Reports of Cases

OPINION OF ADVOCATE GENERAL
KOKOTT
delivered on 22 September 2011 [1]

Case C-524/10

European Commission
v

Portuguese Republic

(Common system of value added tax — Directive 2006/112/EC — Input VAT charged — Flat-rate scheme for farmers — Flat-rate compensation rather than deduction — Flat-rate compensation at nil rate — Conditions)

I – Introduction

1. The common system of value added tax [2] essentially provides for VAT to be levied as generally as possible and at each stage of the production and distribution process. Any undertaking participating in the production or distributions chains is required to add VAT to the net price of its products or services and to pay it to the tax authorities. However, such an undertaking liable to VAT has the right to deduct, i.e. it may deduct the VAT which it has paid to its own suppliers. Consequently, each undertaking only pays VAT on the added value which it creates itself. From an economic point of view, the VAT collected at the different stages is borne by each customer and ultimately solely by the end consumer.

2. The Member States may apply a special scheme, the 'common flat-rate scheme for farmers', to farmers where the application of the normal VAT arrangements is likely to give rise to difficulties. Under that scheme, they may release farmers from the duty to collect VAT, in which case the normal, specifically calculated VAT deduction is replaced by compensation for the input VAT charged, which is calculated on a flat-rate basis.

3. In the present action for failure to fulfil obligations, the European Commission essentially takes issue with the fact that Portugal has fixed the percentage for that flat-rate compensation at a nil rate, with the result that the Portuguese farmers covered by that scheme do not receive any input tax compensation.

1 — Original language: German.

2 — Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1, 'the VAT Directive' or 'the directive').

II – Legislative framework

A – *European Union law*

4. Chapter 7 ('Miscellaneous provisions') of Title XI of the VAT Directive, which is entitled 'Obligations of taxable persons and certain non-taxable persons', contains Article 272(1)(e), which provides that Member States may release taxable persons covered by the common flat-rate scheme for farmers from certain or all obligations referred to in Chapters 2 to 6. These include the duty to identify oneself to the tax authorities as a taxable person for VAT, to issue invoices with VAT, to keep accounts and to submit VAT returns.

5. Chapter 2 of Title XII ('Special schemes') of the VAT Directive, which encompasses Articles 295 to 305, regulates the 'common flat-rate scheme for farmers'.

6. Under Article 296(1) of the directive, where the application to farmers of the normal VAT arrangements, or the special scheme for small enterprises, is likely to give rise to difficulties, Member States may apply to farmers a flat-rate scheme in order to compensate for the VAT payable on their input transactions. The envisaged flat-rate compensation replaces the entitlement to deduct (Article 302). However, a flat-rate farmer may also opt for normal taxation (Article 296(3)).

7. Article 297 of the directive reads as follows:

'Member States shall, where necessary, fix the flat-rate compensation percentages. They may fix varying percentages for forestry, for the different sub-divisions of agriculture and for fisheries.

Member States shall notify the Commission of the flat-rate compensation percentages fixed in accordance with the first paragraph before applying them.'

8. Article 298 of the directive provides:

'The flat-rate compensation percentages shall be calculated on the basis of macro-economic statistics for flat-rate farmers alone for the preceding three years.

The percentages may be rounded up or down to the nearest half-point. *Member States may also reduce such percentages to a nil rate.*' [3]

9. The flat-rate compensation percentages may not have the effect of obtaining for flat-rate farmers refunds greater than the input VAT charged (Article 299). The flat-rate compensation to which the individual flat-rate farmer is entitled is calculated by applying the relevant flat-rate compensation percentage to the net price of the products and services supplied by him (Article 300). The flat-rate compensation is paid either by the customer or by the public authorities (Article 301). Where it is paid by the taxable customer, he may deduct it from the VAT on his own output transactions or claim a refund from the tax authorities (Article 303).

3 — Emphasis added.

B – *Portuguese law*

10. Under Article 9(33) of the Código do Imposto sobre o Valor Acrescentado (VAT Code, 'CIVA'),[4] supplies of goods made in the course of activities listed in Annex A ('List of agricultural production activities') to the CIVA and the agricultural services mentioned in Annex B ('List of agricultural services') are exempt from VAT, provided the supplies are made incidentally by a farmer using his labour force or the equipment normally employed in the agricultural or forestry undertaking operated by him. The abovementioned Annexes A and B correspond, in essence, to Annexes VII and VIII to the VAT Directive.

11. Under Article 29(3) of the CIVA, farmers who effect solely VAT-exempt transactions are exempt from the normal obligation to collect VAT, to issue invoices, to make tax returns and to keep accounts. They may opt for the normal regime, including entitlement to deduct VAT, but they must belong to the chosen regime for a period of five years (Article 12).

III – Facts, pre-litigation procedure and forms of order sought

12. By letter of 6 June 2008 the Commission informed the Portuguese authorities that it considered the optional scheme for farmers which applied in Portugal to be incompatible with the common flat-rate scheme under the VAT Directive. The Portuguese scheme made no provision for input tax compensation, but in reality simply laid down an exemption for agricultural activities, combined with no possibility of deducting VAT.

