# OPINION OF ADVOCATE GENERAL LÉGER
delivered on 12 September 2002 [1]

1. In this case, the Court is called upon to interpret 'economic activities' and 'incidental transactions', concepts referred to in Articles 4 and 19 respectively of Sixth Directive 77/388/EEC. [2]

2. This case arises from a dispute between the Portuguese tax authorities and a mixed holding company [3] which has deducted the input value added tax (hereinafter 'VAT') globally without distinguishing between its various activities. The Tribunal Central Administrativo (Central Administrative Court), Portugal, has asked the Court to determine the extent to which the loans granted by that holding company to the companies in which it holds shares, its other financial activities and the operations it has performed in the context of three consortia [4] affect its entitlement to deduct VAT.

## I — Relevant legislation

*The scope of the Sixth Directive*

3. For the purposes of securing the European Community's own resources and ensuring that the common system of turnover taxes is non-discriminatory, the Community legislature sought to include in the scope of the Sixth Directive the broadest possible range of economic transactions whilst making provision for some of those transactions to be covered by an exemption. [5]

4. The Community legislature thus defined the scope of the Sixth Directive by reference to very broad criteria relating to both the nature of the transaction concerned and the person carrying it out.

1 — Original language: French.

2 — Council Directive 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, hereinafter 'the Sixth Directive').

3 — A mixed holding company is a company which carries out both a holding activity consisting in holding shares in other companies, which is not subject to VAT, and a taxable activity.

4 — In this case a consortium should be understood as referring to a contract whereby two or more natural or legal persons who carry out an economic activity enter into a mutual arrangement to perform in a concerted manner a certain activity or make a certain contribution for the purpose of pursuing any of the purposes specified, which include research or exploration of natural resources (Articles 1 and 2 of Decreto-lei (Decree-law) No 231/81 of 28 July 1981).

5 — Second, fourth and fifth recitals in the preamble to the Sixth Directive.

5. Under point 1 of Article 2 of the Sixth Directive, 'the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such' is subject to VAT.

6. Under Article 4(1) of the Sixth Directive, 'taxable person' means any person who independently carries out any economic activity specified in Article 4(2).

7. Article 4(2) of the Sixth Directive provides:

'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.'

8. Some transactions, which constitute economic activities and are therefore, in principle, covered by the Sixth Directive, are exempt from VAT. Under Article 13B (d) of the directive, that exemption applies inter alia to the following transactions:

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

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

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

...

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

*The right to deduct*

9. VAT must be neutral as regards economic operators, that is to say it must be borne by the final consumer alone.

10. The Community legislature therefore provided for a deduction system under which a taxable person is entitled to deduct, for the purposes of his taxable transactions, all the VAT he has paid in respect of the goods or services supplied to him. [6]

11. The taxable person effects that deduction by way of subtraction from the total amount of value added tax due for a given tax period. Where for a given tax period the amount of authorised deductions exceeds the amount of tax due, the Member States may either make a refund or carry the excess forward to the following period according to conditions which they determine. [7]

12. Where a taxable person uses taxable goods or services both for transactions in respect of which value added tax is deductible and for exempt transactions in respect of which no such right is enjoyed, only such proportion of the VAT is deductible as is attributable to the former transactions. The proportion is determined, in accordance with Article 19 of the Sixth Directive, for all the transactions carried out by the taxable person. [8]

13. Under Article 19(1), that proportion is made up of a fraction having as numerator the total amount, exclusive of VAT, of turnover per year attributable to transactions in respect of which VAT is deductible, and as denominator the total amount, exclusive of VAT, of turnover per year attributable to transactions included in the numerator and to transactions in respect of which VAT is not deductible.

14. Article 19(2) reads:

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

6 — Article 17(2) of the Sixth Directive.

7 — Article 18(2) and (4) of the Sixth Directive.

8 — Article 17(5) of the Sixth Directive.

## II — Facts and procedure

15. Empresa de Desenvolvimento Mineiro SGPS SA (EDM), formerly Empresa de Desenvolvimento Mineiro SA (EDM), (hereinafter 'EDM') is a holding company in the mining sector. It carried out its activities as a public undertaking before it was converted, in September 1989, into a legal person governed by private law and continued its activities as a limited company.

