

## OPINION OF ADVOCATE GENERAL LENZ

delivered on 15 February 1996 \*

### A — Introduction

1. The question referred to the Court by the Cour Administrative d'Appel de Lyon (Fourth Chamber) concerns the Sixth Council Directive on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value added tax: Uniform basis of assessment (hereinafter 'the Sixth VAT Directive')<sup>1</sup> and asks the Court for an interpretation with regard to the right to deduct input tax. The business of the plaintiff company, the appellant in the main proceedings (hereinafter 'the plaintiff'), is primarily that of estate management. In pursuance of that business the company receives from lessees and property owners certain sums of money which, according to the plaintiff, are paid, with the agreement of its customers, into an account in the plaintiff's own name. The plaintiff invests the money which is surplus to requirements — again, according to the plaintiff, with its customers' agreement, — in banks for its own account. As appears from the pleadings and its statement in the oral procedure, the plaintiff acquires the ownership of the sums placed at its disposal as soon as they are paid into its account. In any event, it is under an obligation to pay these sums back. The plaintiff is however entitled

to the proceeds from its investment activity (amounting to 14% of its total income).

2. For the material period, 1 July 1983 to 30 June 1986, the plaintiff deducted the whole of the input tax. After a general audit in 1987 the tax authorities came to the conclusion that deductions could be granted only to the extent of the deductible proportion as the proceeds of the plaintiff's investment activity were exempt from value added tax.

As regards the right to deduct, Article 17(2) provides:

'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 in respect of goods or services supplied or to

\* Original language: German.

1 — Council Directive 77/388/EEC of 17 May 1977 (OJ 1977 L 145, p. 1).

be supplied to him by another taxable person;

4. Article 19(1) provides that a fraction is to be obtained by taking as the numerator the amount of turnover attributable to transactions in respect of which value added tax is deductible. The denominator contains the turnover attributable both to the transactions in respect of which value added tax is deductible and to those in respect of which value added tax is not deductible. According to Article 19(2), however, incidental transactions are to be excluded. Article 19 is worded as follows:

3. If the goods and services are used not only for taxable transactions but also for transactions which, under Article 17(2), provide no right to deduction, Article 17(5) provides that deduction shall be granted only for the transactions providing a right to deduction. It is worded as follows:

'Calculation of the deductible proportion

'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.

1. The proportion deductible under the first subparagraph of Article 17(5) shall be made up of a fraction having:

— as numerator, the total amount, exclusive of value added tax, of turnover per year attributable to transactions in respect of which value added tax is deductible under Article 17(2) and (3),

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

— as denominator, the total amount, exclusive of value added tax, of turnover per year attributable to transactions included in the numerator and to transactions in respect of which value added tax is not

deductible. The Member States may also include in the denominator the amount of subsidies, other than those specified in Article 11A(1)(a).

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:

...

2. By way of derogation from the provisions of paragraph 1, there shall be excluded from the calculation of the deductible proportion, amounts of turnover attributable to the supplies of capital goods used by the taxable person for the purposes of his business. Amounts of turnover attributable to transactions specified in Article 13B(d), in so far as these are incidental transactions, and to incidental real estate and financial transactions shall also be excluded. ...'

(d) the following transactions:

1. the granting and the negotiation of credit and the management of credit by the person granting it;

2. the negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit;

3. transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection and factoring;

4. transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collectors' items; "collectors' items" shall be taken to mean gold, silver or other metal coins or bank notes which are not normally used as

5. The exemption of investment income from value added tax, upon which the authorities rely, is governed by Article 13B(d), which provides:

*'B. Other exemptions*

Without prejudice to other Community provisions, Member States shall exempt the

legal tender or coins of numismatic interest;

5. transactions, including negotiation, excluding management and safekeeping, in shares, interests in companies or associations, debentures and other securities, excluding:

— documents establishing title to goods,

— the rights or securities referred to in Article 5(3);

6. management of special investment funds as defined by Member States;

...

