OPINION OF ADVOCATE GENERAL FENNELLY

delivered on 4 April 2000 *

1. The present reference concerns the calculation of VAT deductions from tax charged on management and technical-advice services provided by mixed holding companies, i.e. companies that hold shares as well as carrying out taxable transactions, to their subsidiaries. Do dividends paid by the latter have the effect of reducing the deductions proportionately? All those who have submitted observations to the Court are *ad idem* in asking for clarification of the problematic proposition enunciated by the Court in *Polysar* [1] that the maintenance of shareholdings in companies would be regarded as economic activity 'where the holding is accompanied by direct or indirect involvement in the management' of such companies.

I — The background

2. Floridienne SA and Berginvest SA (hereinafter 'the applicants') are industrial-holding companies. [2] In addition to holding shares, the applicants are involved in the management of the companies in which they hold shares by providing taxable services to their subsidiaries, such as management, technical assistance, accounting and advisory services. It would appear from uncontested information provided by the applicants to the Court that such services were also provided during the relevant period to former subsidiaries and to certain other companies with which the group did business. Furthermore the applicants have advanced certain sums by way of loans to the subsidiaries or to some of them but not, it seems, to other companies. Consequently, the applicants receive dividends on their shares and interest on their loans. They have claimed the right to deduct from the (output) VAT which they charge in respect of the services provided to their subsidiaries the entirety of the (input) VAT paid by them in the price of goods and services provided to them.

3. The Collectors of VAT for Tournai and Verviers, respectively, issued orders against each of the companies requiring payment of additional VAT in the sums of BEF 13 812 839 and BEF 17 598 876. The said Collectors assert that deductions could properly have been made only for the proportion that the receipts from taxable services bore to the total turnover of the

* Original language: English.

1 — See Case C-60/90 *Polysar Investments Netherlands* [1991] ECR I-3111 (hereinafter '*Polysar*').

2 — At the material time, Floridienne was the group holding company, while Berginvest, its subsidiary, was the parent company of the group's plastics subdivision.

applicants' taxable services plus dividend and interest income. Following upon actions brought by the applicants for annulment of these orders, as well as for damages, the Tribunal de Première Instance (Court of First Instance), Tournai, Belgium (hereinafter 'the national court') has referred the following question to the Court for a preliminary ruling:

'Must share dividends and interest on loans always be excluded from the denominator of the fraction used to calculate the deductible proportion, even where the company receiving such dividends and interest has involved itself in the management of the undertakings paying them, save in the exercise of its rights as shareholder?'

4. The national court has described the applicants' involvement in the management of the subsidiaries as follows:

'[T]hey carry out other activities on behalf of their subsidiaries, such as management and technical assistance, financing and advising, and they are directly involved in the management of the companies in which they hold shares, some of its managers being on the boards of those companies.

In connection with their activities providing services to their subsidiaries, the applicants carry out taxable transactions, giving rise to the right to make deductions in respect of taxes imposed on goods and services supplied to them (input taxes).'

II — Observations and analysis

(i) *Income from dividends*

5. Although findings of fact are exclusively a matter for the national court, it is important to note, immediately, that the findings contained in the order for reference suggest that the relationships between the applicants and their subsidiaries are governed by objective legal measures, such as contracts for the provision of services and the appointment of managers to serve on the boards of the subsidiaries.

6. The applicants claim that the receipt of dividends and interest amount to simple enjoyment of the fruits of investment and do not constitute 'economic activity' within the scope of Community VAT. These receipts should not, therefore, be taken into account when calculating permitted deductions. Belgium relies essentially for its contrary view on the participation of the applicants in the management of their

subsidiaries. Such activity changes the nature of the receipts into the fruits of an extended economic activity which in principle is subject to VAT but exempt by virtue of Article 13B(d)(5) of the Sixth Directive. [3] In order to avoid infringing the principle of neutrality, the dividends must be included, at least partially, in the relevant denominator. At the hearing, counsel for the applicants denied that the national court had made any definite finding that the applicants had involved themselves in the management of their subsidiaries, apart from providing taxable services or exercising rights of nomination which they enjoyed as shareholders. In the alternative, he contested Belgium's view that the receipt of dividends could be regarded as the remuneration for an activity which was to be regarded as taxable but exempt pursuant to Article 13B(d)(5). [4]

