areas. The majority of the

[67] RÅ 1991 not. 82.

[68] RÅ 2002 ref. 67.

[69] RÅ 2002 not. 174.

apartments consisted of two bedrooms equipped with kitchenettes. Four of the apartments were equipped with complete kitchens. The premises allowed the company to provide 35 single rooms for the staff during the training, instead of placing them at a hotel. The participants stay varied from a few days to several weeks. The municipality of Leksand (where the property was situated) considered the building to be similar to a hotel and therefore had to meet the requirements for hotels such as fire alarms etc. The Board of Taxation did not consider the building to constitute a permanent dwelling. The Board referred to the previous cases RÅ 2002 ref. 67 and RÅ 2003 ref. 100 I and II stating that both the character and the use of the property must be considered when assessing whether a building constitutes a permanent dwelling. To achieve a result which is in line with the underlying principles of VAT. The Board also pointed out that in cases where a building is used for both housing purposes and for taxable activities the assessment can be based on other circumstances than if the property is solely used for a taxable activity. In this case, the property was used solely for a taxable activity and not as a permanent dwelling. Therefore, the character of the building was of no relevance.[70]

The STA appealed to the HFD, which also allowed for deduction of input VAT and considering the building to be used for the taxable activities of the company and not constituting a permanent dwelling. The HFD pointed out that the prohibition of deductions of input VAT relating to permanent dwellings was introduced to simplify the assessment of the right to deduct, which would not be possible under the general rule in Chapter 8. Section 3 ML. The court referred to the cases RÅ 2003 ref. 100 I and II where the court previously had found that the prohibition of deduction is to be seen as a general rule which applies irrespective of whether the input VAT relates to a taxable activity or not. The right to deduct must, therefore, be based on if the property is to be considered a permanent dwelling according to Chapter 8. Section 9 first subparagraph point one ML.

The HFD considered that according to case law and the preparatory work that when a property is used both as a permanent dwelling and in a taxable activity, the assessment can be based on other circumstances than if the property is solely used for a taxable activity. The HFD concluded that the property did not constitute a permanent dwelling, based on the fact that it was not used in such a way that it could replace a permanent dwelling for the participants. Consequently, the company was allowed for a deduction of input VAT.[71]

In a more recent case, the HFD delivered a judgment stating that a shelter was not regarded as a permanent dwelling. The rooms of the shelter could only be used for

[70] RÅ 2005 ref. 34.

[71] RÅ 2005 ref. 34.

a few hours per night and access to the rooms were granted every night based on the need of the persons coming there. No rental agreement was concluded and the individuals staying at the shelter did not have any key to the rooms and the staff granted access. The rooms were not equipped kitchens or any other equipment making it possible to cook.[72]

3.3.2 Smaller houses

The case RÅ 2003 ref. 100 I, concerned the deduction of input tax relating to the purchase and the construction of a smaller house. The company intended to use the house as a dwelling for the corporate executive and as an office for the company. Of the building, 30% was to be used for the business consisting of offices, storage rooms, and a garage. The house consisted of two floors with a total area of 271 square meters. At the time of the building of the house, the export manager, the wife, and daughter to the corporate executive was hired. Four offices were therefore needed. Video conference equipment and a kitchenette were also to be installed. The entrance was going to be used by both the company and the corporate executive. Furthermore, the company would dispose of a toilet on the ground floor. The house was equipped with a lift to make it possible for the physically challenged corporate executive to move between the different parts of the house.

The HFD found that even though the property was intended to be used in the course of the business at the time of planning and construction of the building, no adaption was made, or special equipment was installed in the part of the building which was intended to be used for the business. It was not clear which parts of the building that was going to be used for this purpose. The investigation did not show that some areas of the building were separated from the permanent dwelling. According to the HFD, the fact that the spaces in the building designed as permanent dwelling are used as an office in a business means that these spaces should be regarded as a part of a permanent dwelling. The HFD concluded that the input VAT, relating to the construction costs which the company claimed a deduction for must be regarded as attributable to a permanent dwelling. The HFD pointed out that the assessment of whether a building constitutes a permanent dwelling should only be based on the character of the building and that the actual use is of no relevance. A deduction was therefore not allowed according to Chapter 8. Section 9 first subparagraph point one ML.[73]

The HFD also found Chapter 8. Section 9 first subparagraph point one ML to be compatible with 17(6) (now Article 176) of the Sixth Directive since it did not

[72] HFD case nr. 6743-15.

[73] RÅ 2003 ref. 100 I.

extend the prohibition of deduction on permanent dwellings belonging to the taxpayer of and employee, which was in force at the time of Sweden's accession to the European Union.[74]

The case RÅ 2003 ref. 100 II also concerned the purchase of a small house built by a company and the deduction of input VAT. The house was intended to be used for both the business and as a dwelling for the company owner and his family. The house consisted of three floors. The ground floor was used as an office which consisted of three rooms. It had an own entrance and was equipped with a so-called cat 5 network installed at a cost of 100 000 SEK. The space had no ventilation and nothing from the case suggested that the property was to be used for other purposes than for the business. The HFD found that the company had the right to deduct VAT relating to part of the building which was used for the business according to Chapter 8. Section 3 ML.[75]

In the case RÅ 2010 ref. 43, a foundation applied for a preliminary ruling to the Board of Taxation. The foundation had the purpose of promoting scientific research at a University by letting, under favorable conditions, dwellings to researchers. Preferably to foreign guest researchers. The duration of the lettings varied from one month up to one and a half year. Due to an increasing need to provide guest researchers dwellings near the University, the foundation planned for a construction of 24 dwellings. The STA had granted the foundation voluntary tax liability and considered the building in question was to be used as a permanent dwelling according to Chapter 8. Section 9 first subparagraph point one ML. Therefore, the foundation applied to Board with the question whether the building should be regarded as a permanent dwelling. The Board held that the building was not to be regarded as a permanent dwelling. The STA appealed to the decision.

The HFD stated that the prohibition of deductions of input VAT relating to permanent dwellings was introduced to avoid deductions of input VAT relating to costs for private consumption (Government Bill 1993/94:99 p. 212). The court found that the prohibition of deduction must be seen as a general rule which applies, even though the input VAT would be deductible according to the main rule in Chapter 8. Section 3 first subparagraph ML, as VAT attributable to the business activity (referring to RÅ 2003 ref 100 I and II). Regarding the scope of the prohibition, the HFD found that both the character and the actual use of a building can be of relevance (referring to RÅ 2003 ref. 100 I and II).

The HFD held, that the dwellings in question were not different from other apartments on the public housing market and that the general prohibition of

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[74] RÅ 2003 ref. 100 I.