16. Its principal object is, on the one hand, prospecting and exploitation in the mineral sector with a view to investment therein, in particular through the setting-up of undertakings and, on the other hand, managing the shares it holds in companies in that sector. Until it was converted into a legal person governed by private law, its principal object was also to assist the companies in which it has shares in obtaining loans from credit institutions and to provide loan guarantees. [9]

17. It and various other undertakings formed three consortia. The aim of all three consortia is to discover mineral deposits and to investigate the viability of exploiting them. The contracts concluded to establish those consortia stipulated that, where a deposit was discovered whose exploitation would be viable, a company would be formed to carry out that activity.

18. EDM's participation in those consortia involved developing activities of a technical nature and coordinating operations in its capacity as manager and taking part in advisory boards and technical committees established for that purpose.

19. Each consortium member issued invoices to the management setting out the operations carried out and indicating their cost. Those invoices were to be taken as the basis for settling the accounts at a later date between the members of the respective consortia in accordance with the proportional distribution of the expenditure agreed in the respective contracts. [10]

20. Following its application for a refund of excess VAT, EDM was the subject of an inspection by the Portuguese tax authority which covered the financial years 1988 to 1992.

9 — Order for reference, pp. 4 to 9, 14, 16 and 17 [of the original language version].

10 — Order for reference, pp. 15 and 16.

21. The tax authority noted that in the course of those financial years EDM had deducted all the input VAT, which would suggest that it had been carrying out only those transactions in respect of which VAT is deductible.

22. However, EDM was considered by the tax authority also to have carried out exempt transactions and should consequently be considered to be a mixed taxable person required to apply the proportional method for calculating deduction.

23. According to the tax authority, there is no right to deduct in respect of:

— dividends from capital shares in companies;

— interest on loans granted to undertakings in which EDM has shares;

— proceeds from the sale of shares and other negotiable securities;

— profits from other treasury operations; and

— the value of the operations carried out by the consortia in so far as EDM was responsible for those consortia and administered their investments.

24. The tax authority also pointed out that, even though EDM only occasionally sold its company shares, its disposal of securities and its other treasury operations had generated revenue greater than the proceeds from its taxable transactions. [11]

25. The tax authority therefore concluded that all of that revenue should be included in the denominator of the fraction used to calculate the deductible proportion on the ground that it constituted the principal activity pursued by EDM. [12]

26. It set the amount of VAT improperly deducted by EDM at PTE 137 933 862.

27. The Tribunal Tributário de Primeira Instância de Lisboa (Tax Court of First Instance, Lisbon), Portugal, allowed EDM's

11 — Order for reference, p. 22.
12 — Order for reference, pp. 17 and 18.

claim as regards the dividends from its shares in companies and held that they should be excluded from the abovementioned denominator because they fell outside the scope of the Sixth Directive. It dismissed the remainder of EDM's claims in that action.

28. EDM lodged an appeal with the Tribunal Central Administrativo, claiming that the interest on loans, the proceeds from the sale of shares and other negotiable securities and revenue from other treasury operations accrued from transactions incidental to the managing of its shares and mineral prospecting. It maintained that those amounts should therefore be excluded from the denominator of the fraction used to calculate the deductible proportion pursuant to Article 19(2) of the Sixth Directive.

29. It submitted that the operations carried out in the context of the consortia did not constitute transactions subject to VAT for the purposes of Article 4(2) of the Sixth Directive and that the value of those operations should not be included in that fraction.

## III — The questions referred for a preliminary ruling

30. In the view of the Tribunal Central Administrativo, an interpretation of the abovementioned provisions of the Sixth Directive is essential to the decision in the main proceedings. It has therefore decided to stay the proceedings and refer the following questions to the Court for a preliminary ruling:

'(1) Does the annual granting of interest-bearing loans by a holding company to companies in which it has a shareholding, where its principal activity is their management and, to a certain extent also, the guaranteeing of loans contracted by them, constitute an "economic activity" within the meaning of [Article 4(2) of] the Sixth Directive ...?

(2) Does the performance of operations, in connection with a consortium, as in this case, by a company which both is a member thereof and manages it, particularly where they exceed its share as stipulated in the contract, against payment by the other members of the consortium constitute an "economic activity" within the meaning of the Sixth Directive?

(3) Is an undertaking's financial activity which generates annual income which is clearly higher than that from the activity described in its statutes as its principal activity to be regarded as "incidental" for the purposes of Article 19(2) of the Sixth Directive?'

## IV — Assessment

*Introductory remarks*

31. According to the grounds of the order for reference, [13] the referring court seeks to ascertain whether the operations performed by EDM in the context of the three consortia, the interest on the loans it has granted, the proceeds from the sale of shares and other negotiable securities and the revenue from other treasury operations it has made must be included in the denominator of the fraction used to calculate the deductible proportion.