6. The plaintiff had claimed in the main proceedings that Article 19 of the Sixth Directive had not been correctly transposed into

domestic law. In the French authorities' opinion it is possible to speak of incidental transactions only if the amount thereof does not exceed 5% of the total income inclusive of all taxes. As the proceeds from the investment of customers' funds amounted to 14% of the plaintiff's total income, the authorities refused to classify them as incidental transactions.

7. It is clear that the negotiation of the investment contract in particular, the use of funds and the bookkeeping concerning these transactions require the utilization of a part of the plaintiff's business resources for these financial operations. In its accounts the plaintiff has not shown any distribution of goods and services broken down by activities, so that according to the court of reference there is no possibility of any classification as a separate sector according to the provisions of national law.

8. Since, in the view of the Cour Administrative d'Appel de Lyon, it is necessary, in order to decide the outcome of the dispute, to ascertain whether the French authorities' interpretation of the Code Général des Impôts (General Tax Code) is permissible under the Sixth Directive, the national court has referred the following questions to the Court of Justice for a preliminary ruling:

1. Are the aforesaid provisions of Article 19 of the Sixth Directive to be interpreted

according to their wording as meaning that the exercise of the right to deduct by an undertaking subject to value added tax which also receives interest on investments of surplus funds is in principle affected by such investment transactions — regard being had to their nature in relation to the field of application of value added tax?

plaintiff obtains from the investment of the sums put at its disposal, can have any influence on the right to deduct when regarded in relation to the field of application of value added tax. Accordingly it is necessary to consider first whether this income falls in any way within the scope of the Sixth VAT Directive. The parties make widely differing submissions in this respect.

2. If the right to deduct is affected, is the investment interest then to be included in the denominator of the deductible proportion, or to be excluded from it in view of its nature, or as 'incidental ... financial transactions' within the meaning of Article 19(2) of the Sixth Directive in view of the amount or the proportion of total income which it represents, or again because these transactions represent a direct and permanent consequence of the taxable activity, or for any other reason?

10. The plaintiff explains first of all its business relationship with the banks in which it invests for its own account the money it has received from its customers. In the main the money is invested in each case for a fixed period. The plaintiff regards this as providing a service for the banks, which have the benefit of having the money in the account for a stated period. In exchange the plaintiff received a payment from the bank (the interest), which was directly proportionate to the amount of money invested and the duration of the investment. As a service to the bank this activity falls within the field of application of value added tax under Article 2 of the Sixth VAT Directive.

## B — Discussion

### *First question*

9. The basic question here is whether the income at issue in this case, which the

11. I must agree with the plaintiff inasmuch as this does in fact represent a service to the bank. The plaintiff places its money, as with the allocation of a credit, at the disposal of the bank for a given period. The bank is then free to use the money for economic purposes. As a recompense for this service the plaintiff receives interest, the rate of which is fixed according to the amount and duration

of the investment. It is a matter for discussion, however, — and this is the substance of the first question referred to the Court — whether that is a service which falls within the scope of the Sixth VAT Directive. To call an activity a service is not sufficient to classify it within the field of application of the Sixth VAT Directive. Only 'services effected ... by a taxable person acting as such' are in fact subject to value added tax under Article 2(1) of the Sixth VAT Directive. Again, the concept of a taxable person is defined by Article 4 of the Sixth VAT Directive by means of the concept of economic activity, which is, for its part, defined in Article 4(2). That is to say, the Sixth VAT Directive applies to services performed by a taxable person in the course of his economic activity.

investment activity and the activity of estate management. In that respect it relies on the manner in which the plaintiff's activity is organized. On the basis of that organization the plaintiff receives the rents for its own account but is not required to pass them on immediately to the property owner. Thus the money remains for a time in the plaintiff's account, which gives it the opportunity to invest it with the banks. The funds which the plaintiff keeps in its own account are an inseparable element of its economic activity, so that the income from the investment of these funds stems directly from the plaintiff's business activity. It is true that the plaintiff itself is the owner of the money, but the opportunity to invest it comes from the instructions it has received from its customers. For this reason there is also the necessary direct link between the service performed and the consideration received.

