JUDGMENT OF THE COURT (Third Chamber)

15 December 2005 *

In Case C-63/04,

REFERENCE for a preliminary ruling under Article 234 EC from the High Court of Justice of England and Wales, Chancery Division (United Kingdom), made by decision of 21 February 2003, received at the Court on 13 February 2004, in the proceedings

Centralan Property Ltd

v

Commissioners of Customs & Excise,

THE COURT (Third Chamber),

composed of A. Rosas, President of the Chamber, A. La Pergola, J.-P. Puissochet, U. Lõhmus and A. Ó Caoimh (Rapporteur), Judges,

* Language of the case: English.

Advocate General: J. Kokott,
Registrar: L. Hewlett, Principal Administrator,

having regard to the written procedure and further to the hearing on 16 February 2005,

after considering the observations submitted on behalf of:

— Centralan Property Ltd, by R. Cordara QC, and P. Key, Barrister, instructed by Landwell, Solicitors,

— the United Kingdom Government, by K. Manji, acting as Agent, and N. Pleming QC,

— the Commission of the European Communities, by R. Lyal, acting as Agent,

after hearing the Opinion of the Advocate General at the sitting on 17 March 2005,

gives the following

Judgment

1 This reference for a preliminary ruling relates to the interpretation of Article 20(3) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1), as amended by Council Directive 95/7/EC of 10 April 1995 (OJ 1995 L 102, p. 18) ('the Sixth Directive').

2 The reference was made in the course of proceedings between Centralan Property Limited ('Centralan') and the Commissioners of Customs & Excise ('the Commissioners'), who are responsible for the collection of value added tax (VAT) in the United Kingdom, concerning the adjustment of deductions of input VAT.

Legal framework

Community legislation

3 Under Article 2(1) of the Sixth Directive, 'the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such' is subject to VAT.

4 Article 4(3) of the Sixth Directive provides as follows:

'Member States may also treat as a taxable person anyone who carries out, on an occasional basis, a transaction relating to the activities referred to in paragraph 2 and in particular one of the following:

(a) the supply before first occupation of buildings or parts of buildings and the land on which they stand; ...

Member States may apply criteria other than that of first occupation, such as the period elapsing between the date of completion of the building and the date of first supply ...'

5 Article 5 of the Sixth Directive, entitled 'Supply of goods', provides:

'1. 'Supply of goods' shall mean the transfer of the right to dispose of tangible property as owner.

...

3. Member States may consider the following to be tangible property:

(a) certain interests in immovable property;

(b) rights *in rem* giving the holder thereof a right of user over immovable property;

(c) shares or interests equivalent to shares giving the holder thereof *de jure* or *de facto* rights of ownership or possession over immovable property or part thereof.

...'

6 Article 13 of the Sixth Directive provides:

'A. *Exemptions for certain activities in the public interest*

1. Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of such exemptions and of preventing any possible evasion, avoidance or abuse:

...

(i) children's or young people's education, school or university education, ... including the supply of services and of goods closely related thereto, provided by bodies governed by public law having such as their aim or by other organisations defined by the Member State concerned as having similar objects;

...

B. *Other exemptions*

Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse:

...

(b) the leasing or letting of immovable property ...

...

(g) the supply of buildings or parts thereof, and of the land on which they stand, other than as described in Article 4(3)(a);

...

C. *Options*

Member States may allow taxpayers a right of option for taxation in cases of:

(a) letting and leasing of immovable property;

(b) the transactions covered in B(d), (g) and (h) above.

Member States may restrict the scope of this right of option and shall fix the details of its use.'

7 Article 17 of the Sixth Directive provides:

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

2. In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:

(a) value added tax due or paid within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person;

...

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

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

However, Member States may:

...

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

...'

8 Article 19 of the Sixth Directive contains the detailed rules for the calculation of the deductible proportion referred to in Article 17(5) of the directive.

9 Adjustments of deductions are governed by Article 20 of the Sixth Directive, which provides as follows:

'...