13. In their reply of 20 August 2008 the Portuguese authorities disputed the existence of an infringement: the second sentence of the second paragraph of Article 298 of the VAT Directive expressly permits the Member States to fix the flat-rate compensation percentage at a nil rate, irrespective of the amount of input VAT paid by the flat-rate farmers. The Portuguese scheme is also consistent with the aims of the common flat-rate scheme for farmers, in particular the aim of simplification. In addition, the contested scheme is comparable with an exemption without entitlement to deduct. Furthermore, the Member States may freely choose the form and method of implementation of directives, with the result that there is nothing to preclude the Portuguese scheme.

14. As the Commission was not persuaded by these arguments, it sent the Portuguese Republic a reasoned opinion on 26 June 2009, in which it maintained that the Portuguese scheme was not compatible with Articles 296 to 298 of the VAT Directive.

15. By letter to the Commission of 31 August 2009, the Portuguese Republic declined to comply with the reasoned opinion, and maintained its position.

16. The Commission continues to take the view that the Portuguese scheme infringes European Union law and by the present action, which was received at the Court on 11 November 2010, therefore claims that the Court should:

1. declare that, in applying to farmers a special scheme which derogates from the directive and which exempts them from the payment of VAT and applies a zero rate flat-rate compensation to them whilst at the same time making a substantial negative compensation in its own resources to offset the levying of VAT, the Portuguese Republic has failed to comply with Articles 296 to 298 of the VAT Directive;

2. order the Portuguese Republic to pay the costs.

4 — As amended by Decree-Law No 195/89 of 12 June 1989, re-published by Decree-Law No 102/2008 of 20 June 2008 (as published in Corrigendum No 44-A/2008 of 13 August 2008).

17. The Portuguese Republic contends that the Court should

1. dismiss the action;

2. order the Commission to pay the costs.

18. After the conclusion of the written procedure, a hearing was held on 14 September 2011.

IV – Legal assessment

A – *The complaint relating to the zero flat-rate compensation*

1. The interpretation of the second sentence of the second paragraph of Article 298 of the directive

19. In order to resolve the present dispute, it is necessary to clarify, first and foremost, under what conditions the Member States, including Portugal, are entitled, under the VAT Directive, to provide for flat-rate compensation at a nil rate in connection with the flat-rate scheme for farmers. The effect of such a zero rate is that there is no compensation for the VAT charged on the farmers' input transactions.

a) The wording of the second sentence of the second paragraph of Article 298 of the directive

20. Portugal considers a nil rate to be perfectly permissible and refers to the wording of the second sentence of the second paragraph of Article 298 of the directive. That provision expressly states that 'Member States may also reduce such percentages to a nil rate'.

21. The Commission takes the view, however, that this should not be understood as a carte blanche. A nil rate is permissible only under certain conditions, namely where the flat-rate compensation percentage calculated in accordance with the directive is close to zero or where the farmers' input transactions are tax-exempt, with the result that there is nothing to offset.

22. There is no support in the wording of the second sentence of the second paragraph of Article 298 of the directive for such a restriction of the possibility given to the Member States to reduce the flat-rate compensation percentage to a nil rate. However, the wording does not rule out the strict interpretation advocated by the Commission either. It is therefore necessary to consider the general structure and the purpose and objectives of the provision [5] and its drafting history [6] to obtain further guidance as to how that provision is to be interpreted.

b) The drafting history of the second sentence of the second paragraph of Article 298 of the directive

23. As regards the drafting history of the second sentence of the second paragraph of Article 298 of the directive, to which the parties pay particular attention, it should be stated, first of all, that the fourth sentence of the first subparagraph of Article 25(3) of Sixth Council Directive 77/388, [7] which was recast in the VAT Directive, provided from the outset that 'Member States shall have the option of reducing such percentages to a nil rate'.

5 — See Case C-321/02 *Harbs* [2004] ECR I-7101, paragraph 28; Case C-43/04 *Stadt Sundern* [2005] ECR I-4491, paragraph 24; and Case C-518/07 *Commission* v *Germany* [2010] ECR I-1885, paragraph 17.

6 — See Case C-533/07 *Falco Privatstiftung and Rabitsch* [2009] ECR I-3327, paragraph 20; Case C-199/08 *Eschig* [2009] ECR I-8295, paragraph 58; and Case C-203/09 *Volvo Car Germany* [2010] ECR I-10721, paragraph 40.

7 — 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).

24. Apparently, this provision dates back to an amendment to the original Commission draft directive [8] which was proposed by Ireland. In the 'final compromise text' on the special scheme for farmers, [9] prepared by the Commission in the course of the discussions on its draft and sent to delegations with the Council Note (R/2892/1/76(fin 758 rev.1) of 7 December 1976, which includes 'a number of amendments made at the Permanent Representatives Committee meeting on 3 December 1976', there is a new fourth sentence of the first subparagraph of Article 27(3), [10] under which 'Member States shall have the option of reducing such refunds to a nil rate'. It is stated in a footnote that the Permanent Representatives Committee agreed to add this phrase at the request of the Irish delegation.

