OPINION OF ADVOCATE GENERAL VAN GERVEN
delivered on 20 January 1993 *

Mr President,
Members of the Court,

1. In this case the French Conseil d'État has asked the Court to rule on the principle of 'pro rata' deduction in the Sixth VAT Directive [1] as applied to dividends from shareholdings of so-called 'mixed holding companies'. Mixed holding companies are holding companies which, hold shares in other companies and carry on an economic activity at the same time. At the origin of the question is a dispute between Sofitam (formerly, Satam), a limited company incorporated under French law, and the French Minister for Budgetary Affairs.

Background to the dispute

2. Sofitam's object is to manage immovable and movable assets. As parent company of a group of companies of the same name which manufacture and sell petrol pumps, its main activity is to manage a share portfolio. In addition to that activity, it lets real property, an activity which is subject to VAT.

Sofitam receives dividends in return for its participation in its subsidiaries' share capital. It also supplies a number of services to the companies in its group, in exchange for which it receives commission payments and other remuneration, as well as reimbursement of certain personnel costs. According to the order for reference, it does not involve itself in the management of its subsidiary companies, but merely exercises the rights to which it is entitled as shareholder.

3. From the VAT owed by Sofitam in respect of the period 1 January 1976 to 31 December 1979 Sofitam deducted the *full amount* of VAT which had been charged during that period on goods and services which it had received, but without taking into account, when calculating the deduction, the dividends which it had received. The French taxation authority carried out an audit of Sofitam's accounts for that period and found that its sources of revenue were, on the one hand, the letting of buildings and other activities subject to VAT and, on the other hand, dividends (not subject to VAT) from its participation in the share capital of its subsidiary companies.

In the administration's view, the deduction of VAT must be calculated in accordance with the rules laid down in Articles 212, 214 and 219(c) of Annex II to the Code Générale des Impôts (General Tax Code, hereinafter 'the French Law') which apply to undertakings which are not subject to VAT in respect

* Original language: Dutch.

1 — 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.

of the whole of their activities. That means that Sofitam could only make a *pro rata* deduction of the VAT paid by it in respect of goods and services supplied to it, that is to say up to the limit of the percentages arising out of the ratio of the annual amount of turnover subject to VAT to the total annual amount of turnover, including the dividends received by Sofitam. The administration demanded, on the basis of that method of calculation, a further sum by way of tax.

4. Sofitam's defence to that demand is that share dividends, even when received by an undertaking which, like itself, is not subject to VAT in respect of all its activities, do not constitute one of the elements to be taken into account when calculating the *pro rata* deduction as provided for in Article 212 of the French Law. Such dividends are not 'receipts' ('recettes') for the purposes of that provision, in view of the fact that they are not income from production or from services of an industrial or commercial nature, but rather capital transactions which, do not entail any action giving rise to a 'turnover' within the meaning of Article 19 of the Sixth VAT Directive. To apply Article 212 in any other way on the part of a shareholder, conflicts with Article 19 of the Sixth VAT Directive.

5. After its application for discharge from the additional tax assessed on it for the period 1 January 1976 to 31 December 1979 was dismissed by the Tribunal Administratif, Paris, Sofitam brought an action before the Conseil d'Etat for annulment of that judgment and withdrawal of the assessment in question.

The Conseil d'Etat took the view that for the purpose of giving a decision in to the main proceedings the determining factor was whether or not the plea of illegality raised by Sofitam with regard to Article 212 of the French Law was well founded. That is what prompted it to refer to the Court for a preliminary ruling the question:

'whether, in the light of its terms, Article 19 of the Sixth Directive must be interpreted to the effect that share dividends received by an undertaking which is not subject to value added tax in respect of all its transactions must be excluded from the denominator of the fraction used to calculate the deductible proportion or whether, in the light of the purpose and scheme of the system of deduction established by the directive and in particular by the combined provisions of Articles 17 and 19, the latter article is, on the contrary, to be interpreted to the effect that the dividends in question must, as income which is exempt from value added tax, be included in the denominator.'

6. Before answering the question referred by the Conseil d'Etat, I consider it appropriate to point out two important matters, namely the purpose and scheme of the deduction system established by the Sixth VAT Directive and the import of the terms 'taxable person' and 'economic activities' as used in that directive.