12. In the case before the Court the plaintiff's economic activity is that of property management. The services which it performs in that context (for example upkeep, giving instructions to tradesmen and collection of rents) fall within the field of application of the Sixth VAT Directive. It is doubtful whether the investments with the banks for the plaintiff's own account are to be counted as part of its economic activity.

14. In the Commission's opinion there is no such link here. It rightly submits that according to the case-law of the Court there must be a direct link between the service provided, and thus also the recipient of the service, and the consideration received.<sup>2</sup> Such a link exists of course, in the Commission's view, if the customers' funds are invested for the customers' account. However, as, in this instance, the plaintiff is

13. In the opinion of the French Government there is a direct link between the

<sup>2</sup> — Judgment in Case 102/86 *Apple and Pear Development Council* [1988] ECR 1443, paragraph 11 et seq.

investing the money for its own account, it would be in this respect both the supplier and the recipient of the service. That is, the plaintiff invests the money for its own profit. For that reason the investment activity cannot be regarded as a service within the scope of the activity of estate management.

15. But even in this case it might be possible that in investing the money the plaintiff is supplying a service for the customers; that is if — as the French Government submits — the proceeds from the investments represent a part of the consideration for the service of property management. In that case the fee which the customer would have to pay the plaintiff would be correspondingly reduced. It would be immaterial whether the proceeds were paid first to the customer and then to the estate manager as fees or whether they continued to be owned by the plaintiff. On the supposition that the investment reduces the fee to be paid, it could be regarded as an investment for the customer. Then it would be possible to proceed on the basis of a service for the customer. There would also be a link between the service, and thus the recipient of the service, and the consideration received (the reduction of the fee). That service would then be part of the service of estate management and would thus fall as an economic activity within the field of application of value added tax.

16. In my view however there is the following objection to that. If the proceeds from the investment were really part of the consideration for the service, the consideration would have to flow from the contract between the plaintiff and the customer. It would have to be settled precisely in the contract whether the fee was reduced and if so to what extent. As the Commission correctly submits, it is a matter for the national court to establish that. Here at least everything suggests that the proceeds were not part of the consideration. The plaintiff makes no such claim and the oral procedure produced no further clarification either. If the proceeds were in fact part of the consideration there would presumably be a duty on the part of the plaintiff to invest the money as profitably as possible and accounts showing that would have to be rendered. Again, it is a matter for the national court to establish whether there was such a duty. At least there are no indications to that effect. On the contrary the plaintiff gives the impression of having absolute freedom with regard to the investment.

17. If, however, the proceeds are not part of the consideration, there is, in the Commission's view, no service within the meaning of the Sixth VAT Directive. Since the plaintiff invests the funds available to it for its own account, it is simply acting as a private person administering his own assets. The Commission thinks that for that reason there is

no economic activity within the meaning of the Sixth VAT Directive.

18. However, that seems open to question. Even if a service is being supplied not for the customer but for the bank, it might still represent a service within the scope of the plaintiff's economic activity.

19. In the opinion of the French Government the income from the investment falls within the scope of the Sixth VAT Directive because it represents the consideration for an activity requiring to a not inconsiderable extent the use of staff and resources. To that it must be stated that this represents no criterion for designating an activity as an economic activity within the meaning of the Sixth VAT Directive. Even a private individual may employ many advisers for his investment activities. That by no means alters the fact that he continues to act as a private person and does not perform an economic activity within the meaning of the Sixth VAT Directive.

