JUDGMENT OF THE COURT (Fifth Chamber)
11 July 1996 *

In Case C-306/94,

REFERENCE to the Court under Article 177 of the EC Treaty by the Cour Administrative d'Appel de Lyon (France) for a preliminary ruling in the proceedings pending before that court between

Régie Dauphinoise — Cabinet A. Forest SARL

and

Ministre du Budget

on the interpretation of Article 19(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),

THE COURT (Fifth Chamber),

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

* Language of the case: French.

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

after considering the written observations submitted on behalf of:

— Régie Dauphinoise — Cabinet A. Forest SARL, by J.-C. Cavaillé, of the Lyon Bar,

— the French Government, by E. Belliard, Assistant Director of Legal Affairs at the Ministry of Foreign Affairs, and J.-L. Falconi, Secretary for Foreign Affairs in the same directorate, acting as Agents,

— the Greek Government, by V. Kontolaimos, Deputy Legal Adviser at the Legal Council of State, and A. Rokofyllou, Special Adviser to the Assistant Minister for Foreign Affairs, acting as Agents,

— the Commission of the European Communities, by H. Michard and E. Traversa, of its Legal Service, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Régie Dauphinoise — Cabinet A. Forest SARL, represented by J.-C. Cavaillé and J.-C. Bouchard, of the Hauts-de-Seine Bar, the French Government, represented by F. Pascal, Special Adviser in the Legal Affairs Directorate of the Ministry of Foreign Affairs, acting as Agent, the Greek Government, represented by V. Kontolaimos and A. Rokofyllou, and the Commission, by H. Michard, at the hearing on 11 January 1996,

after hearing the Opinion of the Advocate General at the sitting on 15 February 1996,

gives the following

Judgment

1 By judgment of 26 October 1994, received at the Court on 21 November 1994, the Cour Administrative d'Appel de Lyon (Administrative Court of Appeal, Lyon) referred to the Court for a preliminary ruling under Article 177 of the EC Treaty two questions on the interpretation of Article 19(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 Régie Dauphinoise — Cabinet A. Forest SARL ('Régie') and the Ministre du Budget concerning the question whether interest on Régie's treasury placements should be taken into account when calculating the deductible proportion.

3 Article 17 of the Sixth Directive governs the right to deduct. Article 17(2) provides that the taxable person is entitled to deduct only 'in so far as the goods and services are used for the purposes of his taxable transactions'. As regards goods and services to be used by a taxable person both for transactions in respect of which value added tax is deductible and transactions in respect of which value added tax is not deductible, Article 17(5) provides that only such proportion of the tax shall be deductible as is attributable to the taxable transactions.

4 Article 19 lays down the following rules for calculating that proportion. Paragraph 2 of that article provides:

'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, ... shall also be excluded.'

5 Article 13B(d)(1) and (3) state:

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

...

(d)the following transactions:

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

...

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

...'

6 Régie is involved principally in the management of property. That business consists partly in managing let property as agent of the owners and partly in acting as manager of condominiums. As such, it receives advances from the co-owners and lessees for whom it manages the properties. With the agreement of its clients, it invests those sums for its own account with financial institutions. At the hearing it was explained that Régie becomes the owner of the sums advanced with effect from their payment into its account. It remains under obligation to repay but is entitled to retain the interest on the placements, which in the present case amounted to some 14% of its total annual receipts.

7 During the period at issue, 1 July 1983 to 30 June 1986, Régie deducted the whole of the input VAT.

8 However, following a general investigation of Régie's accounting records in 1987, the tax authority took the view that it was appropriate to apply Article 212 of Annex II to the Code Général des Impots Français (French General Tax Code), in the form resulting from Decree No 1163 of 29 December 1979, under which:

'Taxable persons who do not carry out exclusively transactions in respect of which value added tax is deductible are authorized to deduct a fraction of the value added tax charged on goods constituting fixed assets equal to the amount of that tax

multiplied by the ratio between the annual amount of receipts attributable to transactions in respect of which value added tax is deductible and the annual amount of receipts attributable to all transactions carried out ...'.

9 The tax authority argues that, since the interest on Régie's treasury placements was exempt from VAT under Article 261C(1)(a) and (d) of the General Tax Code, which transposed into French law Article 13B(d)(1) and (3) of the Sixth Directive, only a *pro rata* deduction could be made. Furthermore, in accordance with Administrative Instruction 3D of 18 February 1981, in force at the material time, the tax authority took the view that the turnover corresponding to the investment transactions could not be excluded from the calculation of the deductible proportion as 'incidental financial transctions' within the meaning of Article 19(2) of the Sixth Directive, since the receipts from that activity exceeded a threshold of 5% of Régie's total receipts.

10 A demand for arrears of value added tax was therefore sent to Régie, who contested it before the Tribunal Administratif de Grenoble (Administrative Court, Grenoble). The Tribunal Administratif dismissed its application, whereupon Régie appealed to the Cour Administrative d'Appel de Lyon.

11 In its judgment of 26 October 1994 the Cour Administrative d'Appel found that, since Régie had not dealt with its financial transactions in separate accounts and had not allocated specific staff and material resources to them, it could not be regarded as having complied with all the obligations required for the creation of separate sectors. It could not, therefore, claim that a separate sector had been established with regard to its treasury placements.