Purpose and scheme of the deduction system established by the Sixth VAT Directive

7. As the Court of Justice has already held on numerous occasions:

'... A basic element of the VAT system is that VAT is chargeable on each transaction only after deduction of the amount of the VAT borne directly by the cost of the various components of the price of the goods and services and that the deduction procedure is so designed that only taxable persons may deduct the VAT already charged on the goods and services from the VAT for which they are liable'. [2]

The deduction system established by the Sixth VAT Directive is therefore meant:

'to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of value added tax therefore ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way'. [3]

The deduction rules in Article 17 to 20 of the Sixth VAT Directive must be read in the light of that objective.

8. Article 17 lays down principal rules regarding deduction. By virtue of Article 17(2), the taxable person is entitled to deduct from the tax which he is liable to pay the VAT due or paid in respect of goods or services supplied or to be supplied to him by another taxable person 'in so far as the goods and services are used for the purposes of his taxable transactions'. [4] In its judgment in *Intiem* v *Staatssecretaris van Financiën* the Court regards the latter element as including a requirement that there be a *business connection:* the right to deduct applies solely to 'goods and services connected with the pursuit of the taxable person's business'. [5] That is why Article 17(6) provides that VAT shall 'in no circumstances be deductible on expenditure which is not strictly business expenditure'. The Court's conclusion in the *Intiem* case was also that

'this deduction system must be applied in such a way that its scope corresponds as far as possible to the sphere of the taxable person's business activity.' [6]

9. As regards the goods and services which are used by a taxable person both for transactions in respect of which VAT is deductible

2 — Case 286/83 *Rompelman* v *Minister van Financien* [1985] ECR 655, paragraph 16; see also Case 15/81 *Schul* v *Inspecteur der Invoerrechten en Accijnen* [1982] ECR 1409, paragraph 10.

3 — Case 268/83 *Rompelman*, point 19; Case 50/87 *Commission* v *France* [1988] ECR 4797, paragraph 15.

4 — Cf. with regard to the deduction mechanism laid down by Article 17, Case 42/83 *Dansk Denkavit* [1984] ECR 2649, para. 13; Case 295/84 *Rousseau Wilmot* [1985] ECR 3759, paragraph 15.

5 — Case 165/86 *Intiem* v *Staatssecretaris van Financien* [1988] ECR 1471, paragraph 13.

6 — Case 165/86, paragraph 14.

(on the basis of Article 17(2) and (3)) and for transactions in respect of which VAT is not deductible, Article 17(5) of the Sixth VAT Directive provides that 'only such proportion of the value added tax shall be deductible as is attributable to the former transactions'.

Article 19(1) provides that this *deductible proportion* is 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. (...)'

10. Article 17(5) and 19(1) do not explain in more detail what is to be understood by 'turnover' nor, in particular, what falls under 'turnover attributable to transactions in respect of which value added tax is not deductible' which must be taken into account in the denominator of the fraction in Article 19(1). I will return to the first concept (point 15, below). As regards the second concept, I can already point out that it follows from the very system of the directive that this concept refers in any event to turnover attributable to *transactions exempt from VAT*. It would be contrary to the Community legislature's concern for neutrality if a taxable person could deduct the VAT paid in respect of goods and services which he uses for economic activities which are, by virtue of the directive, exempt from VAT. The Court confirmed this in its judgment in Case 8/81 *Becker*, in which it held that 'the scheme of the directive is such that ... by availing themselves of an exemption persons entitled thereto necessarily waive the right to claim a deduction in respect of input'. [7]

However the question referred by the Conseil d'État is whether dividends from shareholdings in companies also constitute 'turnover' which, like turnover from VAT — exempt transactions, must be included in the denominator of the fraction in Article 19(1).

'Taxable person' and 'economic activities' within the meaning of the Sixth VAT Directive

11. As I have stated above (point 7), the right of deduction as laid down in the Sixth VAT Directive is linked to the status of

7 — Case 8/88 *Becker* v *Finanzamt Münster-Innenstadt* [1982] ECR p. 53, paragraph 44.

taxable person. Under Article 4(1) of the directive a taxable person means '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) explains that the *economic activities* referred to comprise all activities of producers, traders and persons supplying services, in particular the exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis. The Court has given the concept of 'exploitation' a wide interpretation: it includes all transactions, whatever their legal form, by which it is sought to obtain income from the goods in question on a continuing basis. [8]

In the judgment in *Polysar* the Court had an opportunity to explain the concepts of 'economic activity' and 'exploitation' — and consequently the concept of 'taxable person' — in regard to so-called 'pure holding companies', that is to say, holding companies whose sole activity consists in holding shares in subsidiary companies. The Court found that the mere acquisition and holding of shares in a company is not to be regarded as an economic activity within the meaning of the Sixth VAT Directive conferring the status of taxable person on the person concerned.