2. In the case of capital goods, adjustment shall be spread over five years including that in which the goods were acquired or manufactured. The annual adjustment shall be made only in respect of one-fifth of the tax imposed on the goods. The adjustment shall be made on the basis of the variations in the deduction entitlement in subsequent years in relation to that for the year in which the goods were acquired or manufactured.

By way of derogation from the preceding subparagraph, Member States may base the adjustment on a period of five full years starting from the time at which the goods are first used.

In the case of immovable property acquired as capital goods, the adjustment period may be extended up to 20 years.

3. In the case of supply during the period of adjustment capital goods shall be regarded as if they had still been applied for business use by the taxable person until expiry of the period of adjustment. Such business activities are presumed to be fully taxed in cases where the delivery of the said goods is taxed; they are presumed to be fully exempt where the delivery is exempt. The adjustment shall be made only once for the whole period of adjustment still to be covered.

However, in the latter case, Member States may waive the requirement for adjustment in so far as the purchaser is a taxable person using the capital goods in question solely for transactions in respect of which value added tax is deductible.

...'

National legislation

Legislation in respect of VAT

10 In the United Kingdom, the relevant provisions of the Sixth Directive were implemented by the Value Added Tax Act 1994 ('the VAT Act') and the Value Added Tax Regulations 1995 ('the VAT Regulations').

11 Pursuant to regulation 101(1) of the VAT Regulations, deductible input tax is limited to 'that amount which is attributable to taxable supplies'.

12 The part of regulation 114 of the VAT Regulations which is applicable in the main proceedings provides for adjustments over a period of 10 years in accordance with the method prescribed in regulation 115. In each of those years, called 'intervals', the owner of a capital item may make an adjustment in respect of one-tenth of the input tax, by reference to the rules laid down by the VAT Regulations.

13 Regulation 115(3) of the VAT Regulations implements Article 20(3) of the Sixth Directive. According to the wording of that provision, it applies '[w]here the whole of the owner's interest in a capital item is supplied by him ... during an interval other than the last interval applicable to the capital item ...'.

14 Under Item 1(a)(ii) of Group 1 in Schedule 9 to the VAT Act, the transfer of the freehold in new non-residential buildings is excluded from the definition of exempt supplies. According to the notes to that group, buildings are still deemed to be new if their construction was completed less than three years before the transfer.

15 With effect from 30 November 1994, a new subparagraph 3A was inserted in paragraph 2 of Schedule 10 to the VAT Act, which provided that, in cases where a legal person opts for taxation of letting and leasing of immovable property under Article 13C(b) of the Sixth Directive, that option does not apply to transactions with a legal person connected to it within the meaning of the VAT Act, if either of those persons is not a 'fully taxable person'. That subparagraph was subsequently repealed with effect from 26 November 1996.

The law of immovable property

16 It is apparent from the documents before the Court that under the law of England and Wales, a 'freehold' can be described, if it is not encumbered with other 'lesser' interests, as the right to occupy immovable property for an unlimited period. A 'lease' is a leasehold interest, which amounts to the right to occupy immovable property for a defined period of time. There is no limit to the length of a lease, and leases for 999 years are common. It is possible for the owner of a freehold to grant a lease for a period of 999 years in return for a substantial premium with no, or very low, subsequent rental payments.

17 Once the owner of a freehold has granted a lease, he no longer owns an 'unencumbered freehold' but merely the 'freehold reversion', that is, a residual

interest in the property which equates to the right to occupy the property once the lease has expired and to receive the rent, if any, throughout the term of the lease. If the rent under the lease is very low and the lease very long, the freehold reversion is of low value.

18 The owner of an unencumbered freehold in a building can transfer his interest in the building by means of more than one transaction. First, he can transfer the right to occupy the property for a limited period, by granting a lease (in return for rent, a premium or a combination of the two). He can then, by transferring the freehold reversion, grant the right to occupy the property on the expiry of the lease, together with the right to receive any rent due under the lease.

The main proceedings and the question referred for a preliminary ruling

19 Centralan is a wholly owned subsidiary of Centralan Holdings Ltd, which is itself wholly owned by the University of Central Lancashire Higher Education Corporation ('the University'). Centralan opted for taxation under Article 13C(b) of the Sixth Directive.

