Provisional text

JUDGMENT OF THE COURT (Fourth Chamber)

24 January 2019 (*)

(Reference for a preliminary ruling — Taxation — Value added tax (VAT) — Sixth Council Directive 77/388/EEC — Directive 2006/112/EC — Deduction of input tax — Goods and services used for both taxable transactions and exempt transactions (mixed-use goods and services) — Determination of the applicable deductible proportion — Branch established in a Member State other than that of its principal establishment — Expenditure incurred by the branch used exclusively for the transactions of the principal establishment — General costs of the branch used for both its transactions and those of the principal establishment)

In Case C?165/17,

REQUEST for a preliminary ruling under Article 267 TFEU from the Conseil d'État (Council of State, France), made by decision of 29 March 2017, received at the Court on 3 April 2017, in the proceedings

Morgan Stanley & Co International plc

v

Ministre de l’Économie et des Finances,

THE COURT (Fourth Chamber),

composed of T. von Danwitz, President of the Seventh Chamber, acting as President of the Fourth Chamber, K. Jürimäe, C. Lycourgos, E. Juhász and C. Vajda (Rapporteur), Judges,

Advocate General: P. Mengozzi,

Registrar: C. Strömholm, Administrator,

having regard to the written procedure and further to the hearing on 1 March 2018,

after considering the observations submitted on behalf of:

– Morgan Stanley & Co International plc, by C. Aldebert and C. Reinbold, avocats,

– the French Government, by D. Colas, E. de Moustier, A. Alidière and S. Ghiandoni, acting as Agents,

– the Portuguese Government, by L. Inez Fernandes, M. Figueiredo and R. Campos Laires, acting as Agents,

– the European Commission, by N. Gossement and R. Lyal, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 3 October 2018,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Article 17(2), (3) and (5) and Article 19(1) 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 (OJ 1977 L 145, p. 1; 'the Sixth Directive'), and of Articles 168, 169 and 173 to 175 of Council Directive 2006/112/EC on the common system of value added tax (OJ 2006 L 347, p. 1).

2 The request has been made in proceedings between Morgan Stanley & Co International plc ('Morgan Stanley') and the ministre de l'Économie et des Finances (Minister for the Economy and Finance, France) ('the tax authority'), concerning the deduction of the value added tax (VAT) paid by the Paris branch of Morgan Stanley ('the Paris branch'), first, in respect of expenditure used for the transactions of the principal establishment located in the United Kingdom and, second, in respect of the general costs used for both transactions of the principal establishment and those of the branch.

Legal framework

Sixth Directive

3 Under Article 4(1) of the Sixth Directive, 'taxable person' means any person who independently carries out in any place any economic activity specified in Article 4(2) of that directive, whatever the purpose or results of that activity.

4 Article 13 B(d) of that directive provided that the financial transactions mentioned in that provision are exempt from VAT.

5 Article 13 C of that directive provided:

'Member States may allow taxpayers a right of option for taxation in cases of:

...

(b) the transactions covered in B(d) ...

...'

6 Article 17(2), (3) and (5) of the Sixth Directive provided:

'2. In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:

(a) [VAT] due or paid in respect of goods or services supplied or to be supplied to him by another taxable person;

...

3. Member States shall also grant to every taxable person the right to a deduction or refund of the [VAT] referred to in paragraph 2 in so far as the goods and services are used for the purposes of:

(a) transactions relating to the economic activities as referred to in Article 4(2) carried out in another country, which would be eligible for deduction of tax if they had occurred in the territory of the country;

...

5. As regards goods and services to be used by a taxable person both for transactions covered by paragraphs 2 and 3, in respect of which [VAT] is deductible, and for transactions in respect of which [VAT] is not deductible, only such proportion of the [VAT] shall be deductible as is attributable to the former transactions.

This proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person.

...'

7 Article 19(1) of the Sixth Directive was worded as follows:

'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 [VAT], of turnover per year attributable to transactions in respect of which value added tax is deductible under Article 17(2) and (3);

– as denominator, the total amount, exclusive of [VAT], 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 Member States may also include in the denominator the amount of subsidies, other than those specified in Article 11 A(1)(a).

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

8 From 1 January 2007, in the context of a recasting of the Sixth Directive, the provisions thereof were replaced by those of Directive 2006/112.

Directive 2006/112

9 The first subparagraph of Article 9(1) of Directive 2006/112 provides:

'"Taxable person" shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.'