20. But there is another reason for which it appears to me inappropriate to exclude the proceeds of investment — as the Commission proposes — entirely from the scope of the Sixth VAT Directive. It is true that the plaintiff invests the money for its own account but, as the French Government correctly submits, it has received the money on

the basis of its economic activity (estate management). That does not mean that it is a question of consideration for its management activity, but if the plaintiff did not pursue that activity it would not have received the customers' money. That is to say that without the economic activity, namely the estate management, the plaintiff would simply not be in a position to pursue the investment activity. That activity cannot therefore be regarded in isolation but only in connection with the economic activity. Therein lies the difference as regards the activity of a private person and the *Wellcome Trust* case cited by the Commission.<sup>3</sup> We may speak of investment by a private person if that person either pursues no economic activity or if the money which he invests stands in no relationship of any kind to his economic activity. In this case, however, the plaintiff invests money which it holds on the basis of its economic activity. In the *Wellcome Trust* case it was a question of the administration of assets under a will by a trust company specially established for the purpose. In that connection there was no visible economic activity on the basis of which the trust company could have received the money. It was to be compared rather to a private person managing his own assets.

21. The case is different here. It is rather a question of a service — a service to the bank — which cannot be regarded in isolation

<sup>3</sup> — See my Opinion, delivered on 7 December 1995, in Case C-155/94 *Wellcome Trust v Commissioners of Customs and Excise* [1996] ECR I-3013, I-3015.

from the plaintiff's economic activity. For that reason the proceeds from the investment activity fall within the scope of the Sixth VAT Directive.

22. The judgment in Case C-60/90 *Polysar Investments Netherlands*<sup>4</sup> does not conflict with the view that the proceeds of the plaintiff's investment activity fall within the scope of the directive. In that case the Court decided that the mere receipt of dividends did not represent an economic activity within the meaning of the Sixth VAT Directive. The plaintiff's investment activity in this case, however, is to be distinguished from the mere receipt of dividends. Dividends are received in connection with participation in undertakings; they are not always paid out and their amount is not fixed. They are 'merely the result of ownership of the property'.<sup>5</sup> The plaintiff's investment activity is different. It puts its money at the disposal of the bank and receives the relevant interest irrespective of whether the bank has managed the money successfully or not. The rate of interest too is determined beforehand. Interest is therefore to be regarded as the *quid pro quo* for a service supplied to the bank. As I mentioned previously (paragraph 18 et seq.), interest falls within the field of application of value added tax because the money comes from the plaintiff's economic

activity. In the case of dividends on the other hand there is no remuneration for any economic activity within the meaning of the Sixth VAT Directive.<sup>6</sup>

23. As the proceeds of the plaintiff's investment activity are accordingly not to be compared to dividends, there is a question also — as the plaintiff submits — of the exploitation of property for the purpose of obtaining income therefrom on a continuing basis within the meaning of Article 4(2) of the Sixth VAT Directive.

24. I therefore come to the conclusion that the proceeds from the plaintiff's investment activity fall within the scope of the Sixth VAT Directive. For that reason the judgment in Case C-333/91 *Sofitam*<sup>7</sup> is inapplicable here. That case concerned dividends not falling within the field of application of value added tax and on those grounds, as the Court stated, lying outside the system of the right to deduct tax. They are therefore to be excluded from the calculation of the deductible proportion. As, in my view, we are concerned here with income which is not excluded from the scope of the Sixth VAT Directive, the *Sofitam* judgment is not relevant here.

4 — [1991] ECR I-3111.

5 — Case C-60/90 op. cit., paragraph 13 et seq.

6 — Judgment in Case C-333/91 *Sofitam* [1993] ECR I-3513, paragraph 13.

7 — Op. cit.

25. If, however, the Court of Justice does not follow my proposal and regards the proceeds of the plaintiff's investment activity as not falling within the field of application of value added tax, then according to the *Sofitam* judgment they would have to be excluded from the calculation of the deductible proportion under Articles 17, 18 and 19 of the Sixth VAT Directive, as otherwise the aim of complete neutrality which the common system of value added tax guarantees would be frustrated.<sup>8</sup>

26. As the Commission states, the French Government tries to restrict this case-law to dividends and the proceeds of financial participation. That means that all other activities, even if they are not subject to value added tax, could be included in the deductible proportion and thus affect the input tax.