25. Council Note R/3260/76 (FIN 892) of 21 December 1976 [11] on the meetings of the Permanent Representatives Committee on 3 and 8 December 1976 then states that 'all delegations were in favour of Member States having the option of reducing the refunds in question to zero'.

26. However, a letter sent to the Council by the Permanent Representative of Ireland on 19 November 1976 [12] concerning Article 27 of the Sixth Directive on VAT – Special scheme for farmers — does not contain the proposal in question and does not allow conclusions to be drawn as to the ideas behind it. It is merely stated, in fairly general terms, that 'the present text raises major difficulties for Ireland. The Commission has been informed of these difficulties with a view to having the draft adapted ...'

27. The Commission argues in the present case that the provision in question can be explained in particular by the fact that at the time certain Member States, including Ireland, had a zero-rate on agricultural inputs and Directive 77/388 continued to permit this, albeit only within strict limits. [13] For such situations the Council accorded the Member States the option of providing for a zero flat-rate compensation.

28. On the other hand, the flat-rate compensation necessarily presupposes the payment of input VAT, [14] with the result that where input transactions are zero-rated, a flat-rate compensation percentage of more than zero is not possible from the outset and no express authorisation is therefore required. Furthermore, at the time the provision in question was incorporated into the draft version of Directive 77/388, Article 27(3) [15] already provided for the Member States to fix the flat-rate compensation percentages 'where necessary'. If a zero-rate applies to the input transactions, it is not necessary and there is also no need for authorisation to apply a zero flat-rate compensation.

29. Portugal refers to the Commission's explanatory memorandum for its original draft directive of June 1973, [16] in which the Commission itself states with regard to paragraphs 4 and 5 of Article 27 ('flat-rate scheme for farmers') that the Member States may freely fix the flat-rate compensation percentages within the upper limits fixed under paragraph 3. The word 'freely' ('*frei*') does not appear in the German version of the explanatory memorandum for the draft, although the French text states '*peuvent librement fixer*', the English 'may freely fix', the Italian '*possono liberamente fissare*' and the Dutch '*vrijelijk kunnen vaststellen*'.

8 — COM(73) 950 final, available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/COM(1973) 950_en.pdf

9 — Sent to the delegations with Council Note R/2892/1/76 (FIN 758) rev. 1 of 7 December 1976, available at http://www.consilium.europa.eu/uedocs/cmsUpload/226.pdf. The German, Danish, Italian, Dutch and English versions are dated 8 December 1976.

10 — Subsequently Article 25 of Directive 77/388.

11 — Available at http://www.consilium.europa.eu/uedocs/cmsUpload/227.pdf. The German version is dated 23 December 1976, whilst the Danish, Italian, Dutch and English versions are dated 22 December 1976.

12 — Council document R/2855/76 (FIN 750) of 23 and 24 November 1976, available at http://www.consilium.europa.eu/uedocs/cmsUpload/222.pdf

13 — The Commission refers inter alia to Case 415/85 *Commission* v *Ireland* [1988] ECR 3097, paragraphs 29 and 30. In that case the Commission had complained, among other things, that Ireland had zero-rated animal feedingstuff, fertilizer and seeds, but the Court considered the nil rate on these agricultural inputs to be compatible with Directive 77/388.

14 — See Case 415/85 *Commission* v *Ireland,* cited in footnote 13, paragraph 25.

15 — Which became Article 25(3) of Directive 77/388 and later Article 297(1) of the VAT Directive.

16 — See footnote 8.

30. The apparent generosity here is surprising. If the Commission had actually wished to give the Member States absolute freedom below the abovementioned upper limits, there would have been nothing easier for it and for the Council than to make such provision in the text of the directive. That did not happen, however. Instead, only at a very late stage in the negotiations did the Council agree, on the insistence of Ireland, on a provision which is much less clear as regards the margin of discretion enjoyed by the Member States.

31. Furthermore, at the time it was considering the Irish proposal for an amendment, the Council also dealt with an addition to the first subparagraph of Article 27(3) proposed by the German Permanent Representation,[17] which considered it to be 'absolutely important',[18] to the effect that the flat-rate compensation percentages may be rounded up or down to the nearest half point. That proposal was incorporated as the fifth sentence of the provision.[19] If the delegations had taken the view, at the time of the original draft directive or at the latest after the addition of the fourth sentence at the instigation of Ireland, that the Member States were completely free to fix the flat-rate compensation percentage, below an upper limit, a rounding-off rule would not have been necessary. Rather, the strict requirements of the rounding-off rule suggest that the Member States do not enjoy completely free discretion.

32. The Commission's arguments in the explanatory memorandum for the original draft directive cannot therefore be crucial in determining the way in which the provision at issue is to be interpreted.

33. The drafting history of the second sentence of the second paragraph of Article 298 of the VAT Directive does not therefore offer any clear guidance whether it is to be interpreted as advocated by the Commission or as advocated by Portugal.

c) The general structure and the purpose and objectives

i) The general structure concerned

34. Certain structural considerations have already been mentioned in the statements on drafting history.

35. It has thus already been stated that in any case provision is made for flat-rate compensation percentages to be fixed under the first paragraph of Article 297 of the directive[20] only where necessary. If VAT is not charged on agricultural inputs, this is not necessary and there would essentially be no need for the second sentence of the second paragraph of Article 298 of the directive in order to be able to fix a zero compensation rate.