10 Article 137(1)(a) of that directive provides that Member States may allow taxable persons a right of option for taxation in respect of the financial transactions referred to in Article 135(1)(b) to (g) of that directive.

11 Under Article 168 of that directive:

'In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:

(a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person;

...'

12 Article 169 of that directive provides:

'In addition to the deduction referred to in Article 168, the taxable person shall be entitled to deduct the VAT referred to therein in so far as the goods and services are used for the purposes of the following:

(a) transactions relating to the activities referred to in the second subparagraph of Article 9(1), carried out outside the Member State in which that tax is due or paid, in respect of which VAT would be deductible if they had been carried out within that Member State;

...'

13 Article 173(1) of Directive 2006/112 provides:

'In the case of goods or services used by a taxable person both for transactions in respect of which VAT is deductible pursuant to Articles 168, 169 and 170, and for transactions in respect of which VAT is not deductible, only such proportion of the VAT as is attributable to the former transactions shall be deductible.

The deductible proportion shall be determined, in accordance with Articles 174 and 175, for all the transactions carried out by the taxable person.'

14 Article 174(1) of that directive reads as follows:

'The deductible proportion shall be made up of a fraction comprising the following amounts:

(a) as numerator, the total amount, exclusive of VAT, of turnover per year attributable to transactions in respect of which VAT is deductible pursuant to Articles 168 and 169;

(b) 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.

...'

15 Article 175(1) of that directive specifies that the deductible proportion is to be determined on an annual basis, fixed as a percentage and rounded up to a figure not exceeding the next whole number.

The dispute in the main proceedings and the questions referred for a preliminary ruling

16 It is apparent from the order for reference that the Paris branch, as a fixed establishment, is subject to VAT in France. It was the subject of two tax inspections covering, as far as VAT is concerned, the periods from 1 December 2002 to 30 April 2005 and from 1 December 2005 to 30 April 2009.

17 In the course of those inspections, it was found that that branch, on the one hand, carried out banking and financial transactions for its local clients, in respect of which it had opted to be liable to VAT, and, on the other, supplied services to the principal establishment located in the

United Kingdom, in return for which it received transfers. The branch deducted the whole of the VAT to which the expenditure attributable to those two categories of services was subject.

18 The tax authorities considered that the VAT charged in respect of the acquisition of the goods and services used solely for internal transactions with the principal establishment located in the United Kingdom was not deductible, since these transactions fell beyond the scope of application of VAT but nonetheless allowed, by way of mitigation, deduction of a fraction of the tax at issue by deducting a proportion applicable to that principal establishment, subject to the exceptions to the right of deduction applicable in France. With regard to mixed expenditure, attributable to transactions carried out with both the principal establishment located in the United Kingdom and clients of the Paris branch, the tax authorities considered that they were only partially deductible and applied the deductible proportion applicable to that principal establishment, adjusted according to the Paris branch's turnover giving rise to the right to deduct, subject to the exceptions to the right of deduction applicable in France.

19 In the light of those corrections, the tax authority sent Morgan Stanley additional assessments to the VAT claimed. The tribunal administratif de Montreuil (Administrative Court, Montreuil, France) rejected Morgan Stanley's applications for discharge from those assessments. The appeals lodged against the ruling of that court were, in turn, dismissed by the cour administrative d'appel de Versailles (Administrative Court of Appeal, Versailles, France).

20 In the appeal brought against the judgment given on appeal, the Conseil d'État (Council of State, France) asks, first, in relation to the expenditure borne by a branch established in one Member State which is used exclusively for transactions of its principal establishment established in another Member State, whether the provisions of the Sixth Directive and of Directive 2006/112 require the Member State in which the branch is registered to apply to that expenditure the deductible proportion of the branch, the deductible proportion of the principal establishment, or a specific deductible proportion based on the solution adopted, vis-à-vis the right of refund, in the judgment of 13 July 2000, *Monte Dei Paschi Di Siena* (C?136/99, EU:C:2000:408), which combines the rules applicable in the Member States in which the branch and the principal establishment are registered, with regard in particular to a possible option mechanism for imposing VAT on transactions.

21 Second, the referring court raises the question of the rules applicable in relation to the expenditure borne by a branch which is used for its transactions in the Member State in which it is registered and for those of its principal establishment, particularly as regards the concept of general costs and the deductible proportion.