27. The Greek Government even goes somewhat further and submits that the transactions to be included in the denominator of the deductible proportion under Article 19(1) cover all the activities of an undertaking which bring a financial benefit. In this respect it refers to the wording of the French version of Article 19(1) of the Sixth VAT Directive. There the concept of 'chiffre d'affaires' is used for the turnover attributable to transactions to be included in the

denominator. That concept, it thinks, goes further than the concept of 'opération' which is normally used. 'Opération' designates the transactions falling within the scope of the VAT Directive, whereas 'chiffre d'affaires' covers all activities bringing a financial benefit. Such a broad interpretation is necessary in order to achieve the objectives of the directive. As such objectives Greece mentions the prevention of evasion and the aim of bringing deduction and the actual level of deductible tax into accord with one another.

28. In addition the Greek Government states that that interpretation saves the tax authorities extensive calculations and the difficult decision as to which transactions are covered by the directive and which are not.

29. Against that it must first be stated that it is the directive itself which requires this distinction when it subjects only economic activities to value added tax. That cannot simply be left out of account. Only certain activities are to be included in the system of value added tax. But that also signifies that all activities which lie outside the scope of the VAT Directive are not only not subject to value added tax but are extraneous to the whole system of value added tax, which means that they are also entirely excluded from the whole field of deduction. For this reason the *Sofitam* judgment cannot be restricted to dividends but must be applied to all income falling outside the scope of the

<sup>8</sup> — Case C-333/91, *op. cit.*, paragraphs 12, 13 and 14.

Sixth VAT Directive and thus outside the system of entitlement to deduction.<sup>9</sup>

in relation to the field of application of the Sixth VAT Directive. All other questions with regard to the effect on the deductible proportion form part of the second question.

30. What is quite clear is that it is impossible — as proposed by the Greek Government — to leave the Court's judgment entirely out of account and to include all income in the proportional calculation.

*The second question*

31. However, I come to the conclusion, as already stated, that the proceeds of the plaintiff's investment activity fall within the scope of the Sixth VAT Directive and accordingly are basically capable of affecting the right to deduction. The answer to the first question referred to the Court should therefore be that the provisions of Article 19 of the Sixth VAT Directive are to be interpreted according to their wording as meaning that the exercise of the right to deduction of an undertaking subject to value added tax which also receives interest on investments of surplus funds is in principle affected by such investment transactions, regard being had to their nature in relation to the field of application of value added tax.

33. This question requires an answer only if the conclusion is reached that the investment proceeds fall within the scope of the Sixth VAT Directive and are therefore capable of affecting the deductible proportion.

34. If the proceeds of the investment activity fall within the scope of the Sixth VAT Directive then under Article 13B(d) they are in any case exempt from value added tax. Since the investment activity may, as already explained, be regarded as the granting of credit to the bank, Article 13B(d)(1), which exempts the granting of credit from value added tax, is relevant.

32. That answers the first question, since according to its wording it relates only to whether the deductible proportion is affected

35. According to Article 17(2) there is a right to deduct only in relation to taxable transactions. That is, the income at issue

<sup>9</sup> — Case C-333/91, *op. cit.*, paragraph 13.

here, which is exempt from value added tax, gives the plaintiff no right to deduct. That means that the plaintiff uses goods and services which it requires in the course of its economic activity not only for the services to its customers, which are taxed, but also for transactions for which there is no right to deduct. In such a case Article 17(5) of the Sixth VAT Directive is relevant, that is, a deductible proportion is to be calculated according to Article 19. As may be seen from Article 19(1) of the Sixth VAT Directive, the income at issue here would have to be included in the denominator of the fraction as it gives no right to deduct. As a result the denominator would be increased and the deductible proportion reduced. That means that in the case before the Court the plaintiff would no longer be able to claim the full deduction.