7. It is necessary to consider the principal relevant provisions of the Sixth VAT Directive. [5]

8. The central crux of the case is the meaning of the term 'economic activity'. As appears from Article 4 of the Sixth Directive, that term defines the scope of the Community VAT system. Article 4(1) of the Sixth Directive provides that a 'taxable person' is to mean 'any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity'. Article 4(2) goes on to provide:

'The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. *The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity*' (emphasis added).

In addition, Article 4(3) permits Member States also to 'treat as a taxable person anyone who carries out, on an occasional basis, a transaction relating to the activities referred to in paragraph 2 ...', before men-

3 — This provision requires, in so far as is material in the present case, Member States to exempt from VAT 'transactions, including negotiation, excluding management and safekeeping, in shares, interests in companies or associations, debentures and other securities ...'.

4 — In his view, the receipt of a dividend could not be equated with 'transactions, including negotiation, ... in shares ...' for the purposes of that provision.

5 — 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.

tioning, in particular, certain transactions relating to buildings or building land.

9. The limitation of the scope of VAT to 'economic activity' means, to give the most obvious example, that an individual who carries on a trade or profession in his own name must keep his personal and business affairs separate. He may not make VAT deductions in respect of his private purchases. Where he diverts business goods or services to his private use, he may have to pay VAT on them. [6]

10. Furthermore, as is clear from the case-law of the Court, upon which the applicants place particular reliance, the notion of 'economic activity' does not encompass the enjoyment of the fruits of the simple ownership of investments, such as shares and bonds or debentures.

11. In *Polysar*, the Court was concerned with a claim by a pure holding company that dividend income received from its holdings of shares should be regarded for VAT purposes as having been obtained in the pursuit of an economic activity. Recalling its dictum in *Van Tiem* [7] as to the wide scope of VAT, the Court stated that 'it does not follow from that judgment ... that the mere acquisition and holding of shares in a company is to be regarded as an economic activity, within the meaning of the Sixth Directive, conferring on the holder the status of a taxable person'. [8] The Court explained this interpretation of the scope of the principle expressed in *Van Tiem* in the following terms: [9]

'[T]he mere acquisition of financial holdings in other undertakings does not amount to the exploitation of property for the purpose of obtaining income therefrom on a continuing basis because *any dividend yielded by that holding is merely the result of ownership of the property*.'

12. In *Wellcome Trust*, the Court was even more explicit. It took the same view in respect of the extremely substantial investment activities of a charitable trust consisting 'essentially in the acquisition and sale of shares and other securities with a view to maximising dividends and capital yields ...'. [10] In *Harnas & Helm* [11] the 'mere acquisition and holding of bonds,

6 — See Articles 5(6) and 6(2) of the Sixth Directive which were discussed recently in Case C-48/97 *Kuwait Petroleum* [1999] ECR I-2323.

7 — Case C-186/89 [1990] ECR I-4363.

8 — *Polysar*, cited in footnote 1 above, paragraph 13.

9 — Ibid. (emphasis added).

10 — Case C-155/94 *Wellcome Trust* v *Commissioners of Customs and Excise* [1996] ECR I-3013, paragraph 34 (hereinafter '*Wellcome Trust*').

11 — Case 80/95 *Harnas & Helm* v *Staatssecretaris van Financiën* [1997] ECR I-745 (hereinafter '*Harnas & Helm*').

activities which are not subservient to any other business activity, and the receipt of income therefrom' were also 'not to be regarded as economic activities conferring on the person concerned the status of a taxable person'. [12]

13. In none of these three cases did the taxpayer carry out any taxable transactions. Each had sought treatment as a taxable person by virtue of its investment activities so as to be able to exercise a right to deduct VAT inputs. Consequently no issue arose about the apportionment of VAT deductions as no deductions were possible.