'The 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.' [9]

However, the Court immediately added that the position is 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'. [10]

12. As I have already stated, the judgment in *Polysar* concerned a pure holding company. As is apparent from the passage cited immediately above, it is accepted that such a holding company is a taxable person within the meaning of the Sixth VAT Directive when it is involved in the management of the companies in which it holds shares.

However, in the present case, we are dealing with a *mixed holding company*. According to the available information, as well as managing its share portfolio, Sofitam pursues ancillary activities that are subject to VAT. On that ground alone it is a taxable person within the meaning of the directive and has a right to deduct subject to the detailed rules

8 — See *inter alia* the judgment in Case C-186/89 *Van Tiem* v *Staatssecretaris van Financien* [1990] ECR I-4363, para. 18; Case C-60/90 *Polysar Investments Netherlands* v *Inspecteur der Invoerrecten en Accijnen* [1991] ECR I-3111, para. 12.

9 — Judgment in the *Polysar* case, paragraph 13.

10 — Judgment in the *Polysar* case, paragraph 14.

set out above (points 8 and 9). The fact that Sofitam does not involve itself in the management of the companies in which it holds shares has no effect in that regard.

The taking into consideration of dividends when calculating the deductible proportion

13. Although the judgment in *Polysar* is irrelevant in the present case for the purpose of determining status as a taxable person, it is of significance for that of answering the question whether dividends must be taken into account when calculating the deductible proportion. Two points of view were defended before the Court in that respect: Sofitam and the Commission are of the opinion that dividends should not be taken into account when calculating the deductible proportion; on the other hand, the French, Greek and — although with certain reservations — the Netherlands Government consider that it should be taken into consideration.

In accordance with the position it took in the main proceedings (see point 4, above), Sofitam submits that the turnover to be taken into account in the denominator of the fraction laid down by Article 19(1) of the Sixth VAT Directive does not include dividends received by a taxable person. Referring to paragraph 13 of the judgment in *Polysar*, cited above, it contends that the receipt of dividends does not constitute an economic activity within the meaning of the Community VAT rules and that consequently is completely outside the scope of those rules. When it refers to 'turnover' attributable to transactions in respect of which VAT is or is not deductible, the Sixth VAT Directive is referring to the total amount of the consideration received by the taxable person on account of the *economic activities* carried out, that is to say, the total price of the goods and services supplied by him, irrespective of whether or not there is a right to deduct.

The Commission also takes the view that dividends — as well as other income of an undertaking and gains resulting from the sale of shares — do not constitute consideration for an activity subject to VAT, and still less for an activity exempt from VAT. According to the Commission, since it concerns remuneration for a capital investment, that transaction falls *outside* the scope of VAT. It also concludes that the income from such financial transactions are not 'turnover' of the recipient undertaking and, consequently, must not be included in the fraction laid down in Article 19(1).

14. On the other hand, the French and Greek Governments consider that 'turnover' within the meaning of Article 19(1) of the Sixth VAT Directive refers to all income which has been received in the course of the undertaking's activity, irrespective of whether it flows from transactions which fall

within the scope of application of VAT. In so far as Article 19(1) refers to turnover attributable to transactions in respect of which there is no right to deduct, that provision covers both transactions exempt from VAT and transactions which fall outside the scope of VAT. According to the French Government, any other interpretation would deprive the system of pro rata deduction of any sense and result in unjustified distortion in the fiscal treatment of holding companies.

The Netherlands Government also takes the view that dividends must be included in the numerator of the fraction as though they were income from activities exempt from VAT. The position is otherwise only where the holding of shares takes place in the course of the taxable person's business. According to it, the latter situation occurs whenever the holding of shares is inextricably bound up with the activities engaged in by the company as a business, (for example the temporary investment of excess cash) or when that holding of shares, if combined with active involvement in the management of the subsidiary companies within the meaning of the judgment in *Polysar*, in itself constitutes a taxable undertaking. If the holding of shares thus takes place in the context of the taxable person's business, then that should not have any consequences for that taxable person's right to deduct and the dividends, assuming that they are not in themselves subject to VAT, would not have to be included in the denominator of the fraction.