being payable only in the case of the private final consumer. At the previous stages those carrying out an economic activity are relieved of value added tax by deduction of input tax. That relief, however, should correspond to the extent of the economic activity of the taxable person and the related tax burdens. For that reason deduction is possible only when goods and services are used for taxable transactions. But if the taxable person is not required to pay any value added tax himself he cannot claim any deduction. For this reason Article 17(5) requires the calculation of a deductible proportion. By that means the claim for deduction is intended to be adjusted as exactly as possible to the transactions effected. If, however, certain transactions (the incidental transactions) are excluded again from the calculation of the deductible proportion, that can only mean that if these transactions were taken into consideration the result would be distorted. That will have to be taken into account below (paragraph 39 et seq.) in determining the concept of incidental transactions.

36. Certainly the income could under Article 19(2) be excluded from the calculation of the deductible proportion as incidental transactions under Article 13B(d). As the concept of incidental transactions is not further elucidated, it must be determined in the context of the entire system of deduction of input tax.

38. The plaintiff has examined the concept of incidental transactions in four different official languages and has come to the conclusion that it does not necessarily refer to minor transactions but that in each case the concepts indicate a certain link with the principal activity. I must concur with that.

37. The possibility of deduction is intended to relieve the taxable person from value added tax in the course of his business activity. This is based on the assumption of a chain of transactions, the value added tax

From the concepts 'accessoire' in the French, 'incidental' in the English and 'accessorio' in the Italian version of the Sixth VAT Directive it appears that these transactions are such as do not belong directly to the taxable

person's actual economic activity but are linked to it in a certain manner.

If we consider the German concept, 'Hilfs-' (auxiliary) transactions, we might possibly arrive at a further attribute of such transactions: they assist the taxable person's principal activity. As that aspect, however, is not reflected in the language versions mentioned above, I feel that that interpretation is too restrictive.

It must therefore be stated that it appears from the wording that incidental transactions are transactions which do not belong directly to the taxable person's actual economic activity but stand in a certain relationship to it. They need not necessarily be minor transactions, but it also appears from the wording that incidental transactions cannot in any event be on a larger scale than the activity itself. These findings must now be systematically tested.

39. Article 17(5) provides for cases in which goods and services are used for the taxable person's economic activity where that activity consists both of transactions which give a right to deduct and transactions for which there is no such right. No right to deduct

may be claimed for the latter, because, for instance, they are transactions of negotiation of credit, on which the taxable person himself has not had to pay value added tax. There is no apparent reason why in such a case, for example, a transaction exempt from value added tax under Article 13B(d) should not be included in the denominator of the fraction for calculating the deductible percentage.

The taxable person is not required to pay any value added tax for a portion of his transactions in the course of his activity — why, then, should he be able to claim deduction? For this reason these untaxed transactions are included in the denominator for the purpose of the calculation of the deductible proportion, as a result of which the amount of the deduction is reduced. A case in which untaxed transactions were left out of the denominator would be conceivable only at the cost of distorting the overall calculation of the deductible input tax.

I shall now explain what is to be understood by the concept 'distortion' in this connection: the criterion for the application of Article 17(5) and with it the calculation of the deductible proportion is the *use* of the taxable person's business assets for taxed transactions, which thus entail a right to deduct, and of transactions which do not entail such a right. But the turnover attributable to every *transaction* is included in the calculation of the deductible proportion. That is, as long as the resources utilized are to some extent related to the transactions arising (taxed or untaxed), there are no difficulties. The position is different, however, if the

resources applied are slender but the transaction for which they are used is proportionally much greater. Then this relatively substantial transaction has the effect of reducing the deduction. The relevant turnover is included in its entirety in the denominator although only slender resources were used for the transaction. The diminution of the deduction therefore becomes disproportionately high.

40. The result as regards the incidental transactions is that they do not form part of the actual economic activity and that the taxable person's business assets are used only to a very slight extent for these transactions.