14. The Court had to address the calculation of deductible proportions in *Sofitam*. [13] The system of deductions is, of course, central to the very nature of the Community VAT regime. Its objective is to ensure that the economic burden of VAT is borne only by the consumer. Traders, as taxable persons, are entitled to deduct VAT paid on goods and services they have purchased from the VAT paid by them to the revenue authorities on their taxable transactions and to pass the remaining burden on to their customers in the form of the price charged. This is reflected in Articles 17 to 20 of the Sixth Directive which are designed 'to relieve the trader entirely of the burden of the VAT payable or to be paid in the course of all his economic activities'. [14]

15. Article 17(1) declares the general principle of a 'right to deduct ...'. The material part of Article 17(2) states that:

'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 be supplied to him by another taxable person ... .'

16. In order to be deductible, therefore, the input VAT must have been paid on 'goods and services *used* for the purposes of his *taxable transactions* ...' (emphasis added). This important and necessary precondition acts as a primary filter against abuse, at least where inputs can readily be related to the corresponding outputs.

12 — Ibid., paragraph 20.

13 — Case C-333/91 *Sofitam* v *Ministre Chargé du Budget* [1993] ECR I-3513 (hereinafter '*Sofitam*').

14 — Case 268/83 *Rompelman* v *Minister van Financiën* [1985] ECR 655, paragraph 19 (hereinafter '*Rompelman*'), Case 50/87 *Commission* v *France* [1988] ECR 4797, paragraph 15 and *Sofitam*, loc. cit., paragraph 10.

17. The present case is, however, directly concerned with the interpretation of Articles 17(5) and 19(1) of the Sixth Directive. The first two paragraphs of Article 17(5) provide:

'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.'

Article 19(1) provides:

'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),

— 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).

The proportion shall be determined on an annual basis, fixed as a percentage and rounded up to a figure not exceeding the next unit.'

18. Belgium claims that the applicants should be permitted to make deductions pro rata according to the proportion that the turnover of their taxable transactions bears to their total turnover, including dividends and interest received from their subsidiaries. The Commission has argued in its written observations that the Sixth Directive contains no rule regarding the method of taking account of income relating to private activities outside the scope of the Directive and that Member States are, accordingly, free to decide on the deduct-

ibility of VAT inputs relating to such activities.

19. I have serious doubts about the correctness of the Commission's suggestion. If Member States chose to permit deduction of VAT in respect of purely private activities, which would amount in reality to reimbursement in most cases, there would potentially be a very serious loss of VAT revenue, a small percentage of which, it must be recalled, is paid to the Community budget. It would amount to relieving the consumer from the burden of VAT, which would be contrary to a central tenet of the system. [15] In any event it does not arise on the facts of this case.

20. The first part of the response to the more relevant argument of the Belgian State and to the question posed by the national court is to be found in *Sofitam*. Sofitam, to use the expression employed by Advocate General Van Gerven in his Opinion in that case, was a '*mixed holding company*', like the applicants in the present case. [16] It had receipts from share dividends and from taxable transactions. France took the same view as is now taken by Belgium in this case, to wit that Sofitam should be allowed to deduct 'only up to the percentage resulting from the ratio between the amount of its taxable receipts and the annual amount of its total receipts, including the dividends which it had received'. [17] *Sofitam* raised directly, therefore, the issue of the interpretation of Article 19(1) of the Sixth Directive. However, unlike in the present case, there was no suggestion that Sofitam was involved in any way in the management of its subsidiaries. [18] In those circumstances, the Court ruled that as 'the receipt of dividends is not the consideration for any economic activity ... it does not fall within the scope of VAT ... [and that] dividends resulting from holdings fall outside the deduction entitlement'. [19] It concluded that: [20]

'Consequently, dividends must be excluded from the calculation of the deductible proportion referred to in Articles 17 and 19 of the Sixth Directive, if the objective of wholly neutral taxation ensured by the common system of VAT is not to be jeopardised.'