22 In those circumstances, the Conseil d'Etat (Council of State) decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

'(1) In circumstances where expenditure of a branch established in one Member State is exclusively used for the transactions of its principal establishment established in another Member State, must the provisions of Article 17(2), (3) and (5) and Article 19(1) of the Sixth Directive …, incorporated in Articles 168, 169 and 173 to 175 of Directive [2006/112], be interpreted to the effect that the Member State in which the branch is registered is to apply to that expenditure the branch's deductible proportion, determined according to the transactions carried out in the Member State in which it is registered and according to the rules applicable in that State, or to apply the proportion applicable to the principal establishment, or to deduct a specific proportion combining the rules applicable in the Member States in which the branch and the principal establishment are registered, with regard in particular to a possible option mechanism for imposing VAT on transactions?

(2) What rules should be applied in the specific case where expenditure borne by the branch is used both for transactions in the Member State where it is registered and for transactions of the principal establishment, particularly as regards the concept of general costs and the proportion of tax deductible?'

Consideration of the questions referred

The first question

23 As a preliminary point, it should be noted that the main proceedings relate to the assessment periods from 2002 to 2009. In those circumstances, both the Sixth Directive and Directive 2006/112, which recast the Sixth Directive from 1 January 2007, are applicable to this dispute.

24 Moreover, in so far as the first question relates to the deductible proportion which the Paris branch must apply to the expenditure that it has borne for the transactions of the principal establishment located in the United Kingdom, it must be held that that question relates to the expenditure, borne by that branch, which is used, exclusively, both for transactions subject to VAT and to transactions exempt from that tax in the Member State of that principal establishment ('mixed-use expenditure'), which was indeed confirmed in Morgan Stanley's written observations.

25 It is also apparent from those observations that the option mechanism mentioned in the first question refers to the option taken up by the Paris branch, pursuant to the national legislation transposing the first subparagraph of Article 13 C of the Sixth Directive and Article 137(1)(a) of Directive 2006/112, to make subject to VAT Morgan Stanley's banking and financial transactions in France, which would be exempt from VAT if that option was not exercised.

26 Accordingly, by its first question, the referring court asks, in essence, whether Article 17(2), (3) and (5) and Article 19(1) of the Sixth Directive, and Articles 168, 169 and 173 to 175 of Directive 2006/112 must be interpreted as meaning that, in relation to the expenditure borne by a branch registered in a Member State, which is used, exclusively, both for transactions subject to VAT and for transactions exempt from that tax which are carried out by the principal establishment of that branch located in another Member State, it is necessary to apply the deductible proportion of that branch, determined on the basis of the transactions that it carries out in the Member State in which it is registered and of the rules applicable in that State, the deductible proportion of that principal establishment, or a specific deductible proportion, combining the rules applicable in the Member State in which that branch is registered and those applicable in the Member State of that principal establishment, where that branch has opted to make transactions carried out in the Member State in which it is registered subject to VAT, transactions which would have been exempt from that tax if such an option had not been exercised.

27 In order to answer that question, it is necessary, in the first place, to recall that, according to settled case-law of the Court, the right of taxable persons to deduct from the VAT which they are liable to pay the VAT due or paid on goods purchased and services received by them as inputs is a fundamental principle of the common system of VAT established by EU legislation. That right of deduction is an integral part of the VAT scheme and in principle may not be limited. The right is exercisable immediately in respect of all the taxes charged on transactions relating to inputs (judgment of 15 September 2016, *Barlis 06 — Investimentos Imobiliários e Turísticos*, C?516/14, EU:C:2016:690, paragraphs 37 and 38 and the case-law cited).

28 The deduction system is intended to relieve the trader entirely of the burden of the VAT due or paid in the course of all his economic activities. The common system of VAT therefore ensures

that all economic activities, whatever their purpose or results, provided that they are in principle themselves subject to VAT, are taxed in a neutral way (judgment of 15 September 2016, *Barlis 06 — Investimentos Imobiliários e Turísticos*, C?516/14, EU:C:2016:690, paragraph 39 and the case-law cited).

29 In that regard, it is apparent from Article 17(2)(a) of the Sixth Directive and Article 168(a) of Directive 2006/112 that a taxable person is entitled, in the Member State in which he carries out his own taxed transactions, to deduct, from the VAT which he is liable to pay, the VAT due or paid in that Member State in respect of goods and services, in so far as those goods and services were used as outputs by the taxable person for the purposes of those transactions (see, to that effect, judgment of 15 September 2016, *Barlis 06 — Investimentos Imobiliários e Turísticos*, C?516/14, EU:C:2016:690, paragraph 40 and the case-law cited).