41. Certainly there must still be some connection with the other transactions, because if none of the resources used for the normal transactions were utilized for the incidental transaction, there would be no occasion for the application of Article 17(5).

In the case before the Court, for example, the income from the investment activity amounts to 14% of the total income. That is to say, that 14% would be included in the denominator and would thus reduce the input tax, although according to the plaintiff's pleadings only a few telephone calls and letters were required for these transactions. That is to say, the secretaries had to use very little time on these transactions and the relevant telephone charges are also very slight. It is not clear why an activity such as this, which is not part of the actual economic activity, should reduce the amount of the deduction disproportionately.<sup>10</sup>

42. For further clarification I should like to refer to the example put forward by the French Government: a supplier who grants his customer a credit for payment for goods delivered and receives interest thereon is acting in the framework of his principal activity. The receipt of the interest is to be regarded as inherent in the principal activity. The proceeds of this credit transaction are exempt from value added tax but are included in the denominator of the fraction under Article 19(1). It would be rather different if the supplier effected credit transactions which did not directly form part of his other economic activity and required only a small portion of the resources needed for the taxable person's activity. We might take as an example here the investment of money (profits) not required, for the time being, for the actual activity. If these transactions were included in the denominator of the fraction and thus

10 — A distortion of the deduction in favour of the taxable person is also possible: if a small transaction requires a comparatively large proportion of the taxable person's business funds, the amount of the deduction would not be sufficiently reduced by the small amount of turnover included in the denominator for the deductible proportion. For such a case the Sixth VAT Directive, in the third subparagraph of Article 17(5), allows the Member States to provide for other types of calculation in order so avoid such a distortion.

reduced the amount of the deduction, that would distort the amount of the deduction as described above. It would no longer correspond exactly to the supplier's economic activity.

43. It may therefore be stated that incidental transactions are transactions which do not belong directly to the taxable person's other economic activity and require only a small portion of the resources available for that activity.

44. The plaintiff also comes to a similar conclusion, although it formulates it differently. For the plaintiff incidental transactions are transactions which bring about no significant increase in the business assets utilized. As, however, the resources (staff and office installations) are available, this formulation might in certain circumstances be misleading. It might also mean that for instance no additional secretary needs to be employed. Here the point is that the secretaries available do not devote much working time to the incidental transactions. For that reason I prefer the formulation that incidental transactions require only a small portion of the business assets needed for the actual activity.

45. It is still necessary, however, to clarify the question of the permissible extent of incidental transactions. It must be said that they certainly must not exceed the extent of the principal activity. In this connection the French Government has laid down a rigid line of demarcation according to which incidental transactions must not account for more than 5% of total income. However, the purpose of the provision in Article 19(2) is to avoid a distortion of the amount of the deduction. However, that also means that the aim is to make possible an adaptation to the individual case. That is no longer possible if the concept of incidental transactions is defined as in France on the basis of percentages. Instead a decision must be taken in individual cases as to whether transactions which meet the conditions mentioned above are of such a nature as to distort the deduction.

46. On the other hand the French Government states that above the 5% limit the taxable person has the opportunity to introduce a separate sector with its own deductible proportion. However, that requires the taxable person to keep separate records for the individual sectors. Apart from the fact that in the sector of incidental transactions even above the 5% limit that might be very difficult, for the very reason that incidental transactions require the use of resources only to a very small extent, the taxable person is burdened with an additional obligation which does not exist under Article 19(2), according to which incidental transactions are excluded in all cases from the calculation of the deductible proportion.

47. The French Government argues, however, that for reasons of legal certainty and to avoid distortions of competition it is necessary to define exactly the concept of incidental transactions. That would mean, however, that Article 19(2) could no longer fulfil its actual purpose. It is intended to make possible an adaptation to the individual case. For this reason too it is not to be interpreted strictly as an exception to Article 17(5) of the Sixth VAT Directive. An exact determination of the extent of incidental transactions is therefore not possible. It is true that criteria may be laid down for such a determination in individual cases and legal certainty may be increased in that way. In any case that would be preferable to an arbitrary limit fixed at 5%.