32. In order to answer that question, it is necessary to establish whether the transactions concerned fall within the scope of the Sixth Directive. [14]

33. It must be recalled that the deduction system is intended to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. [15]

34. As the Court has held on a number of occasions with regard to the receipt of dividends, where the transaction concerned does not fall within the scope of VAT, it falls outside the entitlement to deduct. [16]

35. This means, first, that the revenue from activities falling outside the scope of VAT must not be included in the fraction used to calculate the deductible proportion. Secondly, the taxable person may not deduct the tax he has paid for the supply of goods or services attributable to activities falling outside the scope of the Sixth Directive since, as far as that tax is concerned, he is in the position of the final consumer.

36. The first stage in the reasoning process to establish EDM's deduction entitlements in respect of the transactions at issue therefore involves an assessment as to whether those transactions constitute economic activities carried out by a taxable person acting as such, that is to say whether they are caught by Article 4(2) of the Sixth Directive.

13 — Page 3, under the heading 'The matter at issue'.

14 — See, with regard to investments, Case C-306/94 *Régie dauphinoise* [1996] ECR I-3695, paragraph 14.

15 — Case 268/83 *Rompelman* [1985] ECR 655, paragraph 19, and Case 50/87 *Commission* v *France* [1988] ECR 4797, paragraph 15.

16 — Case C-333/91 *Sofitam* [1993] ECR I-3513, paragraph 13, and Case C-142/99 *Floridienne and Berginvest* [2000] ECR I-9567, paragraph 21.

*The first question*

37. By its first question, the referring court seeks essentially to ascertain whether Article 4(2) of the Sixth Directive must be interpreted as meaning that the annual granting of interest-bearing loans by a holding company to the companies in which it holds shares constitutes an economic activity, where the holding company's principal activity is to manage those shareholdings and, to a certain extent, also to guarantee the loans taken out by them.

38. It should be noted that Article 4 of the Sixth Directive gives VAT a very wide scope. [17] Thus, under Article 4(2) of the Sixth Directive, 'economic activities' include, inter alia, any exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis. [18]

39. However, the Court has also consistently held that mere exercise of the right of ownership by its holder cannot, in itself, be regarded as an economic activity. [19]

40. In *Floridienne and Berginvest*, cited above, the Court inferred from all of the abovementioned judgments that the granting of loans by a holding company to its subsidiaries was subject to VAT on fulfilment of one of two possible conditions, either if those loans in themselves constitute an economic activity of the operator, or if those loans are the direct, permanent and necessary extension of a taxable activity. [20]

41. As to the first of those conditions, the Court described the circumstances in which the granting of such loans could, in itself, be considered an economic activity within the meaning of Article 4(2) of the Sixth Directive.

42. According to the Court, that activity must not be carried out merely on an occasional basis and must not be confined

17 — Case C-186/89 *Van Tiem* [1990] ECR I-4363, paragraph 17.

18 — Case C-80/95 *Harnas & Helm* [1997] ECR I-745, paragraph 12. In the abovementioned judgment in *Régie dauphinoise* (paragraph 17), the Court concluded that interest received by a property management company on placements made for its own account of sums paid by co-owners or lessees cannot be excluded from the scope of VAT, since that interest does not arise simply from ownership of the asset; it is the consideration for placing capital at the disposal of a third party.

19 — As regards the mere acquisition and holding of shares in a company, see Case C-60/90 *Polysar Investments Netherlands* [1991] ECR I-3111, paragraph 13, and *Sofitam*, cited above, paragraph 12. In Case C-155/94 *Wellcome Trust* [1996] ECR I-3013, paragraph 36, the Court drew the conclusion that management by a charitable trust of the assets it holds which consists essentially in the acquisition and sale of shares and other securities with a view to maximising the dividends and capital yields for the purpose of promoting medical research does not constitute an economic activity. In *Harnas & Helm*, cited above, paragraphs 18 and 19, it held that there was no reason to treat bondholding differently from shareholding, since the income from the bonds derives from the mere fact of holding them.