Finally, the Court stated explicitly that the 'share dividends received by an undertaking which is not subject to VAT in respect of the whole of its transactions are to be excluded

15 — See the case-law cited in footnote 14 above.

16 — Paragraph 12 of his Opinion (emphasis in original). The Court described it more generally as 'a holding company'; see paragraph 3.

17 — *Sofitam*, paragraph 3.

18 — Advocate General Van Gerven pointed out (paragraph 12 of his Opinion) that '[a]ccording to the available information, as well as managing its share portfolio, Sofitam pursues ancillary activities that are subject to VAT'.

19 — Paragraph 13.

20 — Paragraph 14.

from the denominator of the fraction used to calculate the deductible proportion'. [21]

21. It follows to my mind that the dividends involved in this case should similarly be excluded, unless the management activities of the applicants in relation to their subsidiaries call for a different interpretation of Article 19(1). It is this possibility that is central to the present case. In *Polysar*, the Court, having ruled that the investment activities of a pure holding company did not amount to 'economic activities', stated that it would be 'otherwise where the holding is accompanied by direct or indirect involvement in the management of the companies in which the holding has been acquired, without prejudice to the rights held by the holding company as shareholder'. [22]

22. The situation contemplated by this qualification did not arise on the facts of *Polysar* or on those of any of the later cases. [23] In *Wellcome Trust* and *Harnas & Helm*, the Court mentioned, by reference to Article 13B(d)(5) of the Sixth Directive, that 'transactions ... effected as part of a commercial share-dealing activity or in order to secure a direct or indirect involvement in the management of the companies in which the holding has been acquired' might fall within the scope of VAT. [24] In the latter case the Court added that such transactions would 'constitute the direct, permanent and necessary extension of the taxable activity'. In each case, the Court cited, without comment, its *Polysar* statement.

23. However, this language, i.e. the reference to extensions of taxable activity, suggests rather that the Court had in mind its judgment in *Régie Dauphinoise-Cabinet A. Forest* v *Ministre du Budget*. [25] Régie was involved principally in the management of property. It managed rented property on behalf of the owners and acted as a manager of condominiums. It received advances from the owners, which were paid into a bank account operated by Régie, which then invested them, by way of diverse treasury placements, with financial institutions on its own account. Régie apparently, however, became the owner of the sums invested and was entitled to retain the interest earned on the placements, albeit subject to a contractual obligation ultimately to repay the relevant principal amounts. In reality, therefore, as the applicants contended at the hearing, Régie's remuneration from its additional investment activities was limited to the interest received.

24. The Court accepted that the placements by Régie with financial institutions could

21 — Paragraph 15.

22 — Paragraph 14. This statement was later cited at paragraph 12 of the judgment in *Sofitam*.

23 — As regards *Sofitam*, see the discussion in paragraph 20 and the accompanying footnote 16 above.

24 — Paragraphs 35 and 16 of the respective judgments.

25 — Case C-306/94 [1996] ECR I-3695 (hereinafter '*Régie Dauphinoise*').

'be regarded as services supplied to those institutions, consisting in the loan of money for a fixed period, duly remunerated by the payment of interest' [26] and, moreover, that 'unlike the receipt of dividends by a holding company ... interest received by a property management company on investments made for its own account of sums paid by co-owners and lessees cannot be excluded from the scope of VAT, since the interest does not arise simply from the ownership of the asset, but is the consideration for placing capital at the disposition of a third party'. [27] The Court was nevertheless careful to distinguish the activities of an undertaking like Régie from simple 'placements made with banks by the manager of a condominium' who was not 'acting as a taxable person'. [28] Accordingly, it concluded that: [29]

'... in the case at issue in the main proceedings, the receipt, by such a manager, of interest resulting from the placement of monies received from clients in the course of managing their properties *constitutes the direct, permanent and necessary extension of the taxable activity*, so that the manager is acting as a taxable person in making such an investment.'