15. I am unable to accept the arguments of the French and Greek Governments, and of the Netherlands Government in so far as it adopts the viewpoint of those governments, for the following reasons. In the judgment in *Polysar* (point 11, above) the Court of Justice unequivocally held that mere financial participation in other undertakings is not an economic activity within the meaning of the Sixth VAT Directive. The Court held in that same judgment that the yield from those participations in the form of dividends is 'merely the result of ownership of the property'. Consequently, such dividends can in no way be regarded as consideration for a well-defined (economic) act or transaction on the part of the shareholder. [11]

That is also indicated by the fact that, in the absence of a specific definition in the Sixth VAT Directive, the concept of 'turnover' in Article 19(2) of the Directive must be interpreted by reference to its general economic meaning in common parlance. [12] In common parlance, that concept refers to the value of the total sales of goods and services by an undertaking during a given period. In my opinion, it is clear that the receipt of dividends cannot be brought under that concept. The Community legislature also uses the

11 — As regards the requirement for a direct link between the performance of services and the consideration received for it, if there is to be a taxable transaction, see Case 102/86 *Apple and Pear Development Council* [1988] ECR 1443, paragraphs 11 to 17; cf. under the Second VAT Directive, Case 154/80 *Cooperatieve Aardappelenbewaarplaats* [1981] ECR 445, paragraphs 12 to 15.

12 — That principle of interpretation was applied by the Court in other VAT cases as well: see in particular Case 139/84 *Van Dijk's Boekhuis* v *Staatssecretaris van Financien* [1985] ECR 1405, paragraph 20.

concept of 'turnover' in that sense in Directive 78/62/EEC on the annual accounts of certain types of companies (the 'Fourth Company Law Directive'). Article 28 of that directive defines 'net turnover' with a view to drawing up the profit and loss account as being:

'the amounts derived from the sale of products and the provision of services falling within the company's ordinary activities, after deduction of sales rebates and value added tax and other taxes directly linked to the turnover'. [13]

The difference between the turnover of an undertaking and the dividends which accrue to it as a result of its holdings in other undertakings is, moreover, clear from the layouts provided for by the Fourth Company Law Directive regarding the presentation of the profit and loss account: in it the heading 'net turnover' is always distinguished from the heading 'income from participating interests'. [14]

16. To include the dividends resulting from shareholdings in the numerator of the fraction laid down by Article 19(1) seems to me, moreover, to be difficult to reconcile with the purpose of the deduction rules set out in the Sixth VAT Directive. As I have already said under point 7 above, these deduction rules are intended to affect undertakings' economic activities in a wholly neutral manner. The approach suggested by the French and Greek Governments would lead to that neutrality being impaired. By including the dividends in the denominator of the fraction, the right of an undertaking to deduct the VAT which it owes or has paid in the course of its economic activities would reduce in proportion to the size of the income which it receives from dividends. In other words, the mere holding of a participating interest is, in my opinion, so passive in nature that this 'activity' does not, in principle imply any use of goods or services in respective of which VAT is due or, at least, implies only an extremely restricted use. It is therefore wholly contrary to the proportional nature of the deductible proportion — which is dictated by the endeavour of the Community rules, aim to achieve neutrality — to include the whole of the amount of dividends received in the denominator of the fraction, since the goods and services subject to VAT are, strictly speaking, not *used* in order to hold the participating interests, or are so used only to a slight extent.

13 — Fourth Council Directive of 25 July 1978 on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies (78/660/EEC), OJ 1978 L 222, p. 11.

14 — See Articles 23 to 26 inclusive of the Fourth Company Law Directive.

Conclusion

17. For the abovementioned reasons I suggest that the Court answers the question referred by the Conseil d'Etat as follows:

Article 19 of the Sixth VAT Directive must be interpreted as meaning that, with a view to calculating the fraction used to calculate the deductible proportion, dividends received by the taxable person on the basis of a mere holding in other undertakings does not constitute turnover attributable to transactions in respect of which value added tax is not deductible.