20 Inhoco 546 Ltd ('Inhoco') is, like Centralan, a wholly owned subsidiary of Centralan Holdings Ltd. Unlike Centralan, Inhoco did not opt for taxation under the above provision.

21 In 1994, the University, whose ability to deduct input VAT is limited, procured the construction of a building known as the Harrington Building ('the Harrington Building').

22 On 14 September 1994, Centralan bought the Harrington Building from the University for the sum of GBP 6 500 000 plus VAT of GBP 1 370 500, and leased it back to the University for a term of 20 years at a yearly rent of GBP 300 000 plus VAT ('the 20-year lease'). That transaction enabled Centralan to deduct the VAT paid on the acquisition of the Harrington Building as input tax.

23 From the perspective of the University, the transactions described in the preceding paragraph had the effect of replacing the non-deductible VAT which had been paid during the construction of the Harrington Building with the non-deductible VAT on the rents paid throughout the term of the 20-year lease. That replacement was not challenged by the Commissioners.

24 In the course of the third interval after the acquisition of the Harrington Building, that is, after the amendment of the VAT Act referred to in paragraph 15 above, Centralan disposed of its whole interest in that building, so that regulation 115(3) of the VAT Regulations had to be applied.

25 That disposal was effected by means of two successive transactions.

26 The first transaction was the grant, on 22 November 1996, of a 999-year lease ('the 999-year lease'), subject to the 20-year lease in favour of the University, to Inhoco for a premium of GBP 6 370 000 and a nominal rent if demanded.

27 By the second transaction, which took place on 25 November 1996, the freehold reversion in the Harrington Building was transferred to the University for a sum of GBP 1 000 ('the transfer of the freehold reversion').

28 The grant of the 999-year lease was an exempt transaction because, although Centralan had opted for taxation of letting and leasing of immovable property, it was a legal person connected to Inhoco within the meaning of paragraph 2(3A) of Schedule 10 to the VAT Act.

29 The transfer of the freehold reversion was a taxable transaction because, even though the University and Centralan are connected legal persons within the meaning of Schedule 10, the provisions of Item 1(a)(ii) of Group 1 in Schedule 9 to the VAT Act excluded, in application of Articles 4(3) and 13B(g) of the Sixth Directive, the exemption for the supply of buildings completed less than three years before.

30 In view of those transactions, a question arose as to how to apply the rules for the adjustment, under regulation 115(3) of the VAT Regulations, of the deduction of the input VAT paid on the acquisition of the Harrington Building by Centralan. The Commissioners claimed that the supply to be taken into account was the 999-year lease and that the transfer of the freehold reversion should be ignored as *de minimis*. In the alternative, they claimed that there should be an apportionment between the grant of the 999-year lease and the transfer of the freehold reversion, in proportion to the respective value of each of those transactions. By virtue of the former interpretation, Centralan would be liable to pay a sum of GBP 796 250 in respect of VAT, whereas, according to the second interpretation, the amount of VAT due would be GBP 796 090.

31 Centralan challenged that point of view before the VAT and Duties Tribunal. It argued that it had disposed of its whole interest in the Harrington Building by the transfer of the freehold reversion alone, with the result that it was not liable under regulation 115 of the VAT Regulations for more than GBP 943.93 in respect of VAT.

32 In rejecting Centralan's argument and the Commissioners' first interpretation, the VAT and Duties Tribunal held that the company had disposed of its whole interest in the Harrington Building by means of two supplies, namely, the grant of the 999-year lease and the transfer of the freehold reversion. According to the Tribunal, those two supplies were made in the course of the same interval and were moreover ineluctably linked and preordained in the sense that there was no likelihood that the transfer of the freehold reversion would not be effected once the 999-year lease had been granted.