36. With this in mind, Article 299 of the directive[21] provides that the flat-rate compensation percentages may not have the effect of obtaining for flat-rate farmers refunds greater than the input VAT charged. It is thus ensured that the flat-rate scheme for farmers does not contain an aid element.[22]

17 — Telex of 19 November 1976 to the Council, Council document R/2847/76 (FIN 747) of 22 and 24 November 1976, available at http://www.consilium.europa.eu/uedocs/cmsUpload/222.pdf.

18 — See Council document R/2892/1/76 (FIN 758) rev. 1 of 7 December 1976 (cited in footnote 9).

19 — See the fifth sentence of the first subparagraph of Article 25(3) of Directive 77/388 and the first sentence of the second subparagraph of Article 298 of the VAT Directive.

20 — Previously the first sentence of Article 25(3) of Directive 77/388.

21 — The draft version of Directive 77/388 contains such a provision in the third sentence of the first subparagraph of Article 27(1), before the fourth and fifth sentences were added; see Council document R/2892/1/76 (FIN 758) rev. 1 of 7 December 1976 (cited in footnote 9).

22 — See, for similar arguments by the Commission in connection with the original draft of Directive 77/388 (cited in footnote 8), but with regard to Article 27(11) of that draft, the explanatory memorandum annexed thereto, according to which excessive compensation would amount to economic aid. See also Case 3/86 *Commission* v *Italy* [1988] ECR 3369, paragraph 14.

37. These two structural aspects tend to suggest that the second sentence of the second paragraph of Article 298 of the directive lays down an autonomous provision and seeks to grant the Member States the option of zero-rated compensation even where VAT is charged on input transactions.

38. On such an interpretation, however, it is difficult to imagine that 'major difficulties' for Ireland resulting from the zero taxation rate applicable there on agricultural inputs could have been the reason for that provision. At the time when Ireland was claiming 'major difficulties',[23] the draft version of Directive 77/388 already contained a provision similar to Article 299 of the VAT Directive,[24] and when, as proposed by Ireland, the precursor to the second sentence of the second paragraph of Article 298 of the VAT Directive was added to the draft version of Directive 77/388,[25] the precursor to the first paragraph of Article 297 of the VAT Directive[26] stated that Member States must fix the flat-rate compensation percentages only 'where necessary'.[27]

39. The abovementioned rounding-off rule in the first sentence of the second paragraph of Article 298 of the directive nevertheless tends to indicate that the second sentence should not be understood to mean that the fixing of a nil rate is unconditional. If the Member States were actually free, under the second sentence of the second paragraph of Article 298 of the directive, which is in the drafting history older, to provide for zero compensation despite a considerable VAT burden, there would be no need for a provision which gives authorisation to round up or down to the nearest half-point the flat-rate compensation percentage calculated on the basis of certain parameters.

40. From a structural point of view, however, the second sentence is again not purely a complement to the first sentence in the sense that rounding-off can also produce a nil rate. First, the order of those sentences was the other way round in Directive 77/388; second, the historical sequence of the insertion of those sentences in the draft version of Directive 77/388 precludes such a view and, third, it is logical that rounding-off can also produce a nil rate. It should be pointed out, for the sake of completeness, that the word 'also' in the second sentence of the second paragraph of Article 298 of the VAT Directive is an innovation of that directive. Since, however, that change is not listed in the provisions governing transposition and entry into force in accordance with the third recital in the preamble to that directive,[28] a substantive amendment was not therefore intended. No further guidance as to the interpretation required here can be derived from this purely editorial amendment.

41. Since the structural considerations discussed above do not point the interpretation of the second sentence of the second paragraph of Article 298 of the VAT Directive clearly in either direction, that provision must be placed in its broader context, and an examination of the purpose and objectives of the flat-rate scheme for farmers must also be undertaken.

23 — See the letter from the Permanent Representative of Ireland of 19 November 1976 (cited in footnote 12).

24 — The third sentence of the first subparagraph of Article 27(3), which became the third sentence of the first subparagraph of Article 25(3) of Directive 77/388.

25 — As the fourth sentence of the first subparagraph of Article 27(3), which became the fourth sentence of the first subparagraph of Article 25(3) of Directive 77/388.

26 — The first sentence of the first subparagraph of Article 27(3), which became the first sentence of the first subparagraph of Article 25(3) of Directive 77/388.

27 — See the different stages of the drafting process, which can be seen from Council documents R/2514/76 (FIN 663) of 22 October 1976 (the German version is dated 27 October 1976), available at http://www.consilium.europa.eu/uedocs/cmsUpload/219.pdf, R/2892/1/76 (FIN 758) of 25 November 1976 (the German version is dated 1 December 1976), available at http://www.consilium.europa.eu/uedocs/cmsUpload/222.pdf, and R/2892/1/76 (FIN 758) rev. 1 of 7 December 1976 (cited in footnote 9).