20 — Paragraph 27.

to managing an investment portfolio in the same way as a private investor. On the contrary, it must be carried out with a business or commercial purpose characterised, in particular, by a concern to maximise returns on capital investment. [21]

43. The Court did not explain specifically what is meant by 'business or commercial purpose'. It is not easy to give a more specific definition of that concept on a theoretical approach. [22]

44. The business purpose, as I see it, involves a holding company introducing permanent human and logistical resources arranged in the same way as the resources of a credit institution and on a greater scale than the resources belonging to a private investor which are used merely for his own needs.

45. Commercial purpose presupposes the intention by a holding company to maximise returns on its capital investment, and therefore the loans must be agreed on conditions which are comparable to the relevant market conditions, as though they had been agreed between a financial institution and its customers. [23]

46. In all cases, the granting of loans by a holding company to its subsidiaries must not be an occasional activity; on the contrary, it must take place with a degree of regularity so that the holding company can obtain income from it on a continuing basis.

47. The second condition to which the Court alludes in the abovementioned judgment in *Floridienneand Berginvest* and which is based on the concept of 'the direct, permanent and necessary extension of a taxable activity' is taken from *Régie dauphinoise*, cited above, a judgment to which the Court expressly refers. [24]

48. In *Régie dauphinoise*, [25] the Court pointed out that services such as placements made with banks by the manager of a condominium would not be subject to VAT if supplied by a person not acting as a taxable person. However, it added that, in the circumstances of that case, the receipt

21 — *Floridienne and Berginvest*, cited above, paragraph 28.

22 — In Case C-230/94 *Enkler* [1996] ECR I-4517, paragraphs 28 and 29, the Court held that where, by reason of its nature, property can be used for both economic and private purposes, it is necessary to examine all the circumstances in which the person concerned uses the property and to compare those circumstances, where appropriate, with those in which the corresponding economic activity is usually carried out. It also held that criteria based on the results of the activity in question cannot in themselves be a decisive factor but that the actual length of the period for which the property is hired, the number of customers and the amount of earnings may be taken into account.

23 — In this regard, see the Opinion of Advocate General Fennelly in *Floridienne and Berginvest*, cited above, point 34.

24 — *Floridienne and Berginvest*, cited above, paragraph 27.

25 — Paragraph 18.

by such a manager of interest resulting from the placement of monies received from clients in the course of managing their properties constituted the direct, permanent and necessary extension of the taxable activity, so that the manager was acting as a taxable person in making such an investment.

49. It is therefore necessary to consider the extent to which the granting of loans by EDM to its subsidiaries fulfils the requirements corresponding to the two conditions described by the Court in *Floridienne and Berginvest*, cited above.

50. The order for reference contains no further information on the loans at issue other than as regards the interest they generated in the financial years 1988 to 1991. [26]

51. To my mind, that information is insufficient to assess whether the granting of the loans in point in itself constitutes an economic activity for the purposes of the first condition referred to in *Floridienne and Berginvest*, cited above. [27] For instance, I have no information concerning the frequency with which those loans are granted, the human and material resources given over by EDM to the granting and management of those loans, the conditions on which those loans have been taken out as compared with the market conditions or the origin of the funds loaned by EDM. [28]

52. It is therefore for the national court to assess whether, in the present case, the loans granted by EDM to its subsidiaries correspond to an occasional transaction or whether they serve a business or commercial purpose to provide income for EDM on a continuing basis.

53. However, it is necessary to assess whether those loans constitute the direct, permanent and necessary extension of the taxable activity on the part of EDM within the meaning of *Régie dauphinoise*, cited above.

26 — PTE 19 509 803 in 1988, PTE 33 224 443 in 1989, PTE 43 603 040 in 1990 and PTE 157 066 829 in 1991 (order for reference, p. 22).

27 — See, to that effect, *Wellcome Trust*, cited above, paragraph 37. In that judgment, the Court stated that the scale of a share sale cannot constitute a criterion for distinguishing between the activities of a private investor, which fall outside the scope of the Sixth Directive, and those of an investor whose transactions constitute an economic activity.

28 — As regards the origin of the funds, the Court held at paragraph 30 of the abovementioned judgment in *Floridienne and Berginvest* that where a holding company merely reinvests dividends received from its subsidiaries in loans to those subsidiaries, this in no way constitutes a taxable activity. The interest on such loans must, on the contrary, be considered to be merely the result of ownership of the asset and is therefore outside the system of deductions.

