

OPINION OF ADVOCATE GENERAL

BOT

delivered on 18 June 2009¹

1. This reference for a preliminary ruling relates, once again, to the term ‘incidental transaction’ referred to in Article 19(2) of Sixth Council Directive 77/388/EEC.²

2. Article 19 of the Sixth Directive lays down the rules for calculating the deductible proportion which applies where a taxable person uses goods and services both for taxable transactions and for transactions which are exempt from value added tax (‘VAT’).

3. Under the Community system of VAT, an economic trader is entitled to deduct in full the VAT he has paid in respect of the exercise of his activities which are themselves subject to VAT. Where he carries out both taxable and exempt activities and acquires goods and services for both types of activity without distinction, he may deduct the VAT charged

on those goods and services only in proportion to the turnover of his taxable activities.

4. Accordingly, under Article 19 of the Sixth Directive, that deduction is equal to a fraction having, as numerator, the turnover attributable to taxable transactions and, as denominator, that turnover plus the turnover attributable to exempt transactions. Article 19(2) provides that turnover attributable to certain real estate and financial transactions shall also be excluded in so far as they are incidental transactions.

5. It follows that, where a transaction is VAT-exempt, its classification as an ‘incidental transaction’ for the purposes of Article 19 of the Sixth Directive has the effect, by reducing the amount of the denominator of the fraction provided for in that article, of increasing the deduction to which the taxable person is entitled.

6. This concept of ‘incidental transaction’ has been interpreted on two occasions, in the

1 — Original language: French.

2 — 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taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1, ‘the Sixth Directive’), repealed, as from 1 January 2007, by Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1), but still applicable at the date of the main proceedings.

judgments in *Régie dauphinoise*³ and *EDM*.⁴ More recently, the Court has also provided useful guidelines for interpreting that expression in the judgment in *Nordania Finans and BG Factoring*.⁵

7. In the present case, the parties disagree as regards the interpretation of the criteria laid down by the Court in those judgments and as regards the conclusions to be drawn from them in the circumstances of the main proceedings.

8. This case concerns a building business whose main activity is carrying out works on behalf of other parties and which, to a limited extent, constructs buildings on its own account in order to sell them. Under the relevant national law, the construction of buildings by a person on his own account is a taxable transaction whereas the subsequent sale of that real estate is an exempt transaction.

9. The referring court wishes to know whether the sale, by that business, of buildings constructed on its own account may be regarded as an 'incidental transaction' within the meaning of Article 19(2) of the Sixth Directive. It asks *inter alia* whether that assessment depends on the fact that that sale, viewed separately, entails only a very limited use of the goods and services on which VAT is payable. It also asks the Court about the effect of the principle of neutrality with regard to that assessment.

10. In this opinion, I shall state the reasons why the criterion of the very limited use of the goods and services put to mixed use cannot apply where, as in the present case, the activity of selling real estate, which is VAT-exempt, constitutes, together with the building activity, one and the same transaction. I shall propose that the Court rule that the sale by a building business of buildings constructed on its own account, where their construction is subject to VAT and their subsequent sale is exempt, cannot constitute an 'incidental transaction' for the purposes of Article 19(2) of the Sixth Directive, since that sale is the direct, permanent and necessary extension of the building activity.

3 — Case C-306/94 [1996] ECR I-3695.

4 — Case C-77/01 [2004] ECR I-4295.

5 — Case C-98/07 [2008] ECR I-1281.

I — Legal background

A — *The Sixth Directive*

1. The deduction system provided for in Articles 17 and 19 of the Sixth Directive

11. VAT is a tax on consumption which is intended to apply generally to goods and services, the burden of which should fall on the end consumer only. In order to ensure that taxable persons responsible for recovering the VAT do not carry the burden thereof, the Sixth Directive provides for a deduction mechanism intended to ensure tax 'neutrality'. Taxable persons are thus allowed to deduct from the tax recovered by them from their customers — and for which they are liable towards the Member State — the input tax which they themselves paid when they purchased the goods and services necessary for carrying on their business.

