JUDGMENT OF THE COURT (Fifth Chamber)
6 April 1995 *

In Case C-4/94,

REFERENCE to the Court under Article 177 of the EC Treaty by the High Court of Justice (Queen's Bench Division) for a preliminary ruling in the proceedings pending before that court between

BLP Group plc

and

Commissioners of Customs and Excise

on the interpretation of Article 2 of the First Council Directive 67/227/EEC of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes (OJ, English Special Edition 1967, p. 14) and Article 17(2) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1),

* Language of the case: English.

THE COURT (Fifth Chamber),

composed of: C. Gulmann, President of the Chamber, J. C. Moitinho de Almeida (Rapporteur) and D. A. O. Edward, Judges,

Advocate General: C. O. Lenz,
Registrar: L. Hewlett, Administrator,

after considering the written observations submitted on behalf of:

— BLP Group plc, by David Milne QC, instructed by Tony Woodgate and Stephen Coleclough, Solicitors,

— the United Kingdom, by John E. Collins, Assistant Treasury Solicitor, acting as Agent, assisted by K. P. E. Lasok, Barrister,

— the Greek Government, by Fokion Georgakopoulos, Assistant Legal Adviser in the State Legal Service, and Kyriaki Grigoriou, Legal Representative in the State Legal Service, acting as Agents,

— the Commission of the European Communities, by Thomas Cusack, Legal Adviser, and Enrico Traversa, of its Legal Service, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of the applicant in the main proceedings, the United Kingdom, the Greek Government and the Commission at the hearing on 8 December 1994,

after hearing the Opinion of the Advocate General at the sitting on 26 January 1995,

gives the following

Judgment

1 By decision of 14 December 1993, received at the Court on 6 January 1994, the High Court of Justice (Queen's Bench Division) referred to the Court for a preliminary ruling under Article 177 of the EC Treaty three questions on the interpretation of Article 2 of the First Council Directive 67/227/EEC of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes (OJ, English Special Edition 1967, p. 14, hereinafter 'the First Directive') and Article 17(2) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1, hereinafter 'the Sixth Directive').

2 Those questions were raised in proceedings between BLP Group plc (hereinafter 'BLP') and the Commissioners of Customs and Excise (hereinafter 'the Commissioners').

3 BLP is a management/holding company which provides services to a group of trading companies producing goods for use in the furniture and DIY industries. In 1989 it bought the share capital of a German company by the name of Berg Mantelprofilwerk GmbH (hereinafter 'Berg'). In June 1991, when BLP's financial position had become worrying, its directors sold 95% of the shares in Berg. The money raised by the sale was used to pay off BLP's debts.

4 In its VAT return for the period ending on 30 September 1991, BLP claimed to deduct the VAT paid on three invoices for professional services supplied to it by

merchant bankers, solicitors and accountants respectively, in connection with the sale of the shares in Berg.

5 The Commissioners held that the sale of shares was an exempt transaction in terms of the VAT legislation and refused to allow the deduction in question, equivalent to £39 845.

6 BLP appealed against that decision to the London Value Added Tax Tribunal, relying *inter alia* on Articles 17 and 19 of the Sixth Directive.

7 According to the second paragraph of Article 2 of the First Directive, 'On each transaction, value added tax, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of value added tax borne directly by the various cost components'.

8 On the right to deduct, Article 17 of the Sixth Directive 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 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.

...'

9 Article 19 deals with the calculation of the deductible proportion provided for in Article 17(5). It states that:

'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),

— 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 ...

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 incidental real estate and financial transactions ...'

10 Having been unsuccessful at first instance, BLP appealed to the Queen's Bench Division of the High Court of Justice. When that court declined to make a reference to the Court of Justice for a preliminary ruling, BLP appealed to the Court of Appeal, which allowed the appeal on that point and remitted the matter to the High Court.

11 In those circumstances the High Court stayed the proceedings and referred the following questions to the Court for a preliminary ruling:

'1. Having regard to Article 2 of the First Directive and Article 17 of the Sixth Directive, where a taxable person ("A") supplies services to another taxable person ("B"), and those services are used by B for an exempt transaction (sale of shares) which was treated as an "incidental financial transaction" and whose purpose and result was to raise money to discharge all of B's indebtedness, are those services supplied by A:

(a) services used for the purpose of an exempt transaction such that input tax thereon is not deductible;

(b) services used for the purpose of taxable transactions (namely B's core business of making taxable supplies) such that input tax thereon is deductible in whole;

(c) services used for both exempt and taxable transactions such that the input tax thereon is deductible in accordance with Article 17(5) of the Sixth Directive?

2. If the answer to Question 1 is that (c) applies and if a Member State has, in the exercise of its discretion under Article 17(5) of the Sixth Directive, adopted a special method falling within Article 17(5)(c) for determining the amount of the input tax which can be deducted, does Article 19 of the Sixth Directive have any application to the determination of the amount of the deductible input tax?

3. If the answer to Question 2 is that Article 19 does apply to the determination of the amount of the deductible input tax, does Article 19(2) allow full deduction of the input tax by excluding the share sale from the calculation of the deductible proportion under Article 19(1) as being an "incidental financial transaction"?'

Question 1

12 BLP considers that Article 17(2)(a) of the Sixth Directive must be given a wide interpretation so as to include within its scope the VAT due or paid in respect of supplies of goods or services directly or indirectly linked to the taxable person's taxable transactions, including exempt supplies of goods or services which are used for carrying out taxable transactions. In the present case, the services supplied in connection with the sale of the Berg shares were used for the purpose of raising

the funds necessary for paying BLP's debts, which derived precisely from the taxable transactions it had effected.