25. At this point, it is apparent that the Court has identified two types of situation as coming potentially within the *Polysar* qualification, namely share-dealing operations and active management of property. However, each of these can be independently justified by reference to the terms of the Sixth Directive. Transactions in shares are explicitly covered by the wording of an exemption (Article 13B(d)(5), quoted in footnote 3 above), while Article 4(2) covers 'the exploitation of tangible or intangible property ...'. Advocate General Van Gerven in his Opinion in *Polysar* drew a careful distinction between the latter type of activity and simple investment when pointing out that both *Rompelman* and *Van Tiem* 'were concerned not only with an investment, that is to say the acquisition of property ... but also with the property acquired subsequently being *made available* to a third party for consideration (in the former case by the letting of the apartment and in the latter by the grant of building rights over the plot)'. [30] He then distinguished between the mere acquisition of property, on the one hand, and its being made available, on the other, for the purposes of determining whether such property has been economically exploited for VAT purposes. [31] The part of his Opinion which is particularly pertinent to the present case also casts the most light on the proper interpretation of the *Polysar* judgment and is worthy of full citation: [32]

'The question remains whether liability to tax may be inferred from the other activities of a holding company. The national

26 — Paragraph 16.
27 — Paragraph 17.
28 — Paragraph 18.
29 — Paragraph 18 (emphasis added).
30 — *Polysar*, loc. cit., footnote 1 above, paragraph 5 of the Opinion (original emphasis).
31 — Ibid.
32 — Opinion of Advocate General Van Gerven, paragraph 6.

court has pointed out that Polysar's activities are concerned solely with the holding of shares in subsidiary companies. It seems to me that such activities, which are undertaken in the exercise of shareholders' rights, do not constitute "economic activities" within the meaning of the directive. The exercise of those rights includes, for instance, participation in the general meeting of the subsidiary's shareholders, the exercise of the right to vote at the meeting and the possibility of influencing company policy thereby and, where appropriate, involvement in the decision appointing the company's directors or officers and/or apportioning the subsidiary's profits, as well as the receipt of any dividends declared by the subsidiary or the exercise of shareholders' preferential rights or options.

In addition to the aforesaid activities which a holding company carries on as a shareholder in other companies, there are activities which, like any other company, it carries on through its organs and which, in so far as they are conducted within the company (in its relations with the shareholders and the company's organs) also cannot be regarded as "economic activities", within the meaning of the Sixth Directive. Those activities include the administration of the holding company, the making up of the annual accounts, the organisation of the general meeting, the decision to spend the holding company's profits and to declare (and possibly pay out) dividends.

Nor, in my view, is there any question of economic activities independently carried on within the meaning of Article 4(1) of the Sixth Directive in the case of activities which the holding company, or persons acting in its name, carries out in its capacity as director or officer of a subsidiary company. A director or officer of the company does not act on his own behalf but only binds the (subsidiary) company whose instrument he is; in other words, where he acts in the exercise of his duties under the company instruments, there is no question of his acting "independently". In that regard, his actions must be equated with those of an employee who, as Article 4(4) of the Sixth Directive expressly states, does not act "independently".'

26. It follows from this passage that, contrary to the view advanced by Belgium in this case, the mere appointment by a holding company of directors or officers, and I would say also managers, of a subsidiary company does not alter the nature of the relationship from the VAT point of view. In general, a holding company does not, by exercising its rights as shareholder, 'exploit' its 'intangible property' in its shares in the sense of Article 4 of the Sixth Directive. As Advocate General Van Gerven noted in respect of such a holding company, 'there are activities

which, like any other company, it carries on through its organs and which, in so far as they are conducted within the company (in its relations with the shareholders and the company's organs), also cannot be regarded as "economic activities"...'. [33] The Advocate General did not, however, deal with the suggestion implicit in the national court's question in the present case that the provision of management and other services to a subsidiary, even pursuant to taxable transactions (and I presume contractual relationships), leads to a different result. I do not believe it does. To my mind, the implication of Advocate General Van Gerven's remarks regarding acting 'in the exercise of ... duties under the company instruments' are equally applicable to objective contractual relationships such as those involved in this case between a parent and subsidiary.