12. However, the right to deduct presupposes that the taxable person uses the goods or services for activities that are themselves subject to VAT. Article 17 of the Sixth Directive, entitled 'Origin and scope of the right to deduct', thus provides that a taxable person is entitled to deduct VAT 'in so far as the goods and services are used for the purposes of his taxable transactions'.

13. Where a taxable person uses goods and services both for taxable transactions, in respect of which VAT is deductible, and for exempt transactions, in respect of which it is not deductible, Article 17(5) of the Sixth Directive provides that only such proportion of the VAT shall be deductible as is attributable to the former transactions. The provision also states that that proportion shall be determined, in accordance with Article 19 of the Sixth Directive, for all the transactions carried out by the taxable person.

14. Article 19 of the Sixth Directive provides:

'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 ...
- as denominator, the total amount, exclusive of value added tax, of turnover per year attributable to transactions included in the numerator and to transactions in respect of which value added tax is not deductible ...

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

the interest on the deposits, which had amounted to some 14% of its total annual receipts during the period in question.⁶

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 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...'

16. The Court examined, first, whether the deposits in question fell within the scope of VAT. It held that they constituted an economic activity on the ground that they could be regarded as services supplied to financial institutions consisting in the loan of money for a fixed period, remunerated by the payment of interest.

2. The interpretation of the concept of incidental transaction

17. As regards whether Régie had made those deposits in its capacity as a taxable person, the Court held that 'the receipt, by such a manager, of interest resulting from the [deposit] 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'.⁷

(a) The judgment in *Régie dauphinoise*

15. Régie dauphinoise — Cabinet A. Forest SARL ('Régie') was involved in the management of let property and also acted as manager of condominiums. As such, it received advances from the co-owners for whom it managed the properties. It invested those sums for its own account with financial institutions. Régie became the owner of the sums advanced with effect from their payment into its account. It remained under an obligation to repay but was entitled to retain

18. The Court subsequently held that the deposits were exempt from VAT by virtue of Article 13B(d) of the Sixth Directive.

⁶ — *Régie dauphinoise*, paragraph 6.

⁷ — *Ibid.*, paragraph 18.

19. Finally, the Court commented on the question of whether those deposits could be regarded as ‘incidental financial transactions’, within the meaning of Article 19(2) of the Sixth Directive. It held, in paragraphs 21 and 22:

‘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.... [I]f 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.

However, [deposits] 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 [deposits] constitutes the direct, permanent and necessary extension of the taxable activity of property management companies. Such [deposits] cannot therefore be characterised 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 propor-

tion would not be such as to affect the neutrality of the system of [VAT].’

(b) The judgment in *EDM*

20. The *EDM* case concerned a holding company in the mining sector whose principal activities were the management of mining company shareholdings and scientific and technological research in the mining sector with a view to investment therein, through the creation of new undertakings. That holding company also granted loans to companies in which it had a shareholding and invested in bank deposits or in securities, such as Treasury notes or certificates of deposit.

21. The Court ruled on the question of whether those financial activities, which were VAT-exempt, could be regarded as incidental transactions, even though they generated income which was higher than that from the principal activity.

22. It pointed out that the purpose of Article 19(2) of the Sixth Directive is to avoid transactions which involve no use, or

only a very limited use, of goods or services subject to VAT distorting the calculation of the deductible proportion and thus to meet the objective of neutrality guaranteed by the common system of VAT.⁸

23. The Court held that the financial activities of the holding company in question are to be regarded as 'incidental transactions' within the meaning of the second sentence of Article 19(2) of the Sixth Directive in so far as those transactions involve only very limited use of assets or services subject to VAT.⁹

24. It stated that, although the scale of the income generated by financial transactions within the scope of the Sixth Directive may be an indication that those transactions should not be regarded as 'incidental' within the meaning of that provision, the fact that income greater than that produced by the activity stated by the undertaking concerned to be its main activity is generated by such transactions does not suffice to preclude their classification as 'incidental transactions'.¹⁰ The Court had previously found that the holding company's principal activity of prospecting was profitable in the medium term only or might even prove to be unprofitable.¹¹

8 — *EDM*, paragraph 75.