33 In those circumstances, the VAT and Duties Tribunal concluded that Article 20(3) of the Sixth Directive and therefore, necessarily, regulation 115(3) of the VAT Regulations must be construed as implicitly providing for an apportionment in a case where the whole ownership interest in a capital item is disposed of in two stages, entailing two supplies, one of which is exempt and the other taxable. On the basis of that reasoning, it decided that Centralan was liable for a sum of GBP 796 090 in respect of VAT.

34 The Commissioners did not appeal the rejection of their argument that the transfer of the freehold reversion should be ignored as being *de minimis*.

35 It is in those circumstances that, in order to ensure the correct application of regulation 115(3) of the VAT Regulations to the facts of the proceedings before it on Centralan's appeal, the High Court of Justice of England and Wales, Chancery Division, decided to stay the proceedings and to refer the following question to the Court:

'Where, during the period of adjustment provided for in Article 20(2) of the Sixth VAT Directive, a taxable person disposes of a building which is treated as a capital good, and the disposal of the building is effected by way of two supplies, being (i) the

grant of a 999-year lease of the building (an exempt transaction under Article 13B(b) of the Directive) for a premium of GBP 6 million, followed three days later by (ii) the sale of the freehold reversion (a taxable transaction under Article 13B(g) and Article 4(3)(a) of the Directive) for a price of GBP 1 000 plus VAT and which either are or are not preordained in the sense that once the first had been carried out there was no chance that the second would not be,

is Article 20(3) of the Sixth VAT Directive to be interpreted so that:

(a) that capital good is regarded until the expiry of the period of adjustment as if it had been applied for business activities which are presumed to be fully taxed;

(b) the capital good is regarded until the expiry of the period of adjustment as if it had been applied for business activities which are presumed to be fully exempt; or

(c) that capital good is regarded until the expiry of the period of adjustment as if it had been applied for business activities which are presumed to be partly taxed and partly exempt in the proportion of the respective values of the taxed sale of the freehold reversion and the exempt grant of the 999-year lease?'

The question referred

36 By its question, the national court asks, in essence, whether under Article 20(3) of the Sixth Directive, in circumstances such as those of the main proceedings, immovable capital goods must be regarded, until the expiry of the period of adjustment mentioned in that provision, as if they had been applied for business activities which are presumed to be fully taxable or fully exempt, or whether they are to be regarded as if they had been applied to business activities which are partly taxable and partly exempt in the proportion of the respective values of the two transactions to which those goods were subject, namely the grant of the 999-year lease and, three days later, the transfer of the freehold reversion.

37 It is clear from the grounds of the order for reference that that question was raised in order to ascertain the method by which the deduction of the input VAT is to be adjusted in circumstances such as those of the main proceedings.

38 In that regard, it should be noted that, as is clear from paragraph 32 above, the VAT and Duties Tribunal held that the two transactions mentioned in that paragraph were ineluctably linked and preordained. In its order for reference, the national court did not cast any doubt on that conclusion. As a result, the question referred by the national court must be examined solely in so far as it envisages a situation in which, as in the main proceedings, two inextricably linked transactions have been concluded.

39 For the purposes of replying to the question thus stated, it must therefore be determined which of the transactions is to be taken into account for the application of Article 20(3) of the Sixth Directive or, if appropriate, to what extent each of those transactions is to be taken into account for that purpose.

Observations submitted to the Court

40 In Centralan's submission, the VAT treatment of capital goods during the remainder of the period of adjustment referred to in Article 20(2) of the Sixth Directive is presumed to be 'fully taxed' or 'fully exempt' depending on whether the supply which finally divests the taxable person of any interest in the capital goods concerned is taxable or exempt. Article 20(3) provides no basis for permitting several transactions to be taken into consideration in proportion to their respective value, since that provision is incompatible with the disposal in stages of the whole of an immovable property, or of all the rights in that property, particularly where the different disposal transactions concern different rights, transferred to different persons at different times. Furthermore, the wording of that provision does not permit an interpretation which takes into consideration the economic significance of the transaction in cases of successive disposals to different economic operators and disregards a transaction on the ground that the amount to which it relates is *de minimis*.

41 Therefore, Centralan submits that only the transfer of the freehold reversion is relevant for the purposes of the adjustment.