[75] RÅ 2003 ref. 100 II.

deduction for permanent dwellings was in principle applicable. The tenants of the foundation did not have the intention to let the apartments similar to the hotel business (RÅ 2002 ref. 67). Not only the design but also the use of the apartments may be considered when determining if the building constitutes a permanent dwelling within the meaning of Chapter 8. Section 9 first subparagraph point one ML. The fact that the lettings was made to the University and not directly to the guest researchers did not lead to another conclusion. Therefore, the foundation was not allowed to deduct input VAT attributable to the acquisitions made for the lettings of dwellings.[76]

3.3.3 Care homes and refugee accommodations

In the case RÅ 1993 ref. 30 the municipality of Norrtälje applied for a preliminary ruling to the Board of Taxation asking whether residential homes consisting of apartments and group homes for senile dement persons was to be considered as permanent dwellings and consequently not allowed for deductions of input VAT relating to those.

The Board found the prohibition of deductions of input VAT relating to permanent dwellings in Section 18 ML (now Chapter 8. Section 9 first subparagraph point one ML) to be of general character meaning that it applies to all types of permanent dwellings. The dwellings provided by the municipality was, according to the Board, let and used by the dwellers in a similar way as on the public housing market. The fact that the apartments were handicap friendly and designed with regard to the needs of each individual did not distinguish the property from other dwellings and therefore falling within the scope of the prohibition. The municipality of Norrtälje appealed against the ruling to the HFD, which agreed with the Board and settled the ruling.[77]

In the case RÅ 1997 not. 245 municipality of Kalmar applied for a preliminary ruling to the Board of Taxation regarding the prohibition of deductions of input VAT relating to permanent dwelling in Chapter 8. Section 9 first subparagraph point one ML. The question referred was whether the letting of immovable property for a retirement home for both permanent and temporary residents was to be considered a permanent dwelling or not. Kalmar municipality argued that the circumstances of the case were different from RÅ 1993 ref. 30 since the apartments differed in terms of standard, size and activities carried out at the care home.

The Board referred to the case RÅ 1993 ref. 30 and considered the care home in Norrtälje to be similar to the one in Kalmar and did not find any reason to come to

[76] RÅ 2010 ref. 43.

[77] RÅ 1993 ref. 30.

a different conclusion. The fact that the apartments were to be used for short-term accommodation did not change the character of the apartments since they seemed to be furnished similarly to those that are used as permanent dwellings. The Board considered the apartments as permanent dwellings, and the deduction was refused. The municipality of Kalmar appealed to the HFD. The HFD agreed with the Board and settled the ruling.[78]

The case RÅ 2005 not. 78 concerned temporary housing modules which were let out for homeless persons. The company referred to the Board of Taxation the question of whether the letting of this housing modules would be regarded as permanent dwellings pursuant to Chapter 3. Section 3 second subparagraph ML. The current housing modules had three different designs to be used for so-called temporary dwelling with the purpose to adapt the homeless persons for normal living. The time of stay of the residents varied from one week up to two years depending on the individual circumstances. Both the Board and the HFD held that the municipality would indeed carry out a kind of care activity, but the primary activity was to offer homeless persons a dwelling. The modules would be used for a more or less as permanent dwellings where the element of care could be considered limited. Therefore, the modules were to be regarded as permanent dwellings and exempt from taxation according to Chapter 3. Section 3 second subparagraph ML.[79]

In the case HFD 2013 ref. 79 I, a building was let out to a municipality for the use of a group home for young adults with congenital disabilities, such as autism or similar conditions. The residents of the group home had been granted the assistance in accordance with the Act concerning support and service for certain disabled[80]. Furthermore, according to Act on compensation for certain VAT for municipalities[81] section 5, counties and federal coordination municipalities have the right to obtain a compensation of VAT relating to social care. However, the Board did not consider the letting to constitute social care and concluded that the building constituted a permanent dwelling and not subject to VAT according to Chapter 3. Section 3 second subparagraph ML. The HFD agreed and settled the ruling.

Two members of the Board contested the judgment considering the letting to be subject to VAT. According to Chapter 3. Section 3 second paragraph ML lettings to a municipality carrying out social care are subject to VAT. The municipality

[78] RÅ 1997 not. 245.

[79] RÅ 2005 not. 78.

[80] Lag om stöd och service till vissa funktionshindrade (SFS 1993:387). Hereinafter ”LSS”.

[81] Lag om ersättning för viss mervärdesskatt för kommuner, landsting, kommunalförbund och samordningsförbund (SFS 2005:807). Hereinafter ”LEMK”.

was engaged in an activity which constituted social care and the letting should, therefore, have been subject to VAT. The dissenting members also referred to the Guide to VAT where the STA stated that elderly care and group homes were to be considered as social care. It was also stated in the recommendation of the National Tax Administration, that retirement homes and group homes should be fully considered as social care and therefore subject to VAT.[82]

In the case HFD 2015 not. 56, a company applied for a preliminary ruling to the Board of Taxation asking whether a building let out to the municipality of Vellinge could be regarded as a permanent dwelling. The municipality used the building as a dwelling for unaccompanied child refugee which was classified as an HVB-home. The building was divided into living areas, common areas and staff areas. The staff consisted of social workers and special pedagogues.

The Board considered the property to constitute a permanent dwelling. The Board stressed the fact that the children's stay could last up to six years and that they had no other home or residence in Sweden. The property would, therefore, be used in a similar manner as in the public housing market (referring to RÅ 2005 not. 78). According to the Board, the element of care in the dwelling and that it was intended to be replaced by other forms of living in the future did not mean that the property changed its character from a permanent dwelling. The Board concluded that care homes for people with extensive need of care as well as temporary dwellings had previously been considered as permanent dwellings (referring to HFD 2013 ref. 79 I and RÅ 2005 not. 78). The HFD agreed with the Board and settled the case.

Two members of the Board contested this judgment considering that the building was not be regarded as a permanent dwelling. The members pointed out that, in the Government Bill 1997/98:153 it has been confirmed that the prohibition of deductions of input VAT relating to permanent dwellings does not apply to HVB-homes such as accommodation for unaccompanied child refugees. Furthermore, they noted that the interpretation of the concept of permanent dwellings and the prohibition of deductions of input VAT relating to permanent dwellings constituted an unauthorized extension of the prohibition.[83]

[82] HFD 2013 ref. 79 I.

[83] HFD 2015 not. 56.