9 — *Ibid.*, paragraph 78.

10 — *Idem.*

11 — *EDM*, paragraph 77.

3. The judgment in *Nordania Finans and BG Factoring*

25. In *Nordania Finans and BG Factoring*, the question was whether or not the vehicles which a leasing undertaking purchases with a view to leasing them and subsequently selling them upon termination of the respective leasing contracts constitute capital goods.

26. As well as carrying on that leasing activity, which was subject to VAT, the undertaking also provided financial services, which were exempt from VAT. It was therefore necessary to determine whether the amount of the turnover corresponding to the sale of vehicles at the end of the leasing contracts was to be taken into account in the calculation of the deductible proportion, as numerator and denominator, as attributable to a taxable activity or excluded from that calculation as corresponding to the purchase of capital goods.

27. The Court held that the expression 'capital goods used by the taxable person for the purposes of his business' in Article 19(2) of the Sixth Directive does not include vehicles which a leasing undertaking purchases with a view to leasing them and subsequently selling them upon termination of the respective leasing contracts, as the sale of such vehicles at the end of those contracts is an integral part of the usual business activities of that undertaking.

B — *The national tax legislation*

28. Paragraph 6(1) of the VAT law (momsloven) provides that VAT is payable by taxable persons who carry out building work and who, on their own account and on their own land, construct buildings for sale. Paragraph 6(2) of that Law provides that, for buildings for which VAT is to be paid under Paragraph 6(1), work carried out and materials used for that purpose are to be treated as supplies made for consideration and, accordingly, as supplies subject to tax.

29. The national court states that those provisions seek to ensure equality amongst building businesses which themselves construct buildings for sale and those which, for the same purpose, enter into construction contracts with third-party contractors because, under Paragraph 13(1)(9) of the VAT law, the sale of real estate is exempt from VAT.

30. As regards the right to deduct, Paragraph 37 of the VAT law provides that registered businesses may, in their input tax return, deduct the tax paid on goods and services used solely for the undertaking's supplies which are not exempt.

31. With regard to purchases intended for mixed use, Paragraph 38 of the VAT law provides:

'For goods and services which a registered business uses for purposes giving entitlement to deduction under Paragraph 37 as well as for other purposes of the business, a deduction may be made for that portion of the tax which is proportional to the turnover in the registrable part of the business. In the turnover declaration, account shall not be taken of turnover amounts relating to the supply of capital goods which have been used for the purposes of the business. ... Nor shall account be taken of turnover amounts attributable to incidental real estate transactions ...'

II — The facts and the questions referred for a preliminary ruling

32. NCC Construction Danmark A/S ('NCC') has a building and contracting business and carries out construction projects on behalf of other parties and on its own account. The sale of real estate is not its principal activity, but rather a separate activity which derives from the building work subject to VAT.

33. For construction carried out on its own account, NCC pays VAT on the building work pursuant to Paragraph 6 of the VAT Law as construction progresses, as if it were a third party for whom that building work is carried out. The requirement to pay VAT on construction carried out on its own account covers building work carried out by NCC's employees, all material used for the building, and work carried out in the planning and on the ground. VAT is also payable on the usual profit for equivalent building work.

34. In 2002, NCC itself sold buildings constructed on its own account. Of a total staff of 2 232 people, only 8 were employed on those sales. In that year, its turnover was almost DKK 4 billion (DKK 3 966 million). The sale of buildings constructed on its own account generated a turnover of DKK 185 million. The sales organisation's share of NCC's common costs, that is, costs for administration, office expenses, accounting, expenditure on premises, etc., amounted to 0.6%.

35. For many years, the national tax authorities granted construction undertakings an unlimited right to deduct for costs which could relate to the building activity itself and to sales. From 1 April 2002, they decided that the tax on common costs could in future be subject only to a partial deduction, on the ground that the turnover from the sale of

buildings would henceforth be regarded as relating to a VAT-exempt activity.