42 The United Kingdom maintains that the purpose of the rules governing the deduction of input VAT, of which Article 20(3) of the Sixth Directive forms part, is to determine the proportion of the VAT deductible as precisely as possible in order to reflect the use of the inputs effected in order to carry out taxable transactions. In its submission, that provision should be interpreted as meaning that, where the capital goods are supplied by means of two preordained transactions of which one is taxable and the other is exempt, the taxable person is presumed to use the capital goods for the rest of the period of adjustment partly for taxable activities and partly for exempt activities, in proportion to the relative values of the taxable supplies and exempt supplies by means of which the capital goods were sold.

43 As a result, the United Kingdom submits, it is necessary to make an apportionment where the supply of goods within the meaning of Article 20(3) of the Sixth Directive is made by means of two preordained transactions, of which one is taxable and the other exempt. It observes that the interpretation suggested by Centralan would mean that the transfer of the Harrington Building would have to be regarded as being taxable in its entirety, although the transfer of the freehold reversion represents less than 0.02% of the value of that property.

44 The Commission of the European Communities argues that Article 20(3) of the Sixth Directive envisages a single transaction which determines the tax position of the goods for the rest of the period of adjustment. It points out that, in accordance with Article 5(1) of that directive, 'supply of goods' means the transfer of the right to dispose of tangible property as owner. According to the Commission, it appears that, under the applicable national law, the grant of a 999-year lease is not a transfer of ownership since the freehold reversion remains. Therefore, the grant of such a lease is not, by itself, a supply of capital goods for the purposes of the said Article 20(3).

45 The Commission suggests therefore, like Centralan, that only the transfer of the freehold reversion must be taken into account for the purposes of the adjustment.

46 In its written observations, the Commission also suggested that, if the Court should hold that the concept of the abuse of rights can be applied in a case such as that of the main proceedings, it is appropriate to add to the reply to the national court that, where a taxable person or a group of connected taxable persons engages in one or several transactions with no economic justification, but which produce an artificial situation the sole purpose of which is to create the conditions necessary for the recovery of input VAT, those transactions must not be taken into consideration.

47 Nevertheless, at the hearing, the Commission recognised, as regards the possible application of the concept of the abuse of rights, that there had been no argument before the national courts on that point and that it had wrongly supposed that, having regard to the short period which elapsed between, first, the construction of the Harrington Building as well as its sale with the grant of the 20-year lease, and, second, the conclusion of the two transactions in question in the main proceedings, it was appropriate to think that all those elements together formed a prearranged scheme.

48 At the same hearing, the United Kingdom adopted, in the alternative, the part of the Commission's written observations dealing with the concept of the abuse of rights.

The Court's reply

Preliminary observations

49 In order to reply to the question referred, it is appropriate, as a preliminary point, to set Article 20(3) of the Sixth Directive in its context, that is, the system of deductions provided for in Articles 17 to 20 of the directive and the objective pursued by that system.

50 According to settled case-law, the right to deduct provided for in Articles 17 to 20 of the Sixth Directive is an integral part of the VAT scheme and in principle may not be limited. It must be exercised immediately in respect of all the taxes charged on transactions relating to inputs (see, among others, Case C-62/93 *BP Supergas* [1995] ECR I-1883, paragraph 18, and Joined Cases C-110/98 to C-147/98 *Gabalfrisa and Others* [2000] ECR I-1577, paragraph 43).

51 As the Court has repeatedly held, the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT (see, among others, Case 268/83 *Rompelman* [1985] ECR 655, paragraph 19; Case 50/87 *Commission* v *France* [1988] ECR 4797, paragraph 15; Case C-37/95 *Ghent Coal Terminal* [1998] ECR I-1, paragraph 15; and Case C-465/03 *Kretztechnik* [2005] ECR I-4357, paragraph 34).

52 It is clear from the wording of Article 17(2) of the Sixth Directive that, for a person concerned to be entitled to the right to deduct, first, he must be a 'taxable person' within the meaning of that directive and, second, the goods and services in question must be used for the purposes of his taxable transactions (see, to that effect, Case C-137/02 *Faxworld* [2004] ECR I-5547, paragraph 24).