4 PERMANENT DWELLINGS AND THE VAT DIRECTIVE

4.1 Before Sweden's accession to the European Union

At the time of implementation of the Sixth Directive in Sweden, the Swedish VAT legislation excluded the right to deduct input VAT relating to permanent dwellings. Consequently, the exclusion from the right to deduct is covered by the standstill clause in the second subparagraph of Article 176.

At the outset, the intention of the Swedish legislator was to prohibit the right to deduct input VAT relating to permanent dwellings belonging to the taxpayer or his employees. Following an editorial change in 1973, the words taxpayer and employee was removed from the prohibition. However, the provision was considered to be, in essence, the same. In connection to Sweden's accession to the EU, a Government Committee held that the prohibition of deductions of input VAT relating to permanent dwellings was in conformity with the Sixth Directive, albeit superfluous.[84]

In the cases RÅ 1988 not. 642 and RÅ 1991 not. 82 the HFD considered the lettings of cabins to asylum seekers to be similar to a hotel business, despite the fact that the stays could amount up to nine months. The assessment was based on the purpose of the business. Regarding care homes the HFD held in the case RÅ 1993 ref. 30 that residential homes and group homes for senile dement persons constituted permanent dwellings.[85] Notwithstanding the intention of the legislator, the HFD considered in the case RÅ 1993 ref. 30 the prohibition to be general covering all permanent dwellings since they are normally used for private purposes.

That will serve as the basis and comparable law in force at the time of the implementation of the Sixth Directive when further analyzing if the prohibition of deductions of input VAT relating to permanent dwellings is in breach of the standstill clause.

[84] See section 3.2.1.

[85] RÅ 1988 not. 642 and RÅ 1991 not. 82. These cases has been presented above.

4.2 Administrative measures and practices by the public authorities

4.2.1 Care homes

Initially, care homes were in the cases RÅ 1993 ref. 30 and RÅ 1997 not. 245 considered as permanent dwellings. The case HFD 2013 ref. 79 I concerned an application for voluntary tax liability regarding a building which was let out to a municipality for the use of a group home for young adults with congenital disabilities such as autism or similar conditions.[86] The residents of the group home had been granted the assistance under LSS. Even though this case concerned voluntary tax liability, the interpretation of the concept permanent dwelling is given the same meaning in Chapter 3. Section 3 second subparagraph and Chapter 8. Section 9 first subparagraph point one ML.[87]

As two of the members of the Board of Taxation noted in HFD 2013 ref. 79 I, the STA have previously stated in their Guidance to VAT that care of elderly and physically challenged individuals in the form of retirements homes and group homes was to be considered as social care.[88] In addition to this, the STA had also stated in a recommendation that social care carried out at retirement homes and group homes should be fully considered as social care.[89] Therefore, the activity carried out at the group home should have been considered as social care exempt from VAT, according to Chapter 3. Section 4 and 7 ML. Furthermore, Chapter 3. Section 3 second subparagraph ML stipulates that lettings to a municipality are subject to VAT, even if the letting is made for a business that is exempt from VAT, such as social care carried out by a municipality. According to the STA, the group home should have been regarded as social care and voluntary tax liability should have been granted.

On the contrary, both the Board of Taxation and the HFD came to the conclusion that the building constituted a permanent dwelling, and voluntary tax liability was therefore not granted. In substance, the Board mainly based its conclusion on the fact that the activity carried out in the group home was not classified as social care

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[86] HFD 2013 ref. 79 I. This case has been presented above.

[87] See section 3.2.

[88] Skatteverkets Handledning för mervärdesskatt 2012, del II, page. 976, <http://www.skatteverket.se/download/18.71004e4c133e23bf6db800067722/SKV+554+utgåva+7+Handledning+för+mervärdesskatt+2012%2C+del+2.pdf>, accessed 2016-06-19.

[89] Riksskatteverkets rekommendation RSV S 1996:7 chapter 4.2, <https://www.skatteverket.se/rattsinformation/arkivforrattsligvagledning/allmannarad/aldre/1996/1996/rsvs199607.4.18e1b10334ebe8bc80003633.html>, accessed 2016-06-19.

under the Social Service Act[90] in force at the time (referring to the case RÅ 1993 ref. 30).

It can be argued that the HFD applied the concept of permanent dwellings correctly and in accordance with the law in force at the time of Sweden's accession to the EU. However, the Board and the HFD, either missed or disregarded the Guide to VAT and the recommendation by the STA, which clearly states that group homes and retirements homes are to be considered as social care in full.

According to the standstill clause provided in Article 176, a Member State can not only through legislative acts but also through administrative measures and practices preclude itself from applying retained exclusions from the right to deduct.[91] Group homes and retirement homes were previously considered to constitute social care by the STA. The STA, thereby, defined the concept of permanent dwellings and subsequently limited the scope of the prohibition in Chapter 8. Section 9 first subparagraph point one ML. Therefore, the standstill clause should have precluded the HFD from applying the concept of permanent dwellings on social care and the case HFD 2013 ref. 79 I should be deemed to be in breach of the standstill clause in the second subparagraph of Article 176.

4.2.2 Refugee accommodations

The case HFD 2015 not. 56 also concerned voluntary tax liability and was not granted as both the Board of Taxation and the HFD considered the building, which was used as an accommodation for unaccompanied child refugees (HVB-home), to constitute a permanent dwelling. Since the stay of the children could amount up to six years, and that the children did not have any other home or dwelling in Sweden. The Board referred to previous case law stating that apartments used in a similar manner as dwellings on the public housing market fall within the scope of the prohibition regarding permanent dwellings. The Board also referred to the case HFD 2013 ref. 79 I, stating that the fact that social care was carried out in the building did not change the character of the building and was still to be considered a permanent dwelling. A case which should be deemed to be in breach of the standstill clause in Article 176 precluding Sweden from interpreting the concept of permanent dwellings to include social care.

Moreover, as stated by the two dissenting members of the Board, HVB-homes such as accommodation for unaccompanied child refugees constitutes social care and are not covered by the prohibition. The STA have expressly stated in the Guidance for VAT that HVB-homes constitutes social care. The STA also pointed

[90] Socialtjänstlag (SFS 2001:435). Hereinafter "SoL".

[91] See section 2.4.5.

out that a municipality can decide to place young persons in HVB-homes or foster homes according to the Act on the care of young persons[92] or SoL.[93] Both SoL and LVU applies to unaccompanied child refugees when municipalities decide to place them in HVB-homes. Therefore, accommodations for unaccompanied child refugees constitutes HVB-homes.[94] In the Government Bill 1997/98/153, it was confirmed that municipalities had received refunds according to LEMK for input VAT since institutional care such as HVB-homes has previously not been regarded as permanent dwellings by the STA.[95]

In a similar manner as in HFD 2013 ref. 79 I, the HFD extended the scope of the prohibition by not taking into account what previously have been stated and applied by the STA through its administrative practices. For these reasons, it can be concluded that the interpretation of the concept of permanent dwellings by the Board of Taxation and, ultimately the HFD constitutes a breach of the standstill clause in Article 176.