36. Since the turnover from the sale of real estate represented 4.7% of overall turnover in 2002 (DKK 185 million out of DKK 3 966 million), the Danish tax authorities demanded from NCC the sum of DKK 562 519 in VAT for the second half of 2002.

37. NCC brought proceedings against that decision on 8 February 2006.

38. The national court points out that sales of buildings constructed by NCC on its own account are now handled by a separate company.

39. Before the national court, the parties put forward the following arguments.

40. NCC maintained that the sales transactions in respect of buildings constructed on its own account constitute ‘incidental transactions’ within the meaning of the fourth sentence of Paragraph 38(1) of the VAT Law and the second sentence of Article 19(2) of the Sixth Directive because they involve only a very limited use of goods and services subject to VAT. It submitted that very limited use of common assets and services is the decisive criterion for establishing whether a transaction is incidental, in accordance with the position adopted by the Court of Justice in the judgment in *EDM*, and that that interpretation must be accepted in order to ensure that the deduction scheme guarantees the complete neutrality of VAT in that regard.

41. The Skatteministeriet (Ministry of Taxation) disputes that analysis and submits that, in the light of the judgments in *Régie dauphinoise* and *EDM*, a transaction may be regarded as ‘incidental’ within the meaning of Article 19(2) of the Sixth Directive only if it fulfils two cumulative conditions, namely if it is not an integral part of the taxable person’s economic activity or connected thereto as a direct, permanent and necessary extension of the taxable activity, and if it involves only a very limited use of the common goods and services.

42. It states that, in the judgment in *EDM*, the first of those conditions was fulfilled, so the Court went on to consider the second condition, but that does not mean that the judgment in *Régie dauphinoise* is no longer valid.

43. The Skatteministeriet maintains that NCC’s sales of buildings constructed on its own account are a direct, permanent and necessary extension of its building activity. It also submits that it is an artificial distinction to look at the sales department alone, because the turnover relating to the sale of real estate is also generated by the whole building business.

44. In the light of these arguments, the Østre Landsret decided to stay proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

‘(1) Is the term “*incidental real estate transactions*” in the second sentence of Article 19(2) of the Sixth Directive... to be interpreted as covering the activities of a taxable building business in connection with the subsequent sale of buildings constructed by the building business on its own account, as an activity fully subject to VAT, with a view to resale?

(2) Does the answer to question 1 depend on the extent to which the sales activities, viewed separately, entail the use of goods and services on which VAT is payable?

(3) Is it consistent with the principle of neutrality of VAT for a building business which, under the legislation of the Member State in question — based on Article 5(7) and Article 6(3) of the Sixth Directive — is required to pay VAT on its internal supplies in connection with the construction of buildings on its own account with a view to their subsequent sale, to have only a partial right to deduct VAT for general costs incurred in the building business, on the ground that the subsequent sale of the real estate is, under the Member State's VAT legislation, exempt from VAT on the basis of Article 28(3)(b) of the Sixth Directive ..., read in conjunction with point 16 of Annex F?

III — Analysis

45. The three questions referred for a preliminary ruling by the national court are closely linked. The first two questions concern the issue whether the sale, by NCC, of buildings constructed on its own account may constitute an 'incidental transaction' within the meaning of Article 19(2) of the Sixth Directive and, if so, whether the relevant criterion for the purposes of that assessment is the extent of the use, for the sales activity viewed separately, of the goods and services on which VAT is payable. The third question concerns the effect of the principle of neutrality on the reply to be given to the previous question.

46. All three questions seek to ascertain whether the turnover from NCC's sales of real estate may be excluded from the denominator of the fraction used to calculate the deductible proportion. I therefore propose that the Court consider them together and to the effect that the national court is asking, in essence, whether Article 19(2) of the Sixth Directive is to be interpreted as meaning that the sale, by a building business, of buildings constructed on its own account, where the construction of those buildings is subject to VAT and the subsequent sale thereof is exempt, may constitute an 'incidental transaction' within the meaning of that provision and, if so, on what conditions.

47. Before considering that question, I should point out that the Danish legislation, inasmuch as it provides that the sale of new buildings is VAT-exempt and the construction by a building business of buildings on its own account is subject to VAT, is compatible with the Sixth Directive.