53 As regards goods and services which are used by a taxable person both for transactions giving rise to the right to deduct and for transactions not giving rise to that right, Article 17(5) of the Sixth Directive provides that only such proportion of the VAT shall be deductible as is attributable to the taxable transactions. That proportion is calculated according to the rules in Article 19 of that directive (see, to that effect, Case C-306/94 *Régie Dauphinoise* [1996] ECR I-3695, paragraphs 3 and 4, and Case C-136/99 *Monte Dei Paschi Di Siena* [2000] ECR I-6109, paragraph 24).

54 It follows that the decisive criterion for the deduction of input VAT is the use of the goods and services concerned for taxable transactions. As the Court has already held, it is only to the extent that an item is used for the purposes of his taxable transactions that a taxable person may deduct from the VAT for which he is liable the VAT paid or payable in respect of that item (Case C-291/92 *Armbrecht* [1995] ECR I-2775, paragraph 27). It is thus clear from the case-law that the use to which the goods or services are put, or are intended to be put, determines the extent of the

initial deduction to which the taxable person is entitled under Article 17 of the Sixth Directive and the extent of any adjustments in the course of the following periods, which must be made under the conditions laid down in Article 20 of that directive (see, to that effect, Case C-97/90 *Lennartz* [1991] ECR I-3795, paragraph 15, and Case C-396/98 *Schloßstraße* [2000] ECR I-4279, paragraph 37).

55 As regards capital goods, Article 20 of the Sixth Directive lays down a special system of adjustment. In that regard, it should be noted that, in the context of Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes — Structure and procedures for application of the common system of value added tax (OJ, English Special Edition 1967, p. 16), the Court held that the special system reserved for capital goods by that directive is explained and justified by the durable use of those goods and the attendant writing-off of their acquisition costs (see, to that effect, Case 51/76 *Verbond van Nederlandse Ondernemingen* [1977] ECR 113, paragraphs 12 and 13). Those considerations apply, mutatis mutandis, to the special system of adjustment of deductions relating to capital goods laid down in Article 20 of the Sixth Directive.

56 Article 20(3) of the Sixth Directive governs the particular case of the supply of capital goods before the end of the period of adjustment. In that case, the annual adjustment is replaced by a single adjustment, based on the presumed use of the capital goods in question for the period still to run. Under that provision, the deductibility of the input VAT depends on whether the supply made is or is not subject to VAT.

57 It follows from the foregoing that the rules laid down by the Sixth Directive in respect of adjustment are intended to enhance the precision of deductions so as to ensure the neutrality of VAT, with the result that transactions effected at an earlier stage continue to give rise to the right to deduct only to the extent that they are used

to make supplies subject to VAT. By those rules, that directive is thus intended to establish a close and direct relationship between the right to deduct input VAT and the use of the goods and services concerned for taxable transactions.

58 It is in the light of those considerations that the application of the rule of adjustment laid down in Article 20(3) of the Sixth Directive to a situation such as that in the main proceedings must be examined.

Application of Article 20(3) of the Sixth Directive

59 In that regard, it must be determined as a preliminary point which transaction or transactions in question in the main proceedings can constitute a 'case of supply during the period of adjustment' within the meaning of Article 20(3) of the Sixth Directive.

60 Under Article 5(1) of the Sixth Directive '"[s]upply of goods" [means] the transfer of the right to dispose of tangible property as owner'.

61 In the question referred, the national court states that the disposal of the Harrington Building was effected by way of two supplies. However, Centralan maintains that Article 20(3) of the Sixth Directive is incompatible with the disposal in stages of the whole interest in immovable property, whereas the Commission submits that the wording of that provision envisages a single transaction. In that regard, the Commission, referring to the national law of property, argues that only the transfer of the freehold reversion seems to constitute the transfer of the right to dispose of the building as owner.