28 — See Article 412 of the directive.

ii) The broader context and the purpose and objectives of the flat-rate scheme

42. The flat-rate scheme for farmers is one of the special schemes of the common system of value added tax and, as such, is to be interpreted strictly. [29]

43. As is intimated by the title of the relevant Chapter 2 of Title XII of the VAT Directive: 'Common flat-rate scheme for farmers', and as is clarified by Articles 296 and 302 in conjunction with Article 272(1)(e) of the directive, the purpose of that special scheme is that the farmers in respect of whom the normal scheme or even the special scheme for small enterprises is likely to give rise to difficulties are intended to be able to obtain a flat-rate compensation for VAT on their input transactions. [30] That scheme is devised in such a way that the farmers covered by it do not levy and pay any VAT on their output transactions, but in return also do not have any right to deduct. Instead, the input VAT is to be offset on a flat-rate basis.

44. It should be borne in mind in this connection that, in accordance with settled case-law, the right to deduct VAT is a fundamental principle of the common system of VAT [31] and in principle may not be limited. [32] The right to deduct ensures the neutrality of VAT. [33]

45. Flat-rate compensation does not achieve VAT neutrality on an individual basis like the entitlement to deduct, but the basic idea of the scheme is to ensure neutrality of VAT for the group of flat-rate farmers as a whole [34] and to be as close to it as possible on an individual basis. This is achieved by the flat-rate compensation percentages which, according to Article 295(1)(7) of the directive, are intended to offset the input VAT charged, being calculated under the first paragraph of Article 298 of the directive on the basis of macro-economic statistics relating to that group [35] and then being applied under Article 300 of the directive to the output transactions of the individual flat-rate farmer.

46. Unlike the case of taxable persons coming under the normal arrangements, the flat-rate scheme for farmers means that no VAT is levied on their output transactions, and it might therefore be asked why there should be any compensation for the input VAT charged where, as Portugal argues, there is also no entitlement to deduct in the case of VAT-exempt output transactions under Article 168 of the directive.

47. However, the special scheme for farmers was specifically not conceived as a form of tax exemption. Because, as the Commission argues, farmers are generally among the first links in long production and distribution chains, leading to the final consumer, [36] the result of a simple exemption of their output transactions would be that the VAT charged on their input transactions would be passed on as hidden VAT and VAT would also be levied on the relevant tax amounts at later stages, so that there would be multiple taxation and the neutrality of the VAT system would be jeopardised.

29 — Case C-321/02 *Harbs*, cited in footnote 5, paragraph 27, and Case C-43/04 *Stadt Sundern*, cited in footnote 5, paragraph 27; see, with regard to the special scheme for small enterprises, Case C-128/05 *Commission* v *Austria* [2006] ECR I-9265, paragraph 22, and my Opinion in Case C-97/09 *Schmelz* [2010] ECR I-10465, point 32.

30 — See also recital 50 in the preamble to the directive.

31 — Case C-25/07 *Sosnowska* [2008] ECR I-5129, paragraph 14; Case C-392/09 *Uszodaépítő* [2010] ECR I-8791, paragraph 15; and Case C-107/10 *Enel Maritsa Iztok 3* [2011] ECR I-3873, paragraph 31.

32 — Case C-371/07 *Danfoss and AstraZeneca* [2008] ECR I-9549, paragraph 26; Case C-368/09 *Pannon Gép Centrum* [2010] ECR I-7467, paragraph 37; and Case C-277/09 *RBS Deutschland Holdings* [2010] ECR I-13805, paragraph 39.

33 — Case C-371/07 *Danfoss and AstraZeneca*, paragraph 26; Case C-392/09 *Uszodaépítő*, paragraph 35; and Case C-438/09 *Dankowski* [2010] ECR I-14009, paragraph 24.

34 — See Article 295(1)(6) and (7).

35 — See Case 3/86 *Commission* v *Italy*, cited in footnote 22, paragraph 8.

36 — In Case 415/85 *Commission* v *Ireland*, cited in footnote 13, paragraph 29, and Case 416/85 *Commission* v *United Kingdom* [1988] ECR 3127, paragraph 20, the Court nevertheless regarded the supply of means of agricultural production in connection with the question whether their supply may exceptionally continue to be zero-rated as sufficiently close to the final consumer.

48. Specifically to avoid such effects of flat-rate compensation, Article 303 of the directive provides that where, rather than the Treasury, the VAT-liable customer pays the flat-rate compensation to the farmer, the customer may deduct that amount from the VAT on his own output transactions or may claim a refund of the amount. It is thus ensured that no hidden VAT is passed on.

49. However, the second sentence of the second paragraph of Article 298 of the directive makes it possible to rule out input tax compensation completely since the flat-rate compensation percentage can also be fixed at a nil rate. This is not an exception to the exception, which takes us back to the fundamental rule and would therefore have to be interpreted broadly,[37] but the VAT treatment of flat-rate farmers is thus even further removed from the normal arrangements than is the case already. The second sentence of the second paragraph of Article 298 of the directive must therefore be given a strict interpretation.