4.2.3 Short-term and temporary lettings

Temporary housing modules let out for homeless persons were in the case RÅ 2005 not. 78 regarded as permanent dwellings. The time of stay varied from one week up to two years, and the purpose of the housing modules was to adapt the homeless persons to normal living. The Board of Taxation based its decision on the cases RÅ 1993 ref. 30 and RÅ 1997 ref. 245, cases in which the HFD previously had held that group homes and retirement homes constituted permanent dwellings. Furthermore, the housing modules were to be regarded as permanent, and the Board added that the element of care, in this case, would be limited.[96] Notwithstanding the fact that the STA had previously considered these types of homes to constitute social care and subsequently subject to VAT when let to a municipality.

The case RÅ 2005 not. 78 also contradicts previous case law such as RÅ 1991 not. 82, in which the HFD expressly pointed out that the assessment of whether a letting is short-term or temporary should be based on the purposes of the business. In RÅ 1991 not. 82 the HFD also pointed out that the duration of stay of the asylum seekers was of no relevance. The HFD also noted that the purpose in RÅ

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[92] Lag (1990:52) med särskilda bestämmelser om vård av unga. Hereinafter ”LVU”.

[93] Skatteverkets handledning för mervärdesskatt 2014, chapter 25, page. 29, http://www4.skatteverket.se/download/18.22f626eb14fb326a4b65be2/1441851273642/SKV%2B553%2BAvsnitt%2B25%2BSjukvård%2Btandvård%2Boch%2Bsocial%2Bomsorg.pdf, accessed 2016-06-19.

[94] SOU 2014:3, p. 237.

[95] Proposition 1997/98:153, p. 11.

[96] RÅ 2005 ref. 78. This case has been presented above.

1991 not. 82 was to provide a temporary dwelling for asylum seekers. A purpose which could be regarded as similar to the circumstances in RÅ 2005 not. 78 where the purpose was to adapt homeless persons to normal living.

Interestingly, neither the National Tax Administration or the HFD in RÅ 1991 not. 82 mentioned or applied the prohibition regarding permanent dwellings, which at the time was in force. That implies that the scope of the prohibition did not cover short-term or temporary lettings of buildings. For that reason, it could be argued that the case RÅ 2005 not. 78 extended the scope of the prohibition of deductions of input VAT relating to permanent dwellings, in relation to previous case law, to also cover lettings for short-term or temporary use.

4.2.4 Lettings of immovable property according to Article 135(1)(l)

The interpretation of the concept of permanent dwellings in the judgments of RÅ 2005 not. 78, HFD 2013 ref. 79 I and HFD 2015 not. 56 is not only in breach of the standstill clause but also deviates from the concept of lettings of immovable property in Article 135(1)(I). A concept which has been defined in the case law of the ECJ. For example, the ECJ held in the case C-284/03 Temco Europe that lettings of immovable property means: ”[…] *essentially the conferring by a landlord on a tenant, for an agreed period and in return for payment, of the right to occupy property as if that person were the owner and to exclude any other person from enjoyment of such a right*[…]”[97]

As Kleerup and Schiess noted, it can, therefore, be questioned if lettings of care homes and refugee accommodation or even temporary short-term accommodation can constitute lettings of immovable property and subsequently permanent dwellings since the residents of such dwellings do not have the full right to dispose of the property as an owner.[98]

4.3 Derogations permitted under Article 176

The ECJ have held that Article 176 allows the Member States to exclude the right to deduct input VAT on certain expenditure even though it is strictly related to a taxable activity. However, the Member States do not have an unfettered discretion to exclude all and any goods and services from the right to deduction.[99] Moreover, the Member State are forbidden to extend the scope of retained exclusions, and the ECJ have stated that derogations under Article 176 can only apply to certain expenditure. That raises the question if the prohibition regarding permanent

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[97] C-284/03, *Temco Europe,* EU:C:2004:730, para 19.

[98] J. Kleerup and R. Schiess, (2014), p. 805-806.

[99] See section 2.4.1.

dwellings is defined in accordance with Article 176. Regarding the strict interpretation of derogations authorized under Article 17(6) (now Article 176) the ECJ have stated the following:

> *"The second subparagraph of Article 17(6) of the Sixth Directive must be read in the light of the first subparagraph of the same provision, which confers on the Council the power to determine, on a proposal from the Commission, what expenditure is not to be eligible for a deduction of VAT, and which specifies that, in no circumstances, is expenditure to be deductible which is not strictly business expenditure, such as that on luxuries, amusements or entertainment.*
>
> *Consequently, and in view of the strict interpretation which it must be given as a derogation, the second subparagraph of Article 17(6) of the Sixth Directive cannot be regarded as permitting a Member State to maintain a restriction of the right to deduct VAT which may also apply in a general manner to any expenditure related to the acquisition of goods, irrespective of its nature or purpose.*
>
> *That interpretation is also obvious in the light of the history of that provision, which demonstrates a continuing intention on the part of the Community legislature to authorise only the exclusion of certain goods or services from the deduction system, and not to authorise general exclusions from that system*[…]*"*[100]

From these statements, it can be derived that the second subparagraph of Article 176 only allows limitations of the right to deduct input VAT relating to expenditure defined with reference to its nature or purpose. The ECJ pointed out that the second subparagraph of Article 176 must be read in the light of the first subparagraph. Which implies that Article 176 requires that the limitations of the right to deduct are clear and specific only covering certain expenditure. Consequently, the Member States can not have limitations of the right to deduct authorized under the second subparagraph of Article 176 which are general, unspecified and vague covering all types of goods or services, even though the legislation existed at the time of the accession to the EU.[101]

On the contrary, the HFD have held in several cases such as RÅ 1993 ref. 30, RÅ 2010 ref. 43 and HFD 2015 not. 56 that the prohibition of deductions of input VAT relating to permanent dwellings must be considered as a general rule which applies to all permanent dwellings.[102]

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[100] C-74/08, *PARAT*, EU:C:2009:261, paras 27-29.

[101] J. Kleerup and R. Schiess, (2014), p. 806-808.

[102] See section 3.3.2; J. Kleerup and R. Schiess, (2014), p. 806-808.