62 However, without it being necessary to take a position on the validity of that last assertion, the Court not having competence to interpret the Member States' national laws, it must be stated that it is clear from the wording of Article 5(1) of the Sixth Directive that 'supply of goods' does not refer to the transfer of ownership in accordance with the procedures prescribed by the applicable national law but covers any transfer of tangible property by one party which empowers the other party actually to dispose of it as if he were the owner of the property (Case C-320/88 *Shipping and Forwarding Enterprise Safe* [1990] ECR I-285, paragraph 7, and Case C-185/01 *Auto Lease Holland* [2003] ECR I-1317, paragraph 32).

63 In that context, it is for the national court to determine in each individual case, on the basis of the facts of the case, whether a given transaction in respect of property results in the transfer of the right to dispose of the property as owner within the meaning of Article 5(1) of the Sixth Directive (see, to that effect, *Shipping and Forwarding Enterprise Safe*, paragraph 13).

64 Therefore, in the main proceedings, if the national court came to the conclusion that, in the specific circumstances of the case, each of the two closely connected transactions concluded by Centralan with Inhoco and the University respectively transferred to each of the latter the right to dispose of the Harrington Building as owner, each of those two transactions could be regarded as constituting a 'supply' within the meaning of Article 5(1) and consequently of Article 20(3) of the Sixth Directive.

65 That interpretation cannot be affected by the Commission's argument that it is difficult to accept that each of two different persons, having different rights over a property, has the right to dispose of it as owner.

66 The various manifestations of the concept of co-ownership in the Member States' legal systems are such as to indicate that it is possible that more than one person may have the right to dispose of property as owner. As a result, the interpretation set out in paragraph 64 above cannot be undermined by the fact that, immediately after the grant of the 999-year lease, Centralan still held the freehold reversion, nor by the fact that the grant of that lease encumbered the freehold interest, with the result that the freehold reversion alone and not the unencumbered freehold interest could be transferred.

67 It follows from the foregoing that, in the main proceedings, both the first transaction, the grant of the 999-year lease, and the second transaction, the transfer of the freehold reversion, can constitute a 'supply' within the meaning of the Sixth Directive.

68 If each of those transactions constitutes a supply, it must be determined which of them must be taken into account for the purposes of the adjustment required by Article 20(3) of the Sixth Directive or, if appropriate, the extent to which each of them must be taken into account for that purpose.

69 In that regard, as the national court observed, account may be taken of, as the case may be:

— the transaction by which Centralan finally divested itself of its interest in the Harrington Building, that is, the transfer of the freehold reversion, a taxable transaction;

— the most economically significant transaction, that is, the grant of the 999-year lease, an exempt transaction; or

— those two transactions together.

70 Under Article 20(3) of the Sixth Directive, in the case of supply during the period of adjustment capital goods are to be regarded as if they had still been applied for business use by the taxable person until the expiry of the period of adjustment. Such business activities are presumed to be fully taxed in cases where the supply of the goods concerned is taxed and they are presumed to be fully exempt where the supply of those goods is exempt.

71 Relying on the fact that the wording of that provision seems to be limited to envisaging the situation in which 'the case of supply during the period of adjustment' consists of a single delivery, Centralan points out that it parted with the ownership of the Harrington Building completely only when it transferred the freehold reversion. It argues that it is on the date of that transfer alone that the deduction must be adjusted.

72 However, it cannot be deduced from the wording of Article 20(3) of the Sixth Directive that, in a situation in which 'the case of supply' consists of two closely and inextricably linked transactions, each of which could in itself be regarded as a supply, only one of those transactions must be taken into consideration for the purposes of the adjustment required by that provision.

73 As is clear from paragraphs 50 to 57 above, the system of deductions and adjustments provided for in Articles 17 to 20 of the Sixth Directive is intended to establish a close and direct relationship between the right to deduct input VAT and the use of the goods and services concerned for taxable transactions.

74 In the specific circumstances of the main proceedings, taking into account each of the two supplies in question in proportion to their respective values is likely to attain that objective most satisfactorily. The adjustment of the deduction of input VAT will reflect the presumed taxable or exempt use of the Harrington Building all the more faithfully if an apportionment has been made on the basis of those values.