50. According to the explanatory memorandum for the original Commission draft, the common flat-rate scheme for farmers is 'only one technical and practical method of applying value added tax', aimed at allowing flat-rate farmers to offset at a flat rate the deductible tax. It was introduced as a transitional scheme in order, above all, to relieve small agricultural holdings of the formalities which are necessary under the normal arrangements.[38]

51. In order to ensure that the European Union's own resources are collected fairly and to avoid the application of value added tax in the various Member States leading to distortions of competition, the common flat-rate scheme must not, according to the explanatory memorandum on the original draft, include financial advantages or disadvantages for the totality of flat-rate farmers.[39] It is clear that application of the flat-rate scheme would not have the same consequences — as regards the collection of the European Union's own resources and the conditions of competition between farmers of different Member States — if flat-rate farmers in one such State were entitled to offset tax at a flat-rate when flat-rate farmers in other States were not entitled to offset tax in this way.[40]

52. Even though the original draft directive has been amended in many respects, I believe that the cited passages of the relevant explanatory memorandum still accurately describe the purpose and objectives of the common flat-rate scheme for farmers. If a Member State could freely decide, despite a considerable VAT burden, not to grant flat-rate compensation, the common flat-rate scheme would be otiose. Such an interpretation would not therefore be consistent with the purpose and objectives of the scheme.

53. Portugal claims, however, that the primary aim of the common flat-rate scheme for farmers is to simplify the VAT system for flat-rate farmers and that its scheme meets that aim by achieving maximum simplification. Using figures for 2005, Portugal states that its agriculture consists almost exclusively of very small family farms, the level of education is very low in some cases, and almost 50% of farmers are already older than 65. A positive flat-rate compensation percentage would inevitably entail certain minimum obligations for farmers, in particular keeping accounts and issuing invoices.

54. There is no question that the common flat-rate scheme, as follows in particular from Article 296(1) in conjunction with Article 272(1)(e) of the directive, has the aim of simplifying the VAT system for certain farmers.[41] However, the directive does not provide for simplification at any price. Instead, simplification is linked to a mechanism which ensures the neutrality of VAT as far as possible by means of flat-rate compensation for VAT charged on inputs.

37 — See Case C-305/01 *MKG-Kraftfahrzeuge-Factoring* [2003] ECR I-6729, paragraph 72, and Case C-175/09 *Axa UK* [2010] ECR I-10701, paragraph 30.

38 — See the draft explanatory memorandum, cited in footnote 8, at Article 27(1), (6), (12), (13) and (16).

39 — See the draft explanatory memorandum cited in footnote 8 at Article 27(1).

40 — See the draft explanatory memorandum cited in footnote 8, at Article 27(2), fourth and fifth indents.

41 — See also Case C-43/04 *Stadt Sundern*, cited in footnote 5, paragraph 28.

d) Interim conclusion

55. Against this background, and in view of the fact that the second sentence of the second paragraph of Article 298 of the directive is to be interpreted strictly, the purpose and objectives of the common flat-rate scheme for farmers require that provision to be interpreted to the effect that it does not accord the Member States a completely free margin of discretion to fix the flat-rate compensation percentage at a nil rate, irrespective of the amount of input VAT actually payable. Rather, such a nil rate is permissible only where it is justified by the VAT burden, because it either does not exist or is so small that it may be ignored.

e) The argument relating to the inadmissibility of a corrective interpretation

56. Portugal invokes, against an interpretation of this kind, the judgment in *Commission* v *United Kingdom* of 15 July 2010.[42] The Court held that a Member State whose national law complies with the clear and precise wording of a provision of a directive cannot be accused of failing to comply with that provision because it allegedly failed to interpret that provision with the aim of correcting it, in order to comply with the overall logic of the common system of VAT and to remedy an error of the European Union legislature.

57. That case ultimately concerned the question whether the United Kingdom was required to understand and apply Article 2(1) of the Thirteenth VAT Directive 86/560/EEC,[43] which merely refers to Article 169(a) and (b) of the VAT Directive, also as referring to Article 169(c). The Commission based its arguments on the drafting history, the general structure and the purpose of the relevant provisions. However, the Court could not concur with the Commission's argument that an actual error had been made and pointed out that even assuming it had been made and the Commission's reading were consistent with the logic of the common system of VAT, it was not for the Court to make such a corrective interpretation.[44]

58. In the present case, however, the situation appears to be different. The second sentence of the second paragraph of Article 298 of the VAT Directive is much less clear than the provision at issue in *Commission* v *United Kingdom* and, on account of the general structure and the purpose and objectives of the common flat-rate scheme, which includes that provision, the question which really arises is when a nil rate may be fixed. As I have explained, according to a teleological interpretation consistent with the wording, the second sentence of the second paragraph of Article 298 of the directive does not allow the Member States absolute freedom. Certainly, a clearer wording for the provision would have been more in keeping with the principle of legal certainty. Nevertheless, it was possible to determine the tenor of that provision using the normal methods of interpretation and, on the basis of that interpretation, a national provision under which, despite a considerable VAT burden, no flat-rate compensation is granted is not compatible with it.