48. As regards, first, the exemption from VAT of the sale of new buildings, this is based on the combined provisions of Article 28(3)(b) of the Sixth Directive, under which the Member States, during a five-year transitional period from 1 January 1978, may continue to exempt the activities set out in Annex F of the directive under conditions existing in the Member State concerned.

49. Annex F of the Sixth Directive, entitled ‘Transactions referred to in Article 28(3)(b)’, refers, in point 16, to ‘supplies of those buildings and land described in Article 4(3)’, that is, in the words of the latter provision, the supply before first occupation of buildings or parts of buildings and the land on which they stand.¹²

50. The Danish Government also states that the aforementioned exemption existed in national law before the entry into force of the Sixth Directive and the national court points out that, in that regard, its national legislation is compatible with the combined provisions of Article 28(3)(b) of the Sixth Directive and point 16 of Annex F thereto.

51. As regards, secondly, taxation on the construction of buildings by a building business on its own account, this is based on the provisions of Articles 5(7) and 6(3) of the Sixth Directive, which treat as a taxable activity the supply of goods and of services by a taxable person for the purposes of his undertaking.

12 — That power to exempt the sale of new buildings was extended by Article 371 of Directive 2006/112 and Annex X(B)(9) thereto.

52. Accordingly, Article 5(7)(a) of the Sixth Directive provides that Member States may treat as supplies made for consideration the application by a taxable person for the purposes of his business of goods produced, constructed, extracted, processed, purchased or imported in the course of such business, where the VAT on such goods, had they been acquired from another taxable person, would not be wholly deductible.

53. Similarly, Article 6(3) of the Sixth Directive states that, in certain circumstances, Member States may treat as a supply of services for consideration the supply by a taxable person of a service for the purposes of his undertaking where the VAT on such a service, had it been supplied by another taxable person, would not be wholly deductible.

54. The analysis of the question raised by the national court must therefore be based on the premiss that the national legislation, inasmuch as it provides that the sale of new buildings is exempt and that the construction of buildings by a building business on its own account is taxable, is compatible with the Community system of VAT.

55. NCC maintains that sales of buildings which it constructs on its own account should be regarded as incidental transactions for the following reasons.

56. Such sales do not form part of its main activity, nor do they constitute a separate area of the undertaking's business. They derive directly from those of its building activities which are fully subject to VAT and they are incidental and marginal in relation to the undertaking's overall turnover (DKK 185 million out of DKK 3 966 million generated by the main activity).

57. Also and most importantly, the calculation of the deduction would be distorted if the turnover from the sale of real estate were taken into account, because, in 2002, the sales department's part of the undertaking's common costs amounted to only 0.6%. As the Court held in paragraph 21 of the judgment in *Régie dauphinoise* and paragraph 76 of the judgment in *EDM*, calculation of the deduction would be distorted if all receipts from a taxable person's financial transactions linked to a taxable activity were to be included in the denominator of the fraction used to calculate the deductible proportion, particularly 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.

58. Finally, NCC states that the Court has consistently held that the objective of the common system of VAT is to guarantee observance of complete neutrality, whatever the objectives or receipts of the undertaking. However, the Danish VAT rules departed from that fundamental principle of the Sixth Directive by choosing to divide a single transaction into two separate transactions: first, the construction of buildings, which is

taxed as the work progresses, and, secondly, the sale thereof, which is VAT-exempt.

59. The taking into account, as from 1 April 2002, of turnover from sales of real estate therefore infringes the principle of neutrality because, by dividing a single transaction into two separate transactions, it fails to relieve the taxable person of the full burden of VAT borne in respect of the construction of buildings on its own account.

60. I consider that NCC's argument cannot be upheld, because the sale of the buildings constructed by that undertaking on its own account and their construction derive from a single transaction usually carried out by the taxable person.

61. I base that analysis on the deduction system laid down in Articles 17 and 19 of the Sixth Directive and on the case-law relating to the term 'incidental transaction' referred to in Article 19(2) of the Sixth Directive.