75 By contrast, in circumstances such as those of the main proceedings, taking into account only the last effected transaction would not attain that objective, since that would amount to disregarding completely the fact that the capital goods in question were also supplied by way of an exempt transaction.

76 As for taking into account the most economically significant transaction, that would not attain the objective pursued either, since it would amount to disregarding the fact that the goods were also supplied as part of a taxable transaction. The latter solution could give rise to even more incoherent results if the respective values of the two successive supplies were close to each other.

77 That interpretation cannot be objected to because no apportionment mechanism is expressly provided for in Article 20(3) of the Sixth Directive, whereas other provisions of the directive, particularly Article 17(5), provide explicitly for such a

mechanism. The adjustment rules relating to capital goods, of which Article 20(3) forms part, must be interpreted in the light of their objective, which is to ensure that deductions of input VAT closely reflect the use of durable inputs for the purposes of taxable transactions.

78 Furthermore, such an interpretation finds support in the Court's case-law. Thus, the Court has held that a proportional approach is required even in circumstances where the wording of the relevant provision of the Sixth Directive does not provide for it expressly (*Armbrecht*, paragraphs 29 and 32, and Case C-230/94 *Enkler* [1996] ECR I-4517, paragraph 38).

79 Centralan and the Commission however highlighted the practical difficulties which may result, in their submission, from taking into account two supplies for the purposes of the application of Article 20(3) of the Sixth Directive. In that regard, they cite particularly the example of two supplies which occur in the course of different intervals.

80 Without it being necessary in this case to consider such an example, since it is hypothetical, it is sufficient to observe that while, admittedly, taking into account more than one supply occurring during the period of adjustment is liable to give rise to certain practical difficulties, it still does not lead to insurmountable difficulties capable of affecting the application of the VAT system. As the Advocate General suggested in points 56 and 58 of her Opinion, in such a case, one might consider, for example, continuing, in application of Article 20(2) of the Sixth Directive, the adjustment of the part of the initial deduction which relates to the interest remaining in the taxable person's ownership until, as the case may be, the transfer of that interest or the end of the period of adjustment.

81 Finally, given that, in circumstances such as those of the main proceedings, in the event that the national court comes to the conclusion mentioned in paragraph 64 above, namely that each of the two transactions in question transferred the right to dispose of the capital goods in question as owner, the adjustment required by Article 20(3) of the Sixth Directive must be made taking into account the two supplies in question in proportion to their respective values, it is not appropriate to consider the possible application of the principle of abuse of rights in such circumstances.

82 In those circumstances, the reply to the question referred for a preliminary ruling must be that Article 20(3) of the Sixth Directive is to be interpreted as meaning that, where a 999-year lease over capital goods is granted to a person against the payment of a substantial premium and the freehold reversion in that property is transferred three days later to another person at a much lower price, and where those two transactions

— are inextricably linked, and

— consist of a first transaction which is exempt and a second transaction which is taxable,

— and if those transactions, owing to the transfer of the right to dispose of those capital goods as owner, constitute supplies within the meaning of Article 5(1) of that directive,

the goods in question are regarded, until the expiry of the period of adjustment, as having been used in business activities which are presumed to be partly taxable and partly exempt in proportion to the respective values of the two transactions.

Costs

83 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Third Chamber) hereby rules:

Article 20(3) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment, as amended by Council Directive 95/7/EC of 10 April 1995, is to be interpreted as meaning that, where a 999-year lease over capital goods is granted to a person against

the payment of a substantial premium and the freehold reversion in that property is transferred three days later to another person at a much lower price, and where those two transactions

— **are inextricably linked, and**

— **consist of a first transaction which is exempt and a second transaction which is taxable,**

— **and if those transactions, owing to the transfer of the right to dispose of those capital goods as owner, constitute supplies within the meaning of Article 5(1) of that directive,**

the goods in question are regarded, until the expiry of the period of adjustment, as having been used in business activities which are presumed to be partly taxable and partly exempt in proportion to the respective values of the two transactions.

[Signatures]