54. It should be borne in mind that EDM's principal object is, on the one hand, prospecting and exploitation in the mineral sector with a view to investment therein, in particular through the setting-up of undertakings and, on the other hand, managing the shares it holds in companies in that sector. [29]

55. Furthermore, it is apparent from the order for reference that the referring court considered that the sales of shares and other negotiable securities by EDM during the period in question, as well as its other treasury operations, likewise constituted an economic activity. [30]

56. Contrary to the view expressed by the Portuguese Government, [31] I take the view that the granting of loans to companies in which EDM holds shares cannot be considered the direct, permanent and necessary extension of any of those various activities.

57. Nor is there such a direct, permanent and necessary link, to my mind, with the activity assigned to EDM prior to its conversion into a legal person governed by private law, that is to say with the assistance it afforded to the companies in which it holds shares in obtaining loans from credit institutions or with its furnishing of loan guarantees.

29 — See point 16 of this Opinion.
30 — Page 22.
31 — Paragraph 41 of its observations.

58. I thus consider that the concept of 'direct, permanent and necessary extension' should be interpreted strictly. I base that view on the considerations set out below.

59. First of all, that concept has been established by case-law but is not included in the Sixth Directive. In that directive, the criterion for application of VAT is performance of an economic activity by a taxable person acting as such.

60. Next, the circumstances of the *Régie dauphinoise* case, cited above, used by the Court to establish that concept, were very specific. As I see it, the Court considered that the receipt by the manager of a condominium of interest resulting from the placement of monies he receives from clients in the course of managing their properties constituted the direct, permanent and necessary extension of the taxable activity because it cannot seriously be considered, from either a practical or an economic point of view, that that manager would place those funds elsewhere than in a credit institution without obtaining any income in that respect. The receipt of such interest therefore constituted the logical and indissociable consequence of the manager's taxable activity.

61. Lastly, that strict interpretation is also justified by the consideration that the concept of 'incidental transactions', referred to in Article 19(2) of the Sixth Directive, must not be made redundant. As the Court

pointed out very logically in *Régie dauphinoise*, cited above, an activity which constitutes the direct, permanent and necessary extension of the taxable activity of taxable persons cannot, by its nature, be characterised as an incidental transaction because it is a systematic consequence of that activity. [32]

62. In the light of those considerations, I propose that the Court's answer to the first question referred should be that Article 4(2) of the Sixth Directive must be interpreted as meaning that the annual granting of interest-bearing loans by a holding company to the companies in which it holds shares, where the holding company's principal activity is to manage those shareholdings and, to a certain extent, also to guarantee the loans taken out by those companies, constitutes an economic activity provided that those loans are not granted on an occasional basis and are effected with a business or commercial purpose characterised, in particular, by a concern to maximise returns on capital investment.

32 — See paragraph 22 of *Régie dauphinoise*, cited above. Having pointed out that the receipt of interest from the placements in question constitutes the direct, permanent and necessary extension of the taxable activity of property management companies, the Court states: 'Such placements cannot *therefore* be characterised as incidental financial transactions within the meaning of Article 19(2) of the Sixth Directive.' The Court reasserted that view in *Floridienne and Berginvest*, cited above, paragraph 27, pointing out that the loans in point are subject to VAT if they constitute either an economic activity of the operator or the direct, permanent and necessary extension of a taxable activity, *without, however, being incidental to that activity*. The part of the sentence that I have italicised does not introduce an additional condition, although it could be interpreted as such on a first reading. It would, after all, be illogical to assume that the Court sought to add a further condition at that point in the reasoning process in the light of the successive stages of the assessment process under which it is necessary first of all to establish whether a transaction falls within the scope of the Sixth Directive before it can be assessed whether it is an incidental transaction.

63. If the referring court considers those conditions to be met, those loans, which fall within the scope of the Sixth Directive, constitute an activity which is exempt from VAT in accordance with point 1 of Article 13B(d) of that directive. It is therefore necessary to establish the extent to which the interest from those loans must be included in the denominator of the fraction used to calculate the deductible proportion.

64. This matter is specifically covered in the third question referred.

*The second question*

65. By its second question, the national court seeks to establish whether the performance of operations, in the context of consortia as in the present case, by a company which is both a member and the administrator of the consortia, in return for payment in consideration of the value of those operations by the other members of the consortia, constitutes an economic activity within the meaning of Article 4(2) of the Sixth Directive, particularly where those operations exceed the company's share as stipulated in the respective contracts.

66. The referring court is seeking in fact to establish whether the operations performed

by EDM in the context of each of the three consortia, of which it is both a member and the administrator, must be regarded as having been carried out for consideration where they exceed the share of the operations which that company had undertaken to perform.