27. The applicants pointed to some anomalies which would flow from treating the share dividend income of the parent companies as 'economic activities' when the latter supplied services under contract to its subsidiaries. The level of deductions would vary with the profitability of the latter. Full deduction would be permissible if there were no profits or even if no dividends were declared. A small percentage reduction would apply when large dividends were declared. The situation would again be different if the services were carried out instead by a specially nominated company within the group. [34]

28. In short, where the corporate structure is properly respected, dividends paid by a subsidiary to a parent do not consist of 'economic activities'. The situation envisaged by the exception in *Polysar* cannot in effect arise in any case where the veil of incorporation has not been illegally breached by the parent company. It remains, of course, possible for it to apply to cases where there is no corporate structure, i.e. where an unincorporated body or an individual directly exploits property.

29. Finally, on this point, the Commission has suggested, in its written observations, that the dividends could be regarded as constituting consideration, within the meaning of Article 11 of the Sixth Directive, for the provision of management services by the parent to the subsidiaries. Dividends are payable equally in respect of all shares of the same type in a company. In my opinion, it is fundamentally inconsistent with the corporate structure to treat the payment of dividends as furnishing consideration in that sense. It is generally accepted in company law that dividends

33 — Ibid.

34 — The applicants point out in their written observations that, with effect from 1 January 1995, the management services in question have been provided by specialised subsidiaries. Moreover, counsel for the applicants pointed out at the hearing, without being contradicted by either the Commission or Belgium, that in certain Member States, notably the United Kingdom, the members of a corporate group can opt for consolidated VAT treatment, in which case the central issue raised by the present case would not arise because the VAT inputs of the parent would be regarded as part of the deductible inputs of the group.

comprise payments made out of *profits* to the shareholders in a company. [35] Indeed, the Court expressly stated in *Sofitam* that 'the receipt of dividends is not consideration for any economic activity within the meaning of the Sixth Directive'. [36] The situation could only be different where, notwithstanding the separate legal personality of the subsidiary, a controlling shareholder has been able to use its shareholding and consequential influence on the management of the subsidiary to extract additional 'payment' for separate taxable services provided by it to that subsidiary. There is nothing in the case-file to suggest that this occurred in the instant case.

30. The decisive point is that denial of the right to deduct VAT inputs from VAT paid on directly related outputs would patently contradict a basic tenet of the VAT system. As this would be the consequence of including non-economic activities in the denominator of the fraction prescribed by Article 19(1) of the Sixth Directive, I would recommend that the Court reject such an interpretation of the Directive.

(ii) *Interest on loans*

31. The same result does not automatically follow for the receipt by the applicants in respect of interest on loans to their subsidiaries. The loans at issue do not necessarily partake of the character of investments as was the case with the bonds in *Harnas & Helm*. [37] In that case, during the relevant period Harnas & Helm held shares and bonds issued in third countries in respect of which it received dividends and interest. The Court held that 'income from the bonds derives from the mere fact of holding them, which entitles the holder to payments of interest' and that '[s]uch interest cannot, therefore, be regarded as a return on an economic activity or transaction carried out by the bondholder, since

35 — In Irish law, for example, under S. 45 of the Companies Amendment Act 1983, distributions or dividends in all registered companies may only be made from the company's accumulated realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated realised losses, so far as not previously written-off in a reduction or reorganisation of capital, i.e. current profits and any profits carried forward, less current losses and any losses carried forward. The link between profits and dividends clearly also underlies company-law provisions that have been adopted by the Community legislature, as may be illustrated by Council Directive 82/121/EEC of 15 February 1982 on information to be published on a regular basis by companies the shares of which have been admitted to official stock-exchange listing, OJ 1982 L 48, p. 26. Article 5(4) of that Directive provides that: 'Where the company has paid or proposes to pay an interim dividend, the figures must indicate the profit or loss after tax for the six-month period and the interim dividend paid or proposed'.