12 The Cour Administrative d'Appel did however find that it was necessary to refer to the Court of Justice the question whether the tax authority's interpretation of Article 212 of Annex II to the General Tax Code was compatible with the Sixth

Directive. Accordingly it stayed proceedings and referred to the Court for a preliminary ruling the questions:

'— first, whether or not, having regard to the wording of the abovementioned provisions of Article 19 of the Sixth Directive, on a proper construction of those provisions, where an undertaking subject to value added tax which also receives interest on treasury placements exercises its right to deduct, those investment transactions must, having regard to their nature in relation to the scope of value added tax, in principle affect the exercise of that right;

— second, if there is an effect on the right to deduct, whether that interest on placements is to be included within the denominator of the ratio, or excluded from it because of its nature, or because, having regard to its amount or the proportion which it represents of total receipts or the fact that the relevant transactions are a direct and permanent extension of the taxable activity, it is an "incidental financial transaction" referred to in Article 19(2) of the Sixth Directive, or, finally, on any other grounds.'

13 By those two questions, which should be examined together, the national court seeks essentially to ascertain whether Article 19(2) of the Sixth Directive must be interpreted as meaning that interest received by a property management company on treasury placements, made for its own account, of sums paid by owners or lessees is to be included in the denominator of the fraction used to calculate the deductible proportion.

14 In order to answer that question it must first be established whether the placements in question fall within the scope of VAT.

15 It follows from Article 2 of the Sixth Directive, which defines the scope of VAT, that only activities of an economic nature are subject to that tax. Under Article 4(1) a taxable person is any person who independently carries out one of those economic activities. The concept of 'economic activities' is defined in Article 4(2) as comprising all activities of producers, traders and persons supplying services, and in particular the exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis. Finally, it follows from Article 2(1) that a taxable person must be acting 'as such' if a transaction is to be subject to value added tax.

16 In the present case, as has already been observed in paragraph 6 of this judgment, Régie becomes owner of the sums entrusted to it by the co-owners and lessees for whom it manages the properties, even though it remains under obligation to repay. Moreover, the constant renewal of treasury placements ensures that the balance in the bank accounts held by Régie is relatively stable. Its placements with financial institutions may therefore 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.

17 Unlike the receipt of dividends by a holding company, in respect of which, in Case C-333/91 *Sofitam* [1993] I-3513, paragraph 13, the Court held that, not being consideration for an economic activity, it did not fall within the scope of VAT, interest received by a property management company on investments made for its own account of sums paid by co-owners or lessees cannot be excluded from the scope of VAT, since the interest does not arise simply from ownership of the asset, but is the consideration for placing capital at the disposition of a third party.

18 It is true that services such as placements made with banks by the manager of a condominium would not be subject to value added tax if supplied by a person not

acting as a taxable person. However, in the case at issue in the main proceedings, the receipt, by such a manager, of interest resulting from the placements 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.

19 To the extent that Régie's placements with financial institutions are to be regarded as services falling within the scope of VAT, those placements are exempt by virtue of Article 13B(d)(1) and (3) of the Sixth Directive.

20 It is therefore necessary to consider whether they constitute incidental financial transactions within the meaning of Article 19(2).

21 The purpose of excluding incidental financial transactions from the denominator of the fraction used to calculate the deductible proportion in accordance with Article 19 of the Sixth Directive is to comply with the objective of complete neutrality guaranteed by the common system of VAT. As the Advocate General has observed at point 39 of his Opinion, if all receipts from a taxable person's financial transactions linked to a taxable activity were to be included in that denominator, even where the creation of such receipts did not entail the use of goods or services subject to VAT or, at least, entailed only their very limited use, calculation of the deduction would be distorted.

22 However, placements by property management companies are the consequence of advances to them by co-owners and lessees for whom they manage their properties. With the consent of their clients, those companies are able to place these monies for their own account with financial institutions. That is why, as the Court has pointed out at paragraph 18 of this judgment, the receipt of interest from those placements constitutes the direct, permanent and necessary extension of the taxable

activity of property management companies. Such placements cannot therefore be characterized as incidental financial transactions within the meaning of Article 19(2) of the Sixth Directive. To take them into account in order to calculate the deductible proportion would not be such as to affect the neutrality of the system of value added tax.

23 In those circumstances the answer to the two questions from the national court is that Article 19(2) of the Sixth Directive is to be interpreted as meaning that interest realized by a company managing immovable property on treasury placements made for its own account of funds paid by the owners or lessees is to be included in the denominator of the fraction used to calculate the deductible proportion.

Costs

24 The costs incurred by the Greek Government 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 action 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 Cour Administrative d'Appel de Lyon, by judgment of 26 October 1994, hereby rules:

Article 19(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, must be interpreted as meaning that the interest realized by a company managing immovable property on treasury placements made for its own account of funds paid by the owners or lessees is to be included in the denominator of the fraction used to calculate the deductible proportion.

Edward Puissochet Moitinho de Almeida

Gulmann Wathelet

Delivered in open court in Luxembourg on 11 July 1996.

R. Grass

Registrar

D. A. O. Edward

President of the Fifth Chamber