62. That term is not defined in the Sixth Directive. Nor does the directive make reference to the law of the Member States

for the purpose of determining its meaning and scope. The term must therefore be interpreted having regard to its legal context and the objectives it pursues.¹³

63. It is not disputed that the deduction system established by the Sixth Directive is designed to relieve the taxable person entirely of the input VAT on the goods and services used for the purposes of his taxable transactions.¹⁴ We have also seen that, under Article 17(5) of the Sixth Directive, where a taxable person carries out both taxable transactions and exempt transactions, only such proportion of the VAT shall be deductible as is attributable to the taxable transactions. Accordingly, Article 19(1) of the Sixth Directive provides that the deductible proportion of the VAT levied on the acquisition of those goods and services shall be made up of a fraction having, as numerator, the turnover from taxable transactions and, as denominator, the total turnover.

64. By those provisions, the Community legislature thus presumed that the share of the use, by the taxable person, of those goods and services for the purposes of his taxable activities, which were deductible, and for the purposes of his exempt activities, which were

not deductible, was in proportion to their respective turnover.

65. Article 19(2) of the Sixth Directive, by providing that turnover from incidental real estate and financial transactions and from the sale of capital goods is to be excluded, seeks to rule out sums which do not reflect the use of goods and services on which VAT is payable and which would therefore distort the result of the calculation of the deductible proportion.

66. That objective was clearly expressed in the statement of reasons of the Proposal for a Sixth Directive submitted by the Commission of the European Communities to the Council of the European Union on 29 June 1973.¹⁵ It has been reproduced consistently in the aforementioned judgments in *Régie dauphinoise*,¹⁶ *EDM*¹⁷ and *Nordania Finans and BG Factoring*.¹⁸ Accordingly, the Court has held that, if all receipts from a taxable person's

¹³ — *Nordania Finans and BG Factoring*, paragraph 18.

¹⁴ — Case C-333/91 *Softiam* [1993] ECR I-3513, paragraph 10, and *Nordania Finans and BG Factoring*, paragraph 19. See, more recently, Case C-74/08 *PARAT Automotive Cabrio* [2009] ECR I-3459, paragraph 17.

¹⁵ — Proposal for a sixth Council Directive on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (*Bulletin of the European Communities*, supplement 11/73, p. 20). According to that proposal, Article 19(2) was justified thus:

'The factors mentioned in this paragraph must be excluded from the calculation of the proportion lest, being unrepresentative of the taxable person's business activity, they should deprive the amount of any real significance. Such is the case with sales of capital items and real estate and financial transactions which are only ancillary operations, that is to say are only of secondary importance in relation to the total turnover of the business. These factors are only excluded if they are not part of the usual business activity of the taxable person.'

¹⁶ — Paragraph 21.

¹⁷ — Paragraphs 75 and 76.

¹⁸ — Paragraph 23.

financial transactions linked to a taxable activity were to be included in the denominator of the fraction used to calculate the proportion, 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.

67. There can be no doubt that that analysis, made in the context of cases relating to financial transactions or to the definition of capital goods, may be transposed to the present case, which concerns the sale of real estate.

68. Several lessons may be drawn from the foregoing considerations and from the judgments in *Régie dauphinoise*, *EDM* and *Nordania Finans and BG Factoring* with regard to the meaning and scope of the term ‘incidental transaction’ contained in Article 19(2) of the Sixth Directive.

69. The first of these is that the term is intended to apply, first and foremost, to specific transactions, which are not part of the undertaking’s usual activity. Thus, the sale, by an undertaking, of a building which it no longer uses may generate a sizeable turnover even though the transaction may have required only a few telephone calls. In that case, it is the unusual or exceptional nature of the transaction which supports the presumption that it is covered by the term ‘incidental

transaction’ within the meaning of Article 19(2) of the Sixth Directive.

70. Conversely, the usual nature of an exempt transaction supports the presumption that it is not an ‘incidental transaction’ within the meaning of that provision.¹⁹ None the less, that presumption is not irrebuttable.