2. The existence of a considerable VAT burden

59. It having been established that the Member States do not have free discretion, irrespective of the actual VAT burden of flat-rate farmers, to fix flat-rate compensation at a nil rate, it must next be examined whether it is 'necessary' in Portugal to grant a flat-rate compensation or whether the VAT burden of the flat-rate farmers amounts to zero or is close to zero.

42 — Case C-582/08 *Commission* v *United Kingdom* [2010] ECR I-7195, paragraph 48.

43 — Thirteenth Council Directive 86/560/EEC of 17 November 1986 on the harmonisation of the laws of the Member States relating to turnover taxes — Arrangements for the refund of value added tax to taxable persons not established in Community territory (OJ 1986 L 326, p. 40).

44 — Case C-582/08 *Commission* v *United Kingdom*, cited in footnote 42, paragraph 28 et seq., paragraphs 36 and 46.

60. In its application, the Commission points out that under the CIVA most agricultural input transactions in Portugal are subject to a tax rate of 6% and machinery, equipment and fuel are subject to a tax rate of 13%. This was essentially confirmed by Portugal in its defence.

61. The Commission also stated that the amount of input VAT that Portuguese flat-rate farmers could not have deducted in 2004 and 2005 was equivalent to 5.3% and 7.9% of their sales. The Portuguese authorities indicated this to the Commission in an audit of own resources for those years which it conducted in Portugal in November 2007.

62. The source and accuracy of these figures are, on points of detail, disputed by the parties. In its reply, however, the Commission rightly points out that the present case is not concerned with determining the actual flat-rate compensation percentages, but the question whether the conditions for fixing zero compensation are met. The Commission has sought to show, on the basis of these figures, that the VAT burden on flat-rate farmers is considerable. Portugal has not substantiated its challenge to that assertion which, in view of the VAT rates applicable to agricultural input transactions in Portugal, is also plausible.

63. It must therefore be concluded that Portugal applies a zero flat-rate compensation even though the input transactions of the Portuguese flat-rate farmers are subject to a considerable VAT burden and it is thus necessary to offset that VAT.

3. The other arguments put forward in Portugal's defence

a) Flat-rate compensation only where the agricultural sector is in tax credit

64. Portugal claims that under the flat-rate scheme the Member States may also take into account the VAT which the flat-rate farmers would be required to pay if they were subject to the normal scheme. It evidently takes the view that a positive flat-rate compensation must be considered only where under the normal scheme the input VAT would exceed the tax payable and the totality of the flat-rate farmers would be in tax credit vis-à-vis the State. If the normal scheme were applied in Portugal, however, the tax payable would exceed the deductible VAT. The zero compensation is therefore consistent with budgetary rationality and does not entail any disadvantages for flat-rate farmers.

65. As the Commission rightly argues in its reply, however, there is nothing in the directive to suggest that a positive flat-rate compensation would have to be granted only in the atypical case that the input VAT burden of the economic sector as a whole exceeded the VAT on the output transactions that would be payable if the normal scheme were applied. If the position taken by Portugal is adopted, the flat-rate scheme would be far removed from the normal scheme and the associated option to deduct VAT; the passing-on of hidden VAT would not, as a rule, be prevented.

66. In so far as purely budgetary considerations might lie behind Portugal's arguments, it should also be pointed out that the common flat-rate scheme for farmers is merely an optional special scheme and that Member States are not required to avail themselves of it. If, however, they decide to apply the special scheme, their implementing provisions must remain within the limits stipulated by the VAT Directive. Portugal's argument that it is for the Member States to choose the form and means of implementation therefore also comes to nothing.

b) No change in the VAT situation of the agricultural sector.

67. Portugal also claims that the Commission is wrong in its view that the VAT situation of the agricultural sector in Portugal has changed in such a way that, unlike previously, a zero flat-rate compensation is now no longer possible. Even though the tax rates have changed, the situations in 1989, when Portugal should have adapted to Directive 77/388 after a transitional period, and today are comparable in terms of the taxation of input and output transactions. Even if a significant change were to be assumed, it took place 17 years previously when Portugal abolished zero-rating on various agricultural inputs in 1992.

68. It is sufficient in this regard to refer to settled case-law, according to which the question whether a Member State has failed to fulfil its obligations must be determined by reference to the situation prevailing in the Member State at the end of the period laid down in the reasoned opinion,[45] and it is solely for the Commission to decide whether[46] and when[47] it initiates proceedings for failure to fulfil obligations. It is not therefore necessary to ascertain the situation in 1989 and in 1992.

c) Compensation by other means

69. Lastly, Portugal claims that, if it is in fact to be granted, the flat-rate compensation is not fiscal in nature, unlike the entitlement to deduct. Rather, it is intended solely to give the flat-rate farmers financial compensation for their operational costs. In Portugal this is nearly always done by means of aid, indemnification, premiums and other State subsidies.

70. However, the common flat-rate scheme for farmers is undoubtedly part of the common system of value added tax, as laid down in the directive. It is not tenable, in my view, to regard this special scheme, in so far as it provides for flat-rate compensation, as non-fiscal. Furthermore, the need for the uniform application of that system does not permit aid or other State subsidies to be chosen as a substitute for insufficient input tax compensation.