30 Thus, the Court has held that, for VAT to be deductible, the input transactions must have a direct and immediate link with the output transactions giving rise to a right of deduction. The right to deduct VAT charged on the acquisition of input goods or services presupposes that the expenditure incurred in acquiring them was a component of the cost of the output transactions that gave rise to the right to deduct (judgment of 16 July 2015, *Larentia + Minerva and Marenave Schiffahrt*, C?108/14 and C?109/14, EU:C:2015:496, paragraph 23 and the case-law cited).

31 Furthermore, under Article 17(3)(a) of the Sixth Directive and Article 169(a) of Directive 2006/112, a taxable person is entitled to deduct the tax due or paid in respect of the goods and services used for the purposes of transactions carried out outside the Member State referred to in paragraph 29 of this judgment, in respect of which VAT would be deductible if they had been carried out within that Member State.

32 The right to deduct laid down in the provisions cited in the previous paragraph is therefore subject to the twofold condition (i) that the transactions of a taxable person effected in a Member State other than the State in which the VAT is due or paid in respect of the goods and services used to carry out those transactions be taxed in the first of those Member States and (ii) that those transactions also be taxed if they were effected in the second of those States (see, to that effect, judgments of 13 July 2000, *Monte Dei Paschi Di Siena*, C?136/99, EU:C:2000:408, paragraph 28, and of 22 December 2010, *RBS Deutschland Holdings*, C?277/09, EU:C:2010:810, paragraphs 31 and 32).

33 In the absence of any further clarification in Article 17(3)(a) of the Sixth Directive and Article 169(a) of Directive 2006/112, it must be held that the latter condition is inter alia fulfilled in a situation, such as that at issue in the main proceedings, in which the transactions taxed in the Member State of the principal establishment are also taxed in the Member State of registration of the branch which has borne the expenditure relating thereto on account of an option exercised by that branch under the national legislation transposing the first subparagraph of Article 13 C of the Sixth Directive and Article 137(1)(a) of Directive 2006/112.

34 In the second place, it should be recalled that Article 4(1) of the Sixth Directive and the first subparagraph of Article 9(1) of Directive 2006/112 define ‘taxable persons’ for VAT purposes as persons who carry out any economic activity ‘independently’ (see, to that effect, judgments of 23 March 2006, *FCE Bank*, C?210/04, EU:C:2006:196, paragraph 33, and of 7 August 2018, *TGE Gas Engineering*, C?16/17, EU:C:2018:647, paragraph 40).

35 With regard to a company whose principal establishment is located in a Member State and whose branch is registered in another Member State, it is apparent from the case-law of the Court that the principal establishment and the branch constitute a single taxable person subject to VAT, unless it is established that the branch carries out an independent economic activity, which would

be the case inter alia if it were to bear the economic risk arising from its business (see, to that effect, judgment of 7 August 2018, *TGE Gas Engineering*, C?16/17, EU:C:2018:647, paragraph 41 and the case-law cited).

36 In this case, nothing in the case file before the Court suggests that the Paris branch acts independently of the principal establishment located in the United Kingdom, for the purposes of the case-law cited in paragraph 35 of this judgment. Accordingly, and subject to verification by the referring court, it must be held that that branch and that principal establishment constitute a single taxable person for VAT purposes.

37 In that context, it should be recalled that a supply of services is taxable only if there exists between the service supplier and the recipient a legal relationship in which there is a reciprocal performance (judgments of 23 March 2006, *FCE Bank*, C?210/04, EU:C:2006:196, paragraph 34, and of 17 September 2014, *Skandia America (USA), filial Sverige*, C?7/13, EU:C:2014:2225, paragraph 24).

38 Thus, it must be pointed out that, in the absence of any legal relationship between a branch and its principal establishment, which, together, form a single taxable person, reciprocal performance between those entities constitutes non-taxable internal flows of funds, unlike taxed transactions carried out with third parties.

39 It follows that a branch registered in a Member State is entitled to deduct, in that State, the VAT charged on the goods and services acquired which have a direct and immediate link with the carrying out of the taxed transactions, including those of its principal establishment established in another Member State, with which that branch forms a single taxable person, on condition that those transactions would also give rise to deduction if they had been carried out in the State in which that branch is registered.