Furthermore, in the case C-184/04 Uudenkaupunging kaupunki the ECJ stated the following:

> *"Analysis of the origin of Article 17(6) of the Sixth Directive shows that the option given to Member States by the second subparagraph of that provision applies only to maintaining exclusions from deduction with regard to categories of expenditure defined by reference to the nature of the goods or services acquired rather than by reference to the use to which they are put or the way in which they are used."*[103]

This analysis of the ECJ supports the finding that exclusions from the right deduct VAT authorized under the second subparagraph of Article 176 only includes certain categories of expenditure which should be defined with reference to the nature of the good or service rather than with reference to how it is put to use or the way in which they are used. In other words, and as noted by Krister Andersson and Anna Sandberg Nilsson, the second subparagraph of Article 176 only allows limitations of the right to deduct input VAT on certain categories of costs which should be defined on the basis of the type of good or service acquired. Contrary to this, the prohibition cover all costs relating to permanent dwellings, and the concept of permanent dwellings is defined in reference to the use which it is put.[104] For example, the HFD stated in the case HFD 2015 not. 56 that if a building is used in a similar manner to a dwelling on the public housing market it constitutes a permanent dwelling, and clearly defining the concept permanent dwelling in reference to how it is put to use.

Since the prohibition applies in a general manner covering all costs relating to permanent dwellings which are defined in reference to how it is put to use rather than by reference to the nature of them it can be concluded that prohibition of deductions of input VAT relating permanent dwellings is not allowed under the second subparagraph of Article 176. Even though it existed before Sweden acceded to the EU.[105]

4.3.1 The purpose of the limitations of the right to deduct under Article 176

In the case C-43/96 Commission v. France, the ECJ pointed out that one of the underlying purposes of limiting the right to deduct under Article 17(6) of the Sixth Directive (now Article 176) was at the outset to exclude deductions of input VAT

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[103] C-184/04, *Uudenkaupungin kaupunki*, EU:C:2006:214, para 49. See also C-305/97, *Royscot Leasing*, EU:C:1999:481, paras 21-25. These cases has been presented above.

[104] K. Andersson and A. Sandberg Nilsson, (2014), p. 7-8. See also J. Kleerup and R. Schiess, (2014), p. 808.

[105] J. Kleerup and R. Schiess, (2014), p. 807-809; K. Andersson and A. Sandberg Nilsson, (2014), p. 8.

on certain expenditure to prevent deductions of input VAT not attributable to the taxable activities of a taxable person. Certain expenditure for which it would be difficult to apportion the use between business and private.[106] From this, it could be derived that the limitations of the right to deduct authorized under the second subparagraph of Article 176 should be retained for the purpose of simplifying.

It can, therefore, be argued that the underlying purpose of limiting the fundamental right to deduct input VAT under Article 176 is to make it more simple to assess the right to deduct input VAT relating to a certain type of expenditure. An approach which was also noted by the HFD in the case RÅ 2005 ref. 34, that the prohibition was introduced to simplify the assessment of the right to deduct which, would not be possible under the main rule in Chapter 8. Section 3 ML.

Examples of provisions simplifying could be the limitation of the right to deduct input VAT relating to cars or other vehicles in Chapter 8. Section 15 and 16 ML which are defined in reference to its nature and not to how it is put to use[107]. Cars and other vehicles also constitute goods which it is possible to use for both private and business purposes. That raises the question if the prohibition of deductions of input VAT relating to permanent dwellings contributes to a more simple assessment of the right to deduct or not. The difficulties in the interpretation of the concept of permanent dwellings is illustrated in the following sections.

4.4 The difficulties in the interpretation of the concept of permanent dwellings

Even though it have been subject to the interpretation of the HFD in numerous cases, it is still difficult to extract a uniform definition of the concept of permanent dwellings. In the cases RÅ84 1:69 and RÅ 1997 not. 245 the HFD stated that the character of the building was crucial. In the judgment of RÅ 2002 ref. 67 the HFD considered a company housing that was built for the purpose of the business to be used similar to a hotel, regardless of the character and the layout of the building.[108]

In RÅ 2005 ref. 34 the actual usage was decisive when assessing whether the building constituted a permanent dwelling or not. The cases RÅ 2003 ref. 100 I and II concerned smaller houses intended to be used both for the business and as dwellings for the employees. In these cases, the underlying purpose of the use of

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[106] C-43/96, *Commission v. France*, EU:C:1998:304, para 19; AG Jacobs Opinion delivered on 13 November 1997, EU:C:1997:537, paras 14-16. This case has been presented above.

[107] See the definition of cars in Chapter 1. Section 13 ML.

[108] RÅ84 1:69, RÅ 1997 not. 245 and RÅ 2002 ref. 67. These cases have been presented above.

the building was given importance even though the court held that both the design and the actual use of the building could be of relevance.[109]

More recently, the HFD held in the case 6743-15 HFD that a shelter did not constitute a permanent dwelling. The HFD held that the both the character and the actual use of the building could be of relevance when determining if the building constitutes a permanent dwelling. The court stated that apartments and other dwellings used in a similar manner as other dwellings on the public housing market fall within the scope of the prohibition.[110] Consequently, a comparison must be made with a dwelling on the public housing market. However, it is not yet clear how much the duration of the stay affects the assessment.[111]

These cases illustrate the difficulties in the interpretation of the concept of permanent dwellings, and the difficulties arising when assessing whether a building constitutes a permanent dwelling or not. Even though the second subparagraph of Article 176 requires that the limitations of the right to deduct are specified and clear, the key issue, to determine if a building constitutes a permanent dwelling, seems to be very much dependent on the circumstances of each individual case. It also illustrates the issues and difficulties inherent in the wording of the provision and in the concept of permanent dwellings.

Consequently, as Andersson and Sandberg Nilsson concluded, the prohibition could be questioned since it does not contribute to a more simple assessment of the right to deduction.[112] In other words, the prohibition fails to fulfill its main purpose, which is to simplify.

4.4.1 A permanent dwelling or a hotel

To illustrate further difficulties in determining whether a building constitutes a permanent dwelling this section provides an examination of how short-term lettings are treated in ML, including the opinion of the STA.

According to Article 135(1)(I) of the VAT Directive, the leasing and lettings of immovable property are exempt from VAT. However, the second subparagraph of this article excludes provisions of accommodation, as defined in the laws of the Member States, in the hotel sector. Which means that accommodation in the hotel sector is subject to VAT. This provision is implemented through Chapter 3. Section 3 first subparagraph point four ML.

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[109] RÅ 2005 ref. 34 and RÅ 2003 ref. 100 I and II. These cases have been presented above.

[110] HFD 6743-15.