67. It should be noted that economic activities carried out by taxable persons are subject to tax only if they have been performed for consideration. This means that the taxable person must be in receipt of consideration and that there must be a direct link between the supply of goods or services and the consideration received. It is precisely that consideration which constitutes the taxable amount in terms of VAT. [33]

68. In that regard, the Court has held that the consideration must be capable of being expressed in money, [34] a requirement also applying to reductions in the price of main supplies. [35]

69. It is clear from the description of the consortia contained in the order for reference that EDM's participation in each of those consortia involved developing activities of a technical nature and coordinating operations in its capacity as manager and taking part in advisory boards and technical committees established for that purpose. [36]

70. On that basis, EDM issued invoices setting out the operations carried out and indicating their cost for the purpose of settling the accounts between the members of the respective consortia.

71. EDM takes the view that such settling of accounts must not be treated as a payment but, rather, as a refund or reimbursement based on the principle that there should be no unjustified enrichment. It its view, those operations did not, therefore, constitute the supply of goods or services in return for consideration and was outside the scope of the Sixth Directive.

72. That argument, in my view, cannot be accepted.

73. It need only be pointed out that those operations are clearly identified, that their cost may be expressed in money and that, in the accounts of the individual consortia, that cost is credited to EDM and debited against the other members.

33 — Under Article 11A(1)(a) of the Sixth Directive, the taxable amount corresponds to everything which constitutes the consideration which has been or is to be obtained by the supplier of goods or services from the purchaser, the customer or a third party for such supplies of goods or services including subsidies linked to the price of such supplies.

34 — Case 154/80 *Coöperatieve Aardappelenbewaarplaats* [1981] ECR 445, paragraph 13.

35 — Case 230/87 *Naturally Yours Cosmetics* [1988] ECR 6365, paragraphs 17 and 18.

36 — See point 18 of this Opinion.

74. However, as regards those operations covered by EDM's contractual obligations, I have difficulty in accepting that the company is performing a taxable transaction given that it receives no consideration from the other members of the consortia.

75. In this regard, the operations performed by the other members of the consortia cannot, to my mind, be regarded as consideration for the operations performed by EDM since they are carried out in performance of the consortium contracts. I therefore consider there to be no direct link between the operations performed by EDM in accordance with its contractual obligations and the operations carried out by the other members of the consortia.

76. I therefore propose that the Court's answer to the second question referred should be that the performance of operations, in the context of consortia as in the present case, by a company which is both a member and the administrator of the consortia, in return for payment in consideration of the value of those operations by the other members of the consortia, constitutes an economic activity within the meaning of Article 4(2) of the Sixth Directive, where those operations exceed the company's share as stipulated in the respective contracts.

77. It follows that the turnover attributable to those operations not covered by EDM's contractual obligations must be included in the denominator of the fraction used to calculate the deductible proportion. However, as pointed out by EDM, inasmuch as those operations do not constitute an activity exempt of VAT, it must also be included in the numerator.

*The third question*

78. By its third question, the national court seeks essentially to ascertain whether Article 19(2) of the Sixth Directive must be interpreted as meaning that the financial activity of an undertaking whose annual revenue is considerably higher than that produced by the activity which is its principal object, according to its statutes, constitutes an incidental activity.

79. It is apparent from the order for reference [37] that the financial transactions at issue here do not merely involve the annual granting of loans by EDM to the companies in which it holds shares; they also involve sales of shares and other negotiable securities as well as other treasury operations.

37 — Page 22.

80. As I have already mentioned, for the purpose of answering the third question referred, it must first be established whether the transactions concerned fall within the scope of the Sixth Directive.

81. I have already set out the circumstances in which the granting of loans by EDM to the companies in which it holds shares can constitute an economic activity within the meaning of Article 4(2) of the Sixth Directive.

82. I take the view that the same conditions must be fulfilled as regards sales of shares and other negotiable securities and as regards the other treasury operations effected by EDM during the period in point.

83. In this connection, it may be seen from EDM's answer to the Court's written questions that that company made placements during that period which were, for the most part, short-term placements. It is also apparent from consideration of the income received by EDM in the course of its financial activities that, although the proceeds from the sale of its shares decreased continuously from 1988 to 1991,[38] that drop was largely offset by increasing revenue from the sale of its other negotiable securities and from its other treasury operations.[39] In view of those factors, it is not impossible for EDM to have used all its assets to carry out transactions which went beyond the activities of a mere investor and by which it was sought to obtain income on a continuing basis.[40]

84. Moreover, it is not disputed that, in accordance with point 5 of Article 13B(d) of the Sixth Directive, transactions in shares, interests in companies and associations, debentures and other securities are exempt from VAT.