71. In fact, the second lesson to be drawn from the aforementioned considerations is that the usual nature of a transaction does not automatically preclude its constituting an ‘incidental transaction’. Accordingly, in the judgment in *EDM*, the Court acknowledged that this could apply in the case of investments of funds and loans made regularly by a holding company in the mining sector. Although those financial activities were carried out regularly, the Court held that they could constitute ‘incidental transactions’ within the meaning of Article 19(2) of the Sixth Directive provided that they involved only a very limited use of the goods and services subject to VAT.

72. However, that possibility of treating a taxable person’s usual activity as an ‘incidental transaction’ within the meaning of that

¹⁹ — See to this effect *Nordania Finans and BG Factoring*.

provision depends on a prior condition, which was not clearly stated by the Court in the judgment in *EDM*, but which stems expressly from the judgment in *Régie dauphinoise* and which is logically required under the Community system of deduction.

connection with his economic activities is subject to the condition that these activities are themselves subject to that tax. The right to deduct therefore implies that the goods and services on which VAT is payable by the taxable person have been used by him to carry out taxable activities.

73. The third lesson to emerge from the case-law is indeed that the exempt activity, in order to be regarded as an incidental transaction, must not constitute the direct, permanent and necessary extension of the taxable activity. As the Danish Government and the Commission point out, an exempt transaction cannot be regarded as an ‘incidental transaction’ within the meaning of Article 19(2) of the Sixth Directive if it has that connection with the taxable activity.

76. Where a taxable person uses goods and services to carry out both taxable activities and exempt activities, the deductible proportion rule becomes applicable, under which the right to deduct is in proportion to the turnover from the taxable transactions. The right to deduct is therefore based on the presumption that those goods and services are used by the taxable person for his taxable activities and his exempt activities in proportion to the turnover from each.

74. That condition was laid down in the judgment in *Régie dauphinoise* in relation to the deposit, by a property management company, of monies received from clients in the course of managing their properties.²⁰

77. Article 19(2) of the Sixth Directive allows that presumption to be disregarded where the tax-exempt activity involves only a very limited use of the goods and services put to mixed use.

75. Such a condition is logically required under the deduction system established in the Sixth Directive. That system is based on the principle that a taxable person’s right to be relieved of the VAT which he has paid in

78. The application of that derogation therefore assumes that the exempt activity may be distinguished from the taxable activity. In other words, it implies that the part of the use of the goods and services for exempt transactions is identifiable. If the exempt activity is closely linked to the taxable activity or overlaps it, the exemption provided for in

20 — The Court considered that, since that activity constituted the direct, permanent and necessary extension of the taxable activity of property management companies, it could not be characterised as an incidental financial transaction (*Régie dauphinoise*, paragraph 22).

Article 19(2) of the Sixth Directive cannot be applied because it is not possible to attribute to each of those activities a share in the use of the goods and services put to mixed use.

79. In that situation, the presumption underlying the deductible proportion stated in Articles 17(5) and 19(1) of the Sixth Directive is therefore irrebuttable. In other words, the turnover from the exempt activity cannot be excluded from the calculation of the deductible proportion because, by its very nature, that activity does not involve a very limited use of the goods and services put to mixed use.

80. Accordingly, in *Régie dauphinoise*, the Court held that investment of funds by the property management company had a direct, permanent and necessary link with the taxable activity of property management, because the funds deposited on a regular basis by that property management company were the direct consequence of that management activity. In fact, the funds were advances made to them by the clients whose properties they managed. Also, those deposits might be necessary because there are strong grounds for thinking that they were fundamental to the break-even basis of the property management company's activity.

81. Conversely, in the judgment in *EDM*, the Court, without expressly saying so, may have considered that the financial activities of the holding company in question did not consti-

tute the direct, permanent and necessary extension of its taxable activity because the funds invested by that holding company with financial institutions or in the form of loans did not come from its taxable activity but were constituted by its company assets.²¹

82. The rule laid down by the Court in *Régie dauphinoise* applies a fortiori where, as in the present case, the exempt activity and the taxable activity derive from the same transaction. In such circumstances, it would be an artificial distinction to exclude the turnover from the exempt activity because it is the same transaction which is successively a taxable transaction, which is deductible, and an exempt transaction, which is not deductible.