48. The following may therefore be stated with regard to a more detailed definition of incidental transactions: they have a certain link with the taxable person's other activity but do not form a direct part thereof. They require the use of the relevant business assets only to a slight extent. They may not exceed the extent of the actual activity. For further clarification I might refer to an example given by the Commission: a person is engaged in property management and as such registered as a taxable person. In reality, however, he manages only a single house. For the remainder of the time he engages in financial transactions. In such a case the person concerned could no longer rely on the incidental nature of the financial transactions as they have meanwhile become his principal activity.

49. On the basis of this definition we must now consider whether the income at issue here may be regarded as attributable to incidental transactions under Article 19(2). The plaintiff thinks it may, because it takes as its sole criterion the fact that no additional resources are required for these financial transactions. The Commission's view is that in principle the decision must be made in each individual case, but that here the financial transactions are by their nature to be regarded as incidental transactions. Finally the French and Greek Governments deny that the transactions are incidental because the 5% limit is exceeded.

50. My view is that here the transactions may be regarded as incidental because the proceeds of investment do not belong directly to the plaintiff's activity and, it states, require only slight administrative expenditure. As already explained in the course of answering the first question, the investment activity does not form part of the plaintiff's activity of property management,<sup>11</sup> but cannot be entirely separated from it. To include in the deductible proportion turnover attributable to the investment activity, which is relatively substantial in comparison to the administrative expenditure required, would unfairly reduce the permissible deduction. It must therefore be

<sup>11</sup> — Paragraphs 14 and 15 *et seq.*

disregarded under Article 19(2) in the calculation of the deductible percentage.

transactions, excluded from the calculation of the deductible percentage because they do not form a direct part of the plaintiff's actual activity but cannot be separated from it and because the plaintiff's business assets are used only to a slight extent for that purpose and would therefore distort the amount of input tax. It is the task of the national court to verify that.

Even though 14% of the total income is attributed to the incidental transactions it still appears justifiable to regard them as such.<sup>12</sup>

For the rest I must refer again to the fact that it is the task of the national court to investigate whether the income may possibly be regarded as part of the consideration for the service performed and whether the plaintiff's investment activity does indeed require only slight administrative expenditure.

That means that the proceeds from the plaintiff's investment activity are, as incidental

51. Finally I should like to refer also to the following point. The court of reference raises the question whether these are incidental *financial transactions*. In any case they are incidental transactions for the purposes of Article 13B(d) of the Sixth VAT Directive. Whether in addition they are financial transactions need not be decided as that would not alter the result. It is important only that they are incidental transactions.

## C — Conclusion

52. I therefore propose that the questions referred to the Court be answered as follows:

- (1) If an undertaking liable to pay value added tax receives income from the investment of customers' funds at its disposal in the course of its economic

<sup>12</sup> — See also my Opinion, delivered on 26 January 1995, in Case C-4/94 *BLP Group* [1995] ECR I-983, at paragraph 64.

activity, the undertaking's right to deduct is basically affected because such income falls within the field of application of the Sixth VAT Directive and may thus also in principle be included in the calculation under Article 19(1) of the Sixth VAT Directive.

(2) Such income is not to be taken into account in the denominator of the deductible proportion since — on the assumption that it requires only slight administrative expenditure — it is attributable to incidental transactions within the meaning of the second sentence of Article 19(2) of the Sixth VAT Directive. That is the position,

- if it does not directly form part of the undertaking's actual economic activity but has a certain connection therewith;
  
- if it requires only a slight portion of the resources utilized for the undertaking's actual economic activity and would therefore unjustifiably reduce the amount of the deduction;
  
- if it does not exceed the turnover attributable to the undertaking's actual economic activity.

It is for the national court to establish that.