36 — Cited in footnote 13 above, paragraph 13. The Court thus agreed with the Commission's observations in that case to the effect that 'dividends do not constitute consideration ... for an activity subject to VAT and still less for an activity exempt from VAT'; see paragraph 13 of the Opinion of Advocate General Van Gerven. In its oral observations in the present case, the Commission accepted that it would be very difficult to determine the proportion of dividends which constituted such consideration.

37 — Cited in footnote 11 above.

it derives from the mere ownership of bonds'.[38] However, it appears from the order for reference in this case and from the submissions of the parties that the applicants provide finance on a *continuing* basis to cover the cash-flow needs of their subsidiaries, which are often not in a position easily to raise finance independently.

32. Belgium, supported by the Commission at the hearing, relies on *Régie Dauphinoise*.[39] The applicants' lending activities — it described them at the hearing as being the financial motors of the group — should be viewed as an extension of their business of providing taxable management services to its subsidiaries. This is contradicted by the applicants who contend, principally, that in lending they merely reinvest, in a manner akin to a private investor, sums received by way of dividend. Alternatively, they suggest that, as the resources used for lending are merely ancillary to the shareholding activity, the interest earned thereon should not be included in the denominator.

33. In *Harnas & Helm* the holding company had also made two ordinary loans to non-related companies. There was nothing in the case-file to indicate that such lending activity occurred other than on a wholly occasional, if not rare, basis. In the present case, it is clear from the order for reference that lending to their subsidiaries is one of the applicants' ongoing activities. It seems to me therefore to be much more akin to the money-management operations considered by the Court in *Régie Dauphinoise* than to the portfolio-management activities at issue in *Wellcome Trust*. It is on this basis, essentially, that Belgium argues that the activity should be viewed as being economic.

34. However, in *Régie Dauphinoise* the sums invested were held by Régie, as Advocate General Lenz stated, 'on the basis of its economic activity'.[40] Here it would appear that some, if not all, of the funds lent by the applicants were derived from its dividend income. An analogy with *Régie Dauphinoise* could only be made if the national court were to conclude that the lending activity was financed largely from the proceeds generated by the applicants' taxable activity of providing services. I agree with the view expressed by Advocate General VerLoren van Themaat that it is 'the *nature* of the activities in question which is relevant'[41] for determining what constitutes an economic activity and I

38 — Ibid., paragraph 18.

39 — Cited in footnote 25 above.

40 — Paragraph 20 of his Opinion in *Régie Dauphinoise*.

41 — See his Opinion in Case 89/81 *Staatssecretaris van Financiën* v *Hong Kong Trade* [1982] ECR 1277, p. 1293 (emphasis in original).

would reiterate the view I expressed in my own Opinion in *Harnas & Helm* that: [42]

'Attention should be focused on the economic and commercial substance of transactions that are alleged to constitute an economic activity, as opposed to the formal financial or commercial classification (namely, in this case, as bond or share acquisitions and holdings) of those activities. It follows, in my opinion, that a person who, like the appellant, deals in bonds may only be considered to be carrying on an economic activity if he is pursuing a business or commercial purpose; in this respect he must provide services to his customers as opposed merely to being a consumer of services.'

35. In this case, I am of the view, although I confess not without some hesitation, that the lending activities of the applicants lack economic or commercial substance. The mere fact that the aim of the loans from the point of view of the subsidiaries is to avoid having to borrow from credit institutions — lending which, as we are told by Belgium, is often refused due to the inadequacy of the autonomous security which may be offered by subsidiaries in industrial-holding groups — does not suffice to render the applicants' activity commercial. In other words, while financially the lending activity of a bank and that of the applicants *vis-à-vis* their subsidiaries would differ little, the economic nature of their underlying activities is different. It may be compared with the difference between the activities giving rise to the receipt of a dividend and those giving rise to a rent cheque, to which I alluded in my Opinion in *Harnas & Helm*. [43] To my mind the lending activity of Harnas & Helm, apart from the fact that it clearly occurred only occasionally, was nevertheless more economic in nature because, unlike the applicants, it furnished loans to third parties.