40 In the third place, as regards goods and services used by a taxable person for both transactions in respect of which VAT is deductible and for transactions in respect of which VAT is not deductible, under 173(1) of Directive 2006/112, which corresponds to Article 17(5) of the Sixth Directive, only such proportion of the VAT as is attributable to those transactions is to be deductible. For this purpose, a deductible proportion must be determined, in accordance with Articles 174 and 175 of Directive 2006/112, ‘for all the transactions carried out by the taxable person’.

41 That pro rata system applies, inter alia, where a branch registered in a Member State incurs expenditure for the purposes both of taxed transactions and VAT-exempt transactions carried out by its principal establishment established in another Member State (see, to that effect, judgment of 13 July 2000, *Monte Dei Paschi Di Siena*, C?136/99, EU:C:2000:408, paragraphs 26 to 28).

42 The Court has made it clear that the deduction system laid down in Article 17(5) of the Sixth Directive and Article 173(1) and (2) of Directive 2006/112 and the methods of deduction of which that system consists apply only to the goods and services used by a taxable person to carry out both economic transactions which give rise to a right to deduct and those which do not, that is to say, goods and services for mixed use (see, to that effect, judgments of 6 September 2012, *Portugal Telecom*, C?496/11, EU:C:2012:557, paragraph 40; of 16 July 2015, *Larentia + Minerva and Marenave Schiffahrt*, C?108/14 and C?109/14, EU:C:2015:496, paragraph 26, and of 9 June 2016, *Wolfgang und Dr. Wilfried Rey Grundstücksgemeinschaft*, C?332/14, EU:C:2016:417, paragraph 26).

43 On the other hand, the goods and services which are used by the taxable person solely to carry out economic transactions giving rise to a right to deduct do not fall within the scope of

Article 17(5) of the Sixth Directive or Article 173(1) of Directive 2006/112, but are covered, as regards the deduction system, by Article 17(2) of the Sixth Directive and Article 168 of Directive 2006/112, respectively (judgment of 6 September 2012, *Portugal Telecom*, C?496/11, EU:C:2012:557, paragraph 41).

44 It follows from that case-law that, as the Commission essentially observed at the hearing, the clarification in the second subparagraph of Article 17(5) of the Sixth Directive and the second subparagraph of Article 173(1) of Directive 2006/112, according to which, in respect of the goods and services used by a taxable person for both taxed transactions and VAT-exempt transactions, the deductible proportion must be determined 'for all the transactions carried out by the taxable person', refers to all the transactions referred to above, in which those mixed-use goods and services acquired by the taxable person have been used, to the exclusion of the other economic transactions carried out by that person.

45 Thus, in so far as, in addition to mixed-use expenditure, the taxable person acquires goods and services which are used exclusively for transactions subject to VAT, the VAT charged on those goods and services may be deducted in full, in accordance with Article 17(2) and (3) of the Sixth Directive, and Articles 168 and 169 of Directive 2006/112 (see, to that effect, judgment of 14 September 2017, *Iberdrola Inmobiliaria Real Estate Investments*, C?132/16, EU:C:2017:683, paragraph 27 and the case-law cited). Conversely, VAT charged on the goods and services used exclusively for the purposes of any transactions exempt from that tax do not give rise to any right to deduct.

46 It follows that, with respect to mixed-use expenditure incurred by a branch registered in a Member State used, exclusively, both for taxed transactions and VAT-exempt transactions carried out by the principal establishment of that branch, established in another Member State, it is necessary to apply a deductible proportion, the denominator of which is formed by the turnover, exclusive of VAT, relating to all those transactions, to the exclusion of the other transactions carried out by the taxable person, following the methodology referred to in Article 19(1) of the Sixth Directive and in Articles 174 and 175 of Directive 2006/112. In that regard, it should be specified that, in accordance with Article 17(3) of the Sixth Directive and Article 169(a) of Directive 2006/112, and with the case-law cited in paragraph 32 of this judgment, only turnover, exclusive of VAT, relating to the taxed transactions carried out by the principal establishment, in respect of which VAT would also be deductible if they had been carried out within the Member State in which the branch was located, may be included in the numerator of the fraction which makes up the deductible proportion.