85. Like the interest on the loans granted by EDM to its subsidiaries, the revenue from the sale of shares and other negotiable securities must be included in the denominator of the fraction used to calculate the deductible proportion pursuant to Article 19(1) of the Sixth Directive unless, in accordance with Article 19(2), incidental transactions are involved.

38 — PTE 482 431 400, PTE 301 040 000, PTE 624 452 and PTE 314 840 from 1988 to 1991 respectively.

39 — Sales of other negotiable securities brought in revenue of PTE 27 849 624.70, PTE 112 169 959.10, PTE 311 100 000 and PTE 927 430 231.70 from 1988 to 1991 respectively and the other treasury operations yielded PTE 11 171 205, PTE 212 227 393.30 and PTE 208 359 328.20 from 1989 to 1991 respectively.

40 — See, to that effect, the Opinion of Advocate General Van Gerven in the abovementioned case of *Polysar Investments Netherlands* (point 12).

86. There is no definition of 'incidental transactions' in the Sixth Directive. To date, no definition has been provided by the Court either. In *Régie dauphinoise*, cited above, the Court merely explained what they are not, stating that an activity which constitutes the direct, permanent and necessary extension of the taxable activity of the taxable person cannot, by its nature, be considered an incidental transaction for the purposes of Article 19(2) of the Sixth Directive.

87. In order to answer the question referred by the national court, the wording, the scheme and the objectives of the Community provisions should be considered in turn, following the Court's methods of interpretation. [41]

88. As regards, first of all, the literal meaning of the adjective '*accessoire*' (incidental), it denotes something happening in connection with or resulting from the main event [42] or something subordinate to something more important. [43] Applied to the transactions referred to in the Sixth Directive, '*accessoire*' (incidental) therefore means that the transactions concerned do not belong directly to the main activity of the taxpayer but are closely linked to it and that they cannot be on a larger scale than the main activity. [44]

89. Accordingly, incidental transactions must, in principle, fulfil two cumulative conditions. The first, qualitative, condition stipulates that those transactions must stand in a certain relationship to the principal activity and the second, quantitative, condition stipulates that they cannot be on a larger scale than the activity itself. [45]

90. However, such consideration of the wording provides no insight into the criterion to be taken as the basis for assessing that quantitative condition or, in particular, into whether, as the national court seeks to establish, such an assessment must be based on the turnover from the activities concerned or, for example, on the size of the workload they represented.

91. In my view, the scheme of the rules governing deduction suggests that account should be taken of the turnover from the activities concerned. [46]

41 — Case C-191/99 *Kvaerner* [2001] ECR I-4447, paragraph 30.

42 — See *Le Petit Robert*, Dictionnaire de la langue française, Paris, ed. Dictionnaires Le Robert, 1996.

43 — See *Hachette*, Dictionnaire de la langue française, Paris, ed. Hachette, 1980.

44 — That literal interpretation corresponds to the wording used in several other language versions. See, in this connection, the Opinion of Advocate General Lenz in the above-mentioned case of *Régie dauphinoise* (point 38).

45 — Idem.

46 — See, to this effect, the explanatory memorandum to the first Commission proposal for the Sixth Directive, *Bulletin of the European Communities*, Supplement 11/73, p. 20.

92. It is, after all, apparent from Article 17 (2) of the Sixth Directive that the right to deduct arises only in respect of the goods and services used by the taxable person for the purposes of his taxable transactions.

93. It also follows from Article 17(3)(c) of the Sixth Directive that that directive provides for deductibility of VAT in respect of goods or services used for the purposes of exempt transactions only by way of a derogation. [47]

94. Lastly, Article 19(2) of the Sixth Directive opens with 'by way of derogation from the provisions of paragraph 1', indicating that it constitutes an exception to the rule laid down in Article 19(1) that turnover attributable to exempt transactions must be included in the denominator of the fraction used to calculate the deductible proportion.

95. The objectives of the rules governing deduction contained in the Sixth Directive support the interpretation I propose.

96. 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. 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. [48]

97. By way of exception to the rule that a right to deduct does not arise in respect of exempt transactions, those transactions are not included in the denominator of the fraction and consequently do not reduce the taxable person's deduction entitlements because they are assumed to have called for negligible use of the taxed economic goods used for the principal activity.