[111] See section 4.4.1.

[112] K. Andersson and A. Sandberg Nilsson, (2014), p. 4-5.

In the case C-346/95, Mrs. Blasi let a building in Germany for accommodation for refugee families. The building contained several dwellings fully equipped with cooking facilities and bathrooms and lavatories. The municipality of Munich paid for the stay. The letting agreements were always concluded for fewer than six months. However, many of the refugees stayed for more than a year. Following a tax assessment, Mrs. Blasi was obliged to pay output tax on the income from the lettings. Mrs. Blasi appealed, and the case was referred to the ECJ with the question whether short-term lettings was to be excluded from the exemption in Article 13B(b)(1) of the Sixth Directive (now Article 135(1)(I)). In addition to this, the referring court in Germany also asked if the duration of the accommodation could serve as a basis for making a distinction between exempt and taxed transactions.[113]

The ECJ began by stating that exemptions must be interpreted strictly.[114] The Court also noted that the Member States enjoy a margin of discretion when determining which provisions of accommodation are to be taxed according to Article 135 (1)(I).[115] The ECJ held that when distinguishing between lettings in the hotel sector and other lettings, the duration constitutes an appropriate criterion for making this distinction. The Court considered that defining short-term accommodation as less than six months reasonable to ensure that the business is similar to a hotel and providing temporary accommodation on a commercial basis.[116] Lastly, the Court pointed out that the duration of the stay stated in the agreement may not reflect the parties real intention. The actual duration of the accommodation would instead have to be taken into consideration.[117]

On the contrary to what the ECJ held in the case of Mrs. Blasi, the Administrative Court in Malmö held in the case 1365-15 that dwellings where the stay only amounted up to a few days up to four months constituted permanent dwellings. This case concerned an application for voluntary tax liability regarding a building. The building was let to the municipality of Malmö. The municipality used the building as a temporary dwelling for homeless persons. The stay of the individuals varied from a few days up to four months (in some exceptional cases). The rooms were not equipped with bathrooms or kitchens making it possible to cook.[118] The Administrative Court in Malmö considered the building to be a

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[113] C-346/95, *Blasi,* EU:C:1998:51, paras 5-17.

[114] C-346/95, *Blasi*, EU:C:1998:51, para 18.

[115] C-346/95, *Blasi*, EU:C:1998:51, para 21.

[116] C-346/95, *Blasi*, EU:C:1998:51, para 24.

[117] C-346/95, *Blasi*, EU:C:1998:51, paras 26-27.

[118] Administrative Court in Malmö, case nr. 1365-15.

permanent dwelling and therefore dismissing the application for voluntary tax liability. The court held that even though the rooms lacked kitchen and bathrooms they could constitute permanent dwellings (referring to RÅ 2005 not. 78 and HFD 2015 not. 56). It also held that dwellings, where the stay amounted from one week up to one month could still be considered as permanent dwellings (referring to RÅ 2013 ref. 79 I, RÅ 2005 not. 78 and RÅ 2010 ref. 43). The court pointed out that the homeless persons did not have any other dwellings, the time of the stay were not limited in time and was, therefore, considered as a permanent dwelling used in a similar manner as dwellings on the public housing market.[119]

As mentioned above, lettings of rooms in hotel business or similar are subject to VAT according to Chapter 3. Section 3 first subparagraph point four ML. The STA have specified two requirements for a letting to be considered as similar to a hotel business. The STA requires that the letting is intended to provide *temporary accommodation* and that the letting will be carried out within the framework of a *hotel business or a similar activity*. According to the STA, when assessing if these requirements are met, the purpose and content of the business are decisive.

In short, the STA states the following: *Temporary accommodation* means that the letting is made for short time. The duration of the letting should be assessed based on the contract and not on the actual stay of the dwellers. According to the STA s*imilar to the hotel business* means that the lettings are marketed with daily or weekly prices. The STA also considers that the duration of the dwellers cannot exceed four months. Strangely, the STA also considers that lettings for maximum 11 months are similar to a hotel business as long as the purpose and content of the business remain the same. However, if the lettings are made to the same person for more than 11 during a period of 12 months, the lettings are presumed to be an exempt letting and not *similar to a hotel business*.[120]

What this means is that lettings of rooms for temporary accommodation can be exempt, and no deductions of input VAT are allowed. Or, if the requirements set up by the STA are met, lettings could be regarded as similar to a hotel business and, therefore taxed and allowed for deductions.

Moreover, the HFD held in the case 6743-15 HFD that a shelter did not constitute a permanent dwelling and stated that the time of the stay is not relevant if the property is used as similar to dwellings on the public housing market.[121] The Administrative Court held in the case 1365-15 that a temporary dwelling for

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[119] Administrative Court in Malmö, case nr. 1365-15.

[120] Skatteverkets ställningstagande, *Skatteplikt vid rumsuthyrning i hotellrörelse, mervärdesskatt,* 2015-12-18, <https://www4.skatteverket.se/rattsligvagledning/350167.html?date=2015-12-18&q=131+675099-15%2F111>, accessed 2016-06-28.

[121] HFD 6743-15. This case has been presented above.

homeless individuals constituted permanent dwelling where they stay amounted from a few days to four months. At the same time, the STA considers certain lettings to be similar to the hotel business under certain conditions if the stay normally amounts up to four months or a maximum of 11 months as long as the purpose and content of the activity remain the same.

In summary, immovable property that is let from two days up to 11 months can either be treated as an exempt activity for which no deductions are allowed. Or, it can be treated as a taxed activity similar to a hotel business for which the right to deduct input VAT can be obtained. In addition to that, immovable property let for more than one day can constitute a permanent dwelling and not allowing for deductions of input VAT since voluntary tax liability can not be granted. A result, which is in breach of the fundamental principle of neutrality underlying the system of VAT, requiring that similar activities which are in competition are treated equally[122]. Moreover, owners of immovable property are given the option to carry out, either an exempt activity or a taxed activity such as a hotel business, which is also impairing the general character of the VAT since the VAT should not affect the choice of traders or consumers.[123]

Interestingly, the Administrative Court of Malmö in case 1365-15 considered the building to constitute a permanent even though the dwellings were not equipped with bathrooms or kitchens (referring to the case HFD 2015 not. 56). That raises the question if the concept of permanent dwellings can include dwellings of more simple character, such as rooms lacking both bathrooms or the possibility to prepare food. Reasonably, a permanent dwelling must be a dwelling in which it is at least possible to prepare food and use a bathroom to be considered permanent. It can, therefore, be argued that the interpretation of the concept of permanent dwellings goes beyond its wording.