47 It should also be specified that the deductible proportion indicated in the previous paragraph cannot necessarily be classified as a 'proportion applicable to the principal establishment', as referred to in the first question referred. Only transactions carried out by the principal establishment to which the mixed-use expenditure of the branch was allocated are concerned.

48 Morgan Stanley submits that the Member State in which the branch is registered must apply to all its input expenditure, irrespective of its connection with the activity of the principal establishment established in another Member State, the deductible proportion of the branch, determined on the basis solely of the transactions which that branch carries out in the State in which it is registered. However, that interpretation cannot be upheld.

49 For the purposes of calculating the deductible proportion applicable to mixed-use expenditure of a branch, that solution does not take account, contrary to the case-law cited in paragraph 30 of this judgment, of the transactions carried out by the principal establishment of that branch, with which that expenditure has a direct and immediate link.

50 That interpretation is not invalidated by the case-law stemming from the judgment of 12 September 2013, *Le Crédit Lyonnais* (C?388/11, EU:C:2013:541), case-law which Morgan Stanley cites in support of its line of argument. It is true that, in paragraphs 40 and 55 of that judgment, the Court held that, in determining the deductible proportion of VAT applicable to it under the deduction system provided for in Article 17(5) of the Sixth Directive, a company, the principal establishment of which is situated in a Member State, may not take into account the turnover of its branches established in other Member States.

51 In that regard, it should, however, be pointed out that, as is apparent inter alia from paragraph 19 of that judgment, the Court was asked to rule in that case on the possibility of taking into account the total turnover of those branches, understood as all their income. Thus, the Court stated inter alia, in paragraph 38 of the judgment of 12 September 2013, *Le Crédit Lyonnais* (C?388/11, EU:C:2013:541), that taking into account of the turnover of all the fixed establishments which the taxable person has in other Member States, for the purposes of determining the deductible proportion of the principal establishment, would serve to increase, in relation to all the acquisitions which that taxable person carried out in the Member State in which its principal establishment is situated, the proportion of VAT which that principal establishment may deduct, even though some of those acquisitions have no connection with the activities of the fixed establishments located outside that State. Thus, the amount of the applicable deductible proportion would be distorted.

52 It follows that, in that judgment, the Court ruled out taking into account, in calculating the deductible proportion of the principal establishment of a taxable person, the turnover of the branches located in other Member States, on the ground that at least some of that turnover had no connection with the input acquisitions effected by that principal establishment. Consequently, the Court did not intend to rule out, in determining the scope of the right to deduct of a fixed establishment of a taxable person located in a Member State, taking into account transactions carried out by a fixed establishment of that taxable person, located in another Member State, which have a direct and immediate link with expenditure borne by the first of those fixed establishments.

53 Moreover, nor can the calculation of the proportion relating to those transactions carried out by that principal establishment be based on the turnover that that branch achieves with that establishment, as the French Government proposes. As was recalled in paragraph 38 of this judgment, that turnover consists of non-taxable internal flows of funds of the taxable person, while, in accordance with Article 17(5) of the Sixth Directive and Article 173(1) of Directive 2006/112, it is necessary to take account, for the purposes of calculating the deductible proportion, of the taxed and VAT-exempt transactions that a taxable person carries out with third parties.

54 In the light of all of the foregoing considerations, the answer to the first question is that Article 17(2), (3) and (5) and Article 19(1) of the Sixth Directive, and Articles 168, 169 and 173 to 175 of Directive 2006/112 must be interpreted as meaning that, in relation to the expenditure borne by a branch registered in a Member State, which is used, exclusively, both for transactions subject to VAT and for transactions exempt from that tax, carried out by the principal establishment of that branch established in another Member State, it is necessary to apply a deductible proportion resulting from a fraction the denominator of which is formed by the turnover, exclusive of VAT, made up of those transactions alone and the numerator of which is formed by the taxed transactions in respect of which VAT would also be deductible if they had been carried out in the Member State in which that branch is registered, including where that right to deduct stems from the exercise of an option, effected by that branch, consisting in making the transactions carried out in that State subject to VAT.

The second question

55 By its second question, the referring court asks, in essence, how Article 17(2), (3) and (5) and Article 19(1) of the Sixth Directive, and Articles 168, 169 and 173 to 175 of Directive 2006/112 must be interpreted, in order to determine the deductible proportion applicable to the general costs of a branch registered in a Member State, which are used both for transactions carried out by that branch in that State and for transactions of the principal establishment of that branch established in another Member State.