36. My hesitation in making this recommendation derives from the express provision for an exemption from VAT in Article 13B(d)(1) of the Sixth Directive in respect of 'the granting and the negotiation of credit and the management of credit by the person granting it'. This clearly indicates, to my mind, that such activity, when carried on as a business, is to be regarded as constituting 'economic activity'. However, I consider that, for such lending activity to be carried on on an economic basis for VAT purposes, the supposed grantor of credit must engage in the activity in question not only on an ongoing basis, a condition satisfied here, but also for commercial purposes, which, to my mind, are absent where it is clear that the sums lent were lent to subsidiaries within the same corporate

42 — Paragraph 24.

43 — Ibid., paragraph 30.

group for the purposes of permitting the latter to carry on their commercial activities *vis-à-vis* third parties. It is clear, especially from the intra-group nature of the loans at issue, that the lending activity of the applicants is not an extension of their taxable service-provision activities but, instead, an extension of their non-taxable investment activities.

(iii) *General conclusions*

37. Consequently, I recommend that share dividends should be excluded from the denominator of the fraction used to calculate the deductible proportions laid down by Article 19(1) of the Sixth Council Directive. Similarly, interest earned on *intra-group loans*, even if made available on an ongoing basis, should also be so excluded provided, first, that they are furnished from funds derived from income on such share dividends rather than from income derived from a separate taxable activity and, second, that they are made available only to subsidiary companies.

38. The result of all this, in so far as Article 19(1) of the Sixth Directive is concerned, is not necessarily that the applicants may deduct all of their VAT inputs. To the extent that the national court is satisfied, notwithstanding the applicants' contention to the contrary, that a not entirely insignificant proportion of those inputs relates to the performance of non-taxable transactions connected with the shareholding and lending activities of the applicants, no right to deduct may arise pursuant to Article 17(2) of the Sixth Directive. A taxable person may only deduct that proportion of its inputs which may properly be assigned to its economic activities. [44] Every taxable person is obliged by Article 22(2) of the Sixth Directive to 'keep accounts in sufficient detail to permit application of the value added tax and inspection by the tax authority', while Article 22(4) requires 'every taxable person' to 'submit a return within an interval to be determined by each Member State', which 'may not exceed two months following the end of each tax period', whose duration is, subject to a maximum of a year, to be determined by each Member State, although it may not 'exceed a year'. The taxable person who seeks to exercise the right to deduct in circumstances where some of its VAT inputs may relate to non-taxable activities is obliged to establish, to the satisfaction of the relevant tax authorities, the proportion of those inputs which it claims are attributable to taxable transactions and thus capable of being deducted.

39. Article 19(1) of the Sixth Directive is, however, inapplicable. It can apply only in

44 — See paragraph 16 above and paragraph 53 of my Opinion in *Harnas & Helm*.

cases where taxable but exempt activities are mixed with taxable ones, since, otherwise, as in this case where the applicants only engage, in my opinion, in taxable and non-taxable activities, there is no difference between the numerator and the denominator of the fraction which that provision envisages. It is therefore for the national court, in the final instance, to determine the extent to which some of the deductible VAT inputs claimed by the applicants may in fact have related to the exercise, respectively, of its non-taxable shareholding activities and its intra-group lending activities and to exclude those inputs from the right of deduction claimed by them.

III — Conclusion

40. It follows, in my view, that the Court should answer the question referred to the Court by the Tribunal de Première Instance, Tournai as follows:

Share dividends should always be excluded from the denominator of the fraction used to calculate the deductible proportions laid down by Article 19(1) of the 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, where the economic relationship between the company owning the shares and the company in which the shares are held is governed by lawfully adopted legal arrangements including contracts for the provision of services and the nomination by a parent company of persons who carry out the activities of the subsidiary. Furthermore, where one company in a group provides, even on a continuing basis, loan finance to meet the regular borrowing needs of other companies in the same group, that activity does not constitute economic activity and the income from such finance should also be excluded from the denominator of that fraction.