98. Such a general assumption can no longer be made if the exempt financial activities generate revenue higher than that produced by the activity described in the statutes of the taxable person as the principal activity.

47 — That article provides that '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 ... 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'.

48 — *Régie dauphinoise*, cited above, paragraph 21.

99. If the opposite reasoning were adopted, a company intending mainly to pursue exempt financial activities could as a result circumvent the rule laid down by the Sixth Directive that input VAT may not be deducted in respect of such activities. It would merely need to name a taxed economic activity as its principal activity in its statutes and use the goods and services it acquires to perform both that activity and its financial activities.

100. Consequently, economic activities cannot be regarded as 'incidental transactions' within the meaning of Article 19(2) of the Sixth Directive if, as is true of the present case, they generate turnover higher than that produced by the taxed activity. [49]

101. Unlike EDM, I see no contradiction whatsoever between that interpretation and case-law. As I have already mentioned, the Court had no occasion in *Régie dauphinoise*, cited above, to present a positive definition of 'incidental transactions'. It did no more than conclude, very logically, from its analysis that the investment activities at issue in that case constituted the direct, permanent and necessary extension of the taxable activity of the taxable person, that they did not constitute incidental transactions.

102. Similarly, the abovementioned judgment in *Wellcome Trust*, also relied on by EDM, does not contradict my interpretation. Admittedly, the Court stated therein that the scale of a share sale cannot constitute a criterion for distinguishing between the activities of a private investor, which fall outside the scope of the Sixth Directive, and those of an investor whose transactions constitute an economic activity. [50] Nevertheless, that statement by no means contradicts the view that financial activities covered by the Sixth Directive cannot be regarded as incidental transactions within the meaning of Article 19(2) of that directive if they generate turnover higher than that produced by the taxable activity.

103. Therefore, in the circumstances of this case, the interest on the loans granted on an annual basis by EDM to the companies in which it holds shares, in so far as those loans constitute an economic activity within the meaning of Article 4(2) of the Sixth Directive, and the revenue from EDM's other financial activities must be included in the denominator of the fraction used to calculate the deductible proportion.

49 — EDM's income from its taxed activities amounted to PTE 82 079 528, PTE 72 836 992, PTE 22 597 883 and PTE 73 019 855 from 1988 to 1991 respectively. It should be noted at this point that the financial transactions carried out by EDM, excluding interest on the loans granted to its subsidiaries, generated, over the same years, revenue of PTE 510 281 024.70, PTE 424 381 164.10, PTE 523 961 845.30 and PTE 1 136 104 399.90 respectively.

50 — Paragraph 37.

104. Should such an outcome be detrimental to EDM because it would mean that its deduction entitlements are reduced to a level below that which corresponds to the use of goods and services in respect of its exempt activities, it is for EDM, in my view, to take the necessary steps as far as the competent tax authorities are concerned in order to distinguish in future between those activities, or some of those activities, and its taxed activities.

105. In the light of those considerations I propose that the Court's answer to the third question referred should be that Article 19 (2) of the Sixth Directive must be interpreted as meaning that, in so far as it constitutes an economic activity, the financial activity of an undertaking whose annual revenue is higher than that produced by the activity which is its principal activity, according to its statutes, does not constitute an incidental activity.

## V — Conclusion

106. In the light of all the foregoing considerations, I propose that the Court should answer the questions referred by the Tribunal Central Administrativo as follows:

(1) Article 4(2) of 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 must be interpreted as meaning that the annual granting of interest-bearing loans by a holding company to the companies in which it holds shares, where the holding company's principal activity is to manage those shareholdings and, to

a certain extent, also to guarantee the loans taken out by those companies, constitutes an economic activity provided that those loans are not granted on an occasional basis and are effected with a business or commercial purpose characterised, in particular, by a concern to maximise returns on capital investment.

(2) The performance of operations in the context of consortia as in the present case, by a company which is both a member and the administrator of the consortia, in return for payment in consideration of the value of those operations by the other members of the consortia, constitutes an economic activity within the meaning of Article 4(2) of Sixth Directive 77/388, where those operations exceed the company's share as stipulated in the respective contracts.

(3) Article 19(2) of Sixth Directive 77/388 must be interpreted as meaning that, in so far as it constitutes an economic activity, the financial activity of an undertaking whose annual revenue is higher than that produced by the activity which is its principal activity, according to its statutes, does not constitute an incidental activity.