83. As NCC has itself stated, the sale of the buildings, which is exempt from VAT, and their construction, which is subject to VAT, derive from the same economic transaction, since NCC constructs buildings in order to sell them. As the Danish Government maintains, it is therefore an artificial distinction to attribute the turnover from the sale of

21 — The Court held, to the same effect, in Case C-142/99 *Floridienne and Berginvest* [2000] ECR I-9567, paragraph 29, that the making by a holding company of loans to subsidiaries to which it supplies administrative, accounting, information technology and general management services cannot be subject to VAT on the ground that it is the direct, permanent and necessary extension of the supply of services, since such loans are neither necessarily nor directly linked to services thus supplied.

buildings constructed by NCC on its own account only to the activity of the sales department, because that turnover also stems in part from the building activity, which is subject to VAT.

the legislation. It is stated in general terms in Article 17(2) of the Sixth Directive and it may be subject to the limitations and derogations expressly provided for in the directive.²⁴ The principle of neutrality and the right to deduct cannot therefore preclude or render inapplicable a provision of national law which transposes such a derogating provision of the Sixth Directive.

84. Indeed, as NCC rightly points out, the consequence of that analysis is to reduce the deduction of the VAT on the common costs although the construction of buildings by that company on its own account constitutes a taxable activity. However, I consider that that situation, as the Community system of VAT stands, is not incompatible with the principle of neutrality.

87. We have already seen that the provisions the VAT law, in so far as they exempt the sale of new buildings from VAT and make subject to VAT the construction, by undertakings like NCC, of buildings on their own account, are compatible with the Sixth Directive. Moreover, the consequences of that legislation for NCC are precisely those which the national legislature wished to achieve, that is, to place building businesses which sell buildings which they have constructed in the same position as vendors of buildings who have to entrust that construction work to third party undertakings.

85. It is true that the principle implies that a taxable person may deduct all the VAT levied on goods and services acquired for the exercise of his taxable activities.²² It is also established that, according to the case-law, the right to deduct VAT, as an integral part of the VAT scheme, is a fundamental principle underlying the common VAT system, and in principle may not be limited.²³

86. However, as the Commission has rightly pointed out, that principle does not transcend

88. The effects of that legislation which are criticised by NCC therefore derive from the derogations from the principle of neutrality which are expressly provided for by the Sixth

²² — *Nordania Finans and BG Factoring*, paragraph 19.

²³ — Case C-25/07 *Sosnowska* [2008] ECR I-5129, paragraphs 14 and 15 and the case-law cited therein, and *PARAT Automotive Cabrio*, paragraph 15.

²⁴ — *PARAT Automotive Cabrio*, paragraph 18.

Directive and intended by the Danish Government on the basis of those provisions.

89. That is why I take the view that, as the Sixth Directive now stands, the principle of the neutrality of VAT does not preclude taking into consideration the turnover from NCC's sales of real estate in the denominator of the fraction laid down in Article 19 of the Sixth Directive, as attributable to an exempt activity.

90. In the light of these considerations, I propose that the Court rule that Article 19(2) of the Sixth Directive is to be interpreted as meaning that the sale by a building business of buildings constructed on its own account, where the construction of those buildings is subject to VAT and their subsequent sale is exempt, cannot constitute an 'incidental transaction' within the meaning of that provision, if that sale constitutes, as in the present case, the direct, permanent and necessary extension of the building activity.

IV — Conclusion

91. In the light of the foregoing considerations, I propose that the Court give the following reply to the questions referred for a preliminary ruling by the Østre Landsret:

Article 19(2) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment is to be interpreted as meaning that the sale by a building business of buildings constructed on its own account, where the construction of those buildings is subject to value added tax and their subsequent sale is exempt, cannot constitute an 'incidental transaction' within the meaning of that provision, if that sale constitutes, as in the present case, the direct, permanent and necessary extension of the building activity.