4. Conclusion

71. It must therefore be concluded that, by fixing the flat-rate compensation percentage at a nil rate, even though the input VAT payable by the flat-rate farmers is neither zero nor close to zero, Portugal has infringed the common flat-rate scheme for farmers.

B – *The complaint relating to calculation of own resources*

72. By its claim, the Commission not only objects to the abovementioned special scheme which Portugal applies to flat-rate farmers, but also complains that Portugal makes a considerable negative compensation in own resources to offset the levying of VAT.

73. Unlike the complaint concerning the special scheme, both parties deal with this second part of the Commission's claim only in passing in their written pleadings.

45 — Case C-494/01 *Commission* v *Ireland* [2005] ECR I-3331, paragraph 29; Case C-333/08 *Commission* v *France* [2010] ECR I-757, paragraph 55; and Case C-20/09 *Commission* v *Portugal* [2011] ECR I-2637, paragraph 31.

46 — Case C-233/00 *Commission* v *France* [2003] ECR I-6625, paragraph 31; Case C-266/03 *Commission* v *Luxembourg* [2005] ECR I-4805, paragraph 35; judgment of 21 January 2010 in Case C-17/09 *Commission* v *Germany*, paragraph 20; and Case C-306/08 *Commission* v *Spain* [2011] ECR I-4541, paragraph 66.

47 — Case C-333/99 *Commission* v *France* [2001] ECR I-1025, paragraph 25; Case C-297/08 *Commission* v *Italy* [2010] ECR I-1749, paragraph 87; Case C-350/08 *Commission* v *Lithuania* [2010] ECR I-10525, paragraph 33; and Case C-306/08 *Commission* v *Spain*, cited in footnote 46, paragraph 66.

74. The Commission devoted to it only one short paragraph in its application. The Commission states that the present case does not seek to establish the extent to which Portugal has failed to fulfil its obligations in connection with the collection of own resources, although it should be pointed out that the Commission could demand an additional payment plus interest in the event that Portugal has infringed the directive and this has resulted in a reduction in the European Union's own resources. In its statements on the interpretation of Article 298 of the directive, the Commission pointed out, somewhat incidentally, that in 2004 Portugal made a negative compensation of approximately EUR 70 million in connection with the calculation of own resources in order to take account of the input VAT not deducted by the flat-rate farmers.

75. In its defence Portugal is equally brief on this point. The present proceedings stem from differences between the Commission and Portugal regarding the correct calculation of own resources in connection with the special scheme for farmers; however, as the Commission itself states, this is not the subject of these proceedings. Even if the Court were to concur with the interpretation of the common flat-rate scheme advocated by the Commission, this could not lead to an increase in Portugal's contribution to own resources, since the maximum level has already been reached. In its rejoinder, Portugal also points out that the Commission relied on provisions of Sixth Directive 77/388 on the calculation of own resources in connection with the common flat-rate scheme for farmers [48] which had not been applied for some time, and at least since the entry into force of Regulation No 1553/89, [49] and which also had no counterpart in the VAT Directive.

76. Portugal has not expressly disputed that it made a negative compensation in own resources having regard to the scheme which it applies to flat-rate farmers, specifically in 2004. However, in view of the Commission's statements reproduced above and confirmed again upon request at the hearing, according to which the present case does not concern the collection of own resources, this cannot be held against Portugal. It follows from Article 38(1)(c) of the Rules of Procedure of the Court of Justice and from the case-law relating to that provision that the application initiating proceedings must state the subject-matter of the dispute and a summary of the pleas in law on which the application is based and that that statement must be sufficiently clear and precise to enable the defendant to prepare its defence and the Court to rule on the application. It is therefore necessary for the points of law and of fact on which a case is based to be indicated coherently and intelligibly in the application itself. [50] These conditions are not met by the Commission's application as regards the second part of its claim.

77. Since the Commission has not expressly withdrawn the second part of its claim and a ruling on it must therefore be given, it must be rejected as inadmissible in the absence of sufficient grounds.

V – Costs

78. Since both parties have applied for the other to be ordered to pay the costs, and both have been partially unsuccessful in their pleadings, I propose that each party should bear its own costs in accordance with Article 69(3) of the Rules of Procedure.

48 — Article 25(12) in conjunction with Annex C to Sixth Directive 77/388.

49 — Council Regulation (EEC, Euratom) No 1553/89 of 29 May 1989 on the definitive uniform arrangements for the collection of own resources accruing from value added tax (OJ 1989 L 155, p. 9).

50 — Case C-412/04 *Commission* v *Italy* [2008] ECR I-619, paragraph 103; Case C-165/08 *Commission* v *Poland* [2009] ECR I-6843, paragraph 42; and Case C-267/09 *Commission* v *Portugal* [2011] ECR I-3197, paragraph 25.

VI – Conclusion

79. I propose that the Court should:

(1) declare that, in applying to farmers a special scheme which derogates from the directive and which exempts them from the payment of VAT and applies flat-rate compensation at a nil rate to them, the Portuguese Republic has infringed Articles 296 to 298 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax;

(2) dismiss the action as to the remainder;

(3) order each party to bear its own costs.