4.4.2 Voluntary tax liability

As a rule, immovable property is exempt from taxation and, therefore, VAT is not charged on the transaction. Hence, the owner of the property has no right to deduct input VAT relating to the property. According to Chapter 9. Section 1 ML, owners of immovable property which is let for business premises, can apply for voluntary tax liability which means that the owner is obliged to charge VAT on the letting. The voluntary tax liability also allows the property owner to deduct input VAT relating to the property. Thus, property owners are relieved from the burden of the VAT. However, if the property constitutes a permanent dwelling, it is not possible to become voluntarily liable to tax since permanent dwellings are not

[122] See section 2.2.

[123] See section 2.1.

subject to VAT, according to Chapter 3. Section 2 second subparagraph ML. In other words, VAT is not charged on for example lettings of immovable property constituting permanent dwellings since ML does not allow for voluntary tax liability. Yet, the ML prohibits deductions of input VAT relating to permanent dwellings even though permanent dwellings are exempt.

The effect of these two provisions is that the person who lets property constituting a permanent dwelling do not have the right to deductions since permanent dwellings are exempt, and deductions are prohibited. In addition to that, the person renting the property does not have the right to deduct even though the letting is exempt. In other words, these two provisions give rise to a form of ”double regulation” and the prohibition in Chapter 8. Section 9 first subparagraph point one ML could, therefore, be deemed as superfluous.

Not only could the prohibition be deemed to be superfluous, when determining if a property owner can be granted voluntary tax liability, the concept of permanent dwellings also gives rise to difficult distinctions very much dependent on the circumstances of each specific case. That is illustrated in the judgment of the case 1113-15 recently delivered by the HFD which concerned a company’s application for voluntary tax liability to be able to obtain the right to deduct input VAT incurred during the construction of the building. The company intended to let the building to the municipality of Linköping for group homes. The application concerned 152 square meters of a total area of 484 square meters, including a kitchen with dining area, living room, TV-room, rooms for the staff, laundry, cleaning supply and a garbage room. The area also included 33.7% of a total area of 48 square meters constituting technical room, supplies, and entrances. The question was whether these areas was attributable to the permanent dwellings of the residents of the group home.

In the judgment, the HFD began by stating that voluntary tax liability may only be granted for a particular building or a particular part of a building. Therefore, it is not possible to grant voluntary tax liability for only a percentage of an area partly used as a permanent dwelling. Voluntary tax liability can only be granted for clearly defined parts where taxable activities are carried out.

Furthermore, the HFD held that voluntary tax liability could not be granted for entrances and other areas such as corridors and stairwells since they are necessary for the letting and attributable to a permanent dwelling. The HFD considered the kitchen, dining area, living rooms and TV-rooms as areas that could be let out for other activities.

Lastly, the HFD held that since the apartments of the residents were equipped with all the facilities that apartments normally are on the public housing market such as

kitchens, bedrooms, and lavatories. The common areas did not constitute complements to the apartments constituting permanent dwellings. Voluntary tax liability was granted for that particular area of 150 square meters consisting of a kitchen, dining room, living room and TV-room.[124]

This case illustrates that the assessment of whether a building constitutes a permanent dwelling is very much dependent on the circumstances of each particular case, and it is still not perfectly clear when a building can partly be granted voluntary tax liability. For example, if the apartments would differ in terms of facilities or equipment, would then the common areas be attributable to the permanent dwellings?

4.5 The fundamental principle of the right to deduction

As seen above, the ECJ have held in several cases that the right to deduct is an integral part of the VAT and a fundamental principle underlying the system of VAT, which may not in principle be limited. The deduction mechanism relieves the trader of the VAT, and the system of VAT achieves its goal of only taxing private consumption. Derogations from this essential principle are only permitted when expressly provided in the VAT Directive. Existing derogations, especially under Article 176 must, therefore, be interpreted strictly.[125]

Even though the wording of the prohibition in Chapter 8. Section 9 first subparagraph point one ML suggest an extensive scope covering all types of dwellings, the intention of the Swedish legislator when introducing the prohibition of deductions of input VAT relating to permanent dwellings was to prohibit deductions of VAT relating to dwellings used by the taxpayer or his employees. Furthermore, the preparatory work introducing the prohibition also concerned and discussed the right to deduct more generally and the legislator clearly expressed that all other input VAT that could relate to private expenditure should be deductible, such as VAT in costs for representation. Nothing in the preparatory work is suggesting or indicating that the prohibition regarding permanent dwellings would comprise any other dwellings than dwellings used by the taxpayer or the employees of the taxpayer.[126] In 1973, the words taxpayer and employees were removed from the provision. However, the intention was not to extend or change the scope of the prohibition. It can be derived from the preparatory work that the legislator did not have any intention to introduce a general prohibition covering all types of dwellings emphasizing the right to

[124] HFD case nr. 1113-15.

[125] See section 2.4.6.

[126] Proposition 1968:100, p. 137-138; A. Sandberg Nilsson, (2014), p. 377-378.

deduct as fundamental. An approach which would be more in conformity with the fundamental principle of the right to deduct input VAT underlying the system of VAT.[127]

As previous chapters in this thesis show, the scope of the prohibition now covers other dwellings than those belonging to the taxpayer or its employees. The HFD have through its case law included group homes, retirement homes, accommodation for refugees, temporary homes for homeless persons. Although the wording prohibition in Chapter 8. Section 9 first subparagraph point one ML seems to include all permanent dwellings, no explicit support for such an interpretation can be found in the preparatory work. In addition to this, the prohibition also cover lettings made in several stages for which there is no legal support (RÅ 2010 ref. 43)[128]. Clearly, the HFD have not interpreted the prohibition of deductions of input VAT relating to permanent dwellings strictly which is required according to the fundamental principle of the right to deduct.

The ECJ have in several cases stressed the right to deduct. For example, the ECJ held that a person who purchases a house for private purposes and at the same time acts a taxable person using, for example, a room of that house to carry out economic activity. That person is allowed to allocate that specific room to the business and allowed for deduction of input VAT relating to that room.[129] Yet the prohibition in Chapter 8. Section 9 first subparagraph point one ML applies in a general manner not allowing for deductions of input VAT allocated to an economic activity carried out in a private dwelling. The ECJ also pointed out that the principle of neutrality supports the interpretation that a person should only bear the burden of VAT when the good or service are used for private consumption.[130] Therefore, and as Kleerup and Schiess pointed out, the general prohibition in Chapter 8. Section 9 first subparagraph point one ML is contrary to EU law.[131] This finding is also supported in a more recent case delivered by the ECJ in 2013 in which the Court held that the operation of photovoltaic installation (solar panels) installed on a private dwelling constituted an economic activity within the meaning of the VAT Directive and therefore subject to VAT and allowed for deductions of input VAT on costs related to the activity.[132] Consequently, as Sandberg Nilsson pointed out, the prohibition can and should be abolished mainly because the general rule in Chapter. 8 Section 3 ML does not

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[127] See section 3.2.1; A. Sandberg Nilsson, (2014), p. 378.