56 In that regard, it should be recalled that the existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to the right to deduct, for the purposes of the case-law cited in paragraph 30 of this judgment, is necessary, in principle, before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement. The right to deduct VAT charged on the acquisition of input goods or services presupposes that the expenditure incurred in acquiring them was a component of the cost of the output transactions that gave rise to the right to deduct (judgment of 14 September 2017, *Iberdrola Inmobiliaria Real Estate Investments*, C?132/16, EU:C:2017:683, paragraph 28 and the case-law cited).

57 Moreover, a taxable person also has a right to deduct even where there is no direct and immediate link between a particular input transaction and an output transaction or transactions giving rise to the right to deduct, where the costs of the services in question are part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such costs do have a direct and immediate link with the taxable person’s economic activity as a whole (judgment of 14 September 2017, *Iberdrola Inmobiliaria Real Estate Investments*, C?132/16, EU:C:2017:683, paragraph 29 and the case-law cited).

58 In those circumstances, where the economic activity of the taxable person consists of both taxed transactions and VAT-exempt transactions, it is necessary to apply to the general costs of that taxable person the deduction system provided for in Article 17(5) of the Sixth Directive and Article 173(1) of Directive 2006/112. In accordance with the reasoning set out in paragraphs 40 to 46 of this judgment, the deductible proportion relating to those general costs must be based on all the economic transactions carried out by the taxable person, following the methodology referred to in Article 19(1) of the Sixth Directive and in Articles 174 and 175 of Directive 2006/112.

59 With respect to the deductible proportion to apply to the general costs of a branch registered in a Member State, where the taxable person carries out transactions in both that State and the Member State in which his principal establishment is established, it is necessary that, in the numerator of the fraction making up that deductible proportion, besides the taxed transactions

carried out by that branch, solely the taxed transactions carried out by that principal establishment must appear, in respect of which VAT would also be deductible if they had been carried out in the State in which that branch is registered.

60 In the light of the foregoing considerations, the answer to the second question is that Article 17(2), (3) and (5) and Article 19(1) of the Sixth Directive, and Articles 168, 169 and 173 to 175 of Directive 2006/112 must be interpreted as meaning that, in order to determine the deductible proportion applicable to the general costs of a branch registered in a Member State, which are used for both transactions of that branch in that State and transactions of the principal establishment of that branch established in another Member State, account must be taken, in the denominator of the fraction which makes up that deductible proportion, of the transactions carried out by both that branch and that principal establishment, it being specified that it is necessary that, in the numerator of that fraction, besides the taxed transactions carried out by that branch, solely the taxed transactions carried out by that principal establishment must appear, in respect of which VAT would also be deductible if they had been carried out in the State in which the branch concerned is registered.

Costs

61 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Fourth Chamber) hereby rules:

1. **Article 17(2), (3) and (5) and Article 19(1) 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, and Articles 168, 169 and 173 to 175 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as meaning that, in relation to the expenditure borne by a branch registered in a Member State, which is used, exclusively, both for transactions subject to value added tax and for transactions exempt from that tax, carried out by the principal establishment of that branch established in another Member State, it is necessary to apply a deductible proportion resulting from a fraction the denominator of which is formed by the turnover, exclusive of value added tax, made up of those transactions alone and the numerator of which is formed by the taxed transactions in respect of which value added tax which would also be deductible if they had been carried out in the Member State in which that branch is registered, including where that right to deduct stems from the exercise of an option, effected by that branch, consisting in making the transactions carried out in that State subject to value added tax.**

2. **Article 17(2), (3) and (5) and Article 19(1) of Sixth Directive 77/388, and Articles 168, 169 and 173 to 175 of Directive 2006/112 must be interpreted as meaning that, in order to determine the deductible proportion applicable to the general costs of a branch registered in a Member State, which are used for both transactions of that branch in that State and transactions of the principal establishment of that branch established in another Member State, account must be taken, in the denominator of the fraction which makes up that deductible proportion, of the transactions carried out by both that branch and that principal establishment, it being specified that it is necessary that, in the numerator of that fraction, besides the taxed transactions carried out by that branch, solely the taxed transactions carried out by that principal establishment must appear, in respect of which value added tax would also be deductible if they had been carried out in the State in which the branch concerned is registered.**

[Signatures]

* Language of the case: French.