13 In BLP's opinion, to restrict deduction under Article 17(2) to the VAT due or paid on supplies of goods or services directly linked to taxable transactions would be contrary to the actual wording of that provision, would mean that transactions which ought to be subject to the same rules would have to be treated differently, and would be incompatible with the principle of the neutrality of VAT.

14 In that respect BLP observes that there is no reason why services supplied by accountants or solicitors for the carrying out of taxable transactions should give the right to deduct VAT, when no such right exists in a case such as the present one. In neither case are the services in question incorporated into the final product.

15 BLP further observes that if, in order to meet its liquidity requirements, it had taken out a bank loan, the VAT on the services of an accountant, required for obtaining that loan, would have been deductible in full. The principle of fiscal neutrality requires that economic decisions should not be influenced by tax factors.

16 Moreover, BLP submits that the services in question were used both for a transaction not giving the right to deduct, namely the sale of shares, and for taxable transactions, namely all those falling within the company's objects. Article 19 of the Sixth Directive, on calculation of the proportion in the case of mixed transactions, therefore applies and since the exempt transaction is an incidental financial transaction, in accordance with paragraph 2 of that article it should not be taken into consideration in calculating the proportion provided for in paragraph 1.

17 That argument cannot be accepted.

18 Paragraph 2 of Article 17 of the Sixth Directive must be interpreted in the light of paragraph 5 of that article.

19 Paragraph 5 lays down the rules applicable to the right to deduct VAT where the VAT relates to goods or services used by the 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'. The use in that provision of the words 'for transactions' shows that to give the right to deduct under paragraph 2, the goods or services in question must have a direct and immediate link with the taxable transactions, and that the ultimate aim pursued by the taxable person is irrelevant in this respect.

20 That interpretation is confirmed both by Article 2 of the First Directive and by Article 17(3)(c) of the Sixth Directive.

21 Article 2 of the First Directive states that only the amount of tax borne directly by the various cost components of a taxable transaction may be deducted.

22 Article 17(3)(c) provides:

'Member States shall also grant to every taxable person the right to a deduction or refund of the value added tax referred to in paragraph 2 in so far as the goods and services are used for the purposes of:

...

(c) any of the transactions exempted under Article 13B(a) and (d) paragraphs 1 to 5, when the customer is established outside the Community or when these transactions are directly linked with goods intended to be exported to a country outside the Community.'

23 It follows from that provision that it is only by way of exception that the directive provides for the right to deduct VAT on goods or services used for exempt transactions.

24 Moreover, if BLP's interpretation were accepted, the authorities, when confronted with supplies which, as in the present case, are not objectively linked to taxable transactions, would have to carry out inquiries to determine the intention of the taxable person. Such an obligation would be contrary to the VAT system's objectives of ensuring legal certainty and facilitating application of the tax by having regard, save in exceptional cases, to the objective character of the transaction in question.

25 It is true that an undertaking whose activity is subject to VAT is entitled to deduct the tax on the services supplied by accountants or legal advisers for the taxable person's taxable transactions and that if BLP had decided to take out a bank loan for the purpose of meeting the same requirements, it would have been entitled to deduct the VAT on the accountant's services required for that purpose. However, that is a consequence of the fact that those services, whose costs form part of the undertaking's overheads and hence of the cost components of the products, are used by the taxable person for taxable transactions.

26 In that respect it should be noted that a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system. The principle of the neutrality of VAT, as defined in the case-law of the Court, does not have the scope attributed to it by BLP. That the common system of VAT ensures that all economic activities, whatever their purpose or results, are taxed in a wholly neutral way, presupposes that those activities are themselves subject to VAT (see in particular Case 268/83 *Rompelman* v *Minister van Financiën* [1985] ECR 655, paragraph 19).

27 Finally, as to the argument that Article 19 of the Sixth Directive applies, that provision presupposes that the goods or services have been used by the taxable person both for transactions in respect of which there is a right to deduct and for transactions where there is no such right. In the present case, however, the services in question were used for an exempt transaction.

28 The answer to Question 1 must therefore be that Article 2 of the First Directive and Article 17 of the Sixth Directive are to be interpreted as meaning that, except in the cases expressly provided for by those directives, where a taxable person supplies services to another taxable person who uses them for an exempt transaction, the latter person is not entitled to deduct the input VAT paid, even if the ultimate purpose of the transaction is the carrying out of a taxable transaction.

Questions 2 and 3

29 In view of the answer which has been given to Question 1, there is no need to answer Questions 2 and 3.

Costs

30 The costs incurred by the Greek Government, the United Kingdom and the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT (Fifth Chamber),

in answer to the questions referred to it by the High Court of Justice (Queen's Bench Division) by order of 14 December 1993, hereby rules:

Article 2 of the First Council Directive 67/227/EEC of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes and Article 17 of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment, must be interpreted as meaning that, except in the cases expressly provided for by those directives, where a taxable person supplies services to another taxable person

who uses them for an exempt transaction, the latter person is not entitled to deduct the input VAT paid, even if the ultimate purpose of the transaction is the carrying out of a taxable transaction.

Gulmann Moitinho de Almeida Edward

Delivered in open court in Luxembourg on 6 April 1995.

R. Grass
Registrar

C. Gulmann
President of the Fifth Chamber