[128] A. Sandberg Nilsson, (2014), p. 378.

[129] C-25/03, *HE,* EU:C:2005:241, para 52.

[130] C-25/03, *HE,* EU:C:2005:241, paras 46-48.

[131] J. Kleerup and R. Schiess, (2014), p. 807.

[132] C-219/12, *Fuchs,* EU:C:2013:413, paras 36-37. See also A. Sandberg Nilsson, (2014), p. 379-380.

allow for deductions of input VAT relating to private consumption.[133] That would also bring ML more into line with the VAT Directive and the fundamental principle of the right to deduct underlying the system of VAT.

[133] A. Sandberg Nilsson, (2014), p. 376.

5 Conclusions

The following chapter summarizes the analysis and the conclusions made in the previous chapters.

5.1 Summarizing conclusions

Under Article 176 of the VAT Directive, the Council shall determine what expenditure is not eligible for a deduction of VAT. Until these rules are adopted, the Member States are allowed to retain all the exclusion in force under their national laws at the 1 of January 1979. Or in the case of the Member States acceding the EU after that date, on the date of their accessions. The ECJ have held that the second subparagraph of Article 176 contains a standstill clause which means that the Member States can only lawfully amend their national laws with the effect of reducing the scope of retained exclusions and, thereby bringing its legislation into line with the objective of the VAT Directive. The standstill clause prohibits the Member States to extend the scope of existing derogations.

The prohibition of deductions of input VAT relating to permanent dwellings was in force at the time of Sweden's accession to EU in 1995. The prohibition constituted an exclusion from the right to deduct, which Sweden was allowed to retain under Article 17(6) of the Sixth Directive (now Article 176). Consequently, the prohibition constitutes a derogation authorized in accordance with Article 176 and is covered by the standstill clause.

The prohibition of deductions of input VAT relating to permanent dwellings was introduced into the Swedish legislation in 1969 with the intention to prohibit deductions of input VAT relating to dwellings belonging to the taxpayer or its employees. In 1973, the wording taxpayer and employee was removed from the provision only stating that deductions of input VAT on permanent dwellings was to be prohibited. However, the intention of the legislator was not to extend the scope of the prohibition.

In 1995, when Sweden acceded to the EU, the prohibition applied to permanent dwellings belonging to the taxpayer or employees and also to care homes (RÅ 1993 ref. 30). It did not apply to temporary accommodation for asylum seekers which was regarded as a business similar to a hotel (RÅ 1991 not. 82). Even though the wording of the provision, at that time, implied that all permanent dwellings were included within the scope of the prohibition. Nothing is indicating or even suggesting, in the preparatory works that it would apply to any other dwellings than those belonging to the taxpayer or its employees. Since the prohibition of deductions of input VAT relating to permanent dwellings constitutes

a so-called standstill legislation, Sweden as a Member State of the EU is not allowed to extend the scope. Nonetheless, the concept of permanent dwellings has through the case law of the HFD come to include not only dwellings belonging to a taxable person or its employees but also retirement homes, accommodations for refugees and temporary accommodation for homeless persons.

In the case law of the ECJ, it is settled that a Member State can preclude itself from applying retained exclusions from the right to deduct under Article 176, not only through legislative acts but also through measures and practices by the tax authorities. The STA have considered group homes and HVB-homes to not constitute permanent dwellings. Consequently, the STA limited the scope of the prohibition not to cover social care. Despite that, the HFD considered in the cases HFD 2013 ref. 79 I and HFD 2015 not. 56, group homes and HVB-homes to constitute permanent dwellings.

Moreover, the ECJ have held that derogations under Article 176 can not apply in a general manner and should be defined with reference to the nature or purpose of the good or service. On the contrary, the concept of permanent dwellings is defined with reference to both its nature and how it is put to use. The HFD have also held that the prohibition constitutes a general rule covering all costs related to permanent dwellings.

The concept of permanent dwellings has been subject to the interpretation of the HFD in numerous cases in which the difficulties in determining whether a building constitutes a permanent dwelling are illustrated. It is still not entirely clear when a letting of a building constitutes a permanent dwelling or a taxable activity such as a hotel or an exempt permanent dwelling. Even though the ECJ have held that a duration of a stay up to six months is to be regarded as a hotel, accommodations where the stay ranges from two days up to 11 months can either be regarded as a hotel or a permanent dwelling.

The prohibition of deductions of input VAT relating to permanent dwellings is not just in breach of the standstill clause. It can also be concluded that, even though the prohibition existed before Sweden acceded the EU, it is not allowed under Article 176 since it is a general rule covering all costs related to permanent dwellings. The concept of permanent dwellings is also deviating from concepts developed by the EJC.

Against that background, it can be concluded that the prohibition of deductions of input VAT relating to permanent dwellings is not in conformity with the VAT Directive. Additionally, the difficulties in the application of the prohibition that have been illustrated in the previous chapters of this thesis shows that the

prohibition fails to fulfill its primary purpose, to simplify the assessment of taxable persons right to deduct input VAT relating to permanent dwellings.

5.2 Final remarks

By concluding that the prohibition of deductions of input VAT relating to permanent dwellings in the Swedish VAT legislation is not in conformity with the VAT Directive and that the concept of permanent dwellings is diverging from concepts developed by the ECJ. It is remarkable that no attention is given to the concept of permanent dwellings in the Government Directive 2016:58.

The purpose of the prohibition is to avoid deductions of input VAT relating to private consumption. However, and as noted by the Government Committee and Sandberg Nilsson, the right to deduct can instead be determined in accordance with the general rule in Chapter. 8 Section 3 ML since it already prohibits deductions of input VAT relating to private consumption. Consequently, the prohibition could be deemed to be superfluous, and could be abolished without any further risk of allowing deductions of VAT relating to private consumption. The abolition of the prohibition would also bring ML more into line with the VAT Directive.

However, the concept of permanent dwellings would still remain in Chapter. 3 Section 3 second subparagraph ML and should be reviewed and revised by the inquiry appointed through the Government Directive. Hopefully, the issues surrounding the prohibition and the concept of permanent dwellings will be addressed and solved in the new legislation, which will be proposed by the inquiry.

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