OPINION OF ADVOCATE GENERAL MISCHO

delivered on 7 June 2001 [1]

1. Every finance manager may, at any given moment, and even if the situation of the entity concerned is fundamentally healthy, find himself confronted with delicate problems when receipts of funds from day to day do not correspond to the outgoings he must face. It is the way in which the Italian Republic intended to deal with such a discrepancy that requires it today to explain itself to the Court with respect to a failure to fulfil obligations with which it is charged by the Commission of the European Communities.

2. As the Government of that Member State explains, 'in 1993 the Italian State was obliged to deal with the direct loss of receipts as a result of the failure to collect VAT on imports at customs.

It therefore considered it appropriate to provide, in respect of a limited category of taxable persons (namely, those who during the preceding year had declared intra-Community imports in excess of 10% of their total imports), that their tax credits would be refunded by means of Government bonds and not carried forward for deduction in the following years.

Giving refunds by way of Government bonds valid from 1 January 1994 to this category of taxable persons who, before customs borders were opened, guaranteed immediate tax receipts therefore enabled the tax authorities to ensure the stability of internal receipts in respect of the financial year 1993 likewise.'

3. The measures adopted by the Italian Republic appear in two successive texts. In the first place, there is Decree-Law No 16 of 23 January 1993 (GURI No 18 of 23 January 1993), which became Law No 75 of 24 March 1993 (GURI No 69 of 24 March 1993).

4. Article 11(1) and (2) of the latter provide:

'Taxable persons who, during 1992, imported goods and services from other Member States the value of which exceeded

1 — Original language: French.

10% of their total transactions for that year, and who declared a VAT credit of not less than ITL 100 000 000, may not carry that credit forward and deduct it in subsequent years ... .

Articles 10(1) and (2) apply to the discharge of the credits referred to in Article 11(1) ... [those provisions govern the discharge of credits arising from the settlement of annual income tax returns and VAT by issuing Government bonds to the taxable persons concerned]. In that case, the application [for a refund of VAT by the issue of Government bonds] must be submitted by 31 March 1993 at the latest; the time-limit for performing verification procedures is 30 June 1993; interest on credits is to be calculated to 31 December 1993; Government bonds are to be drawn with effect from 1 January 1994; the maximum value of bonds may not exceed ITL 7 500 billion, that expense to be allocated to the appropriate entry in the budget of the Ministry for the Treasury for the 1993 financial year; the Minister for the Treasury's decree concerning the characteristics, the conditions and the procedure for the issue of the Government bonds is to be published in the Official Journal by 30 November 1993 at the latest.'

5. Those particular refund arrangements were extended by Decree-Law No 250 of 28 June 1995 (GURI No 150 of 29 June 1995), which became Law No 349 of 8 August 1995 (GURI No 196 of 23 August 1995), Article 3a(1) of which provides:

'For the purposes of discharging credits of value added tax and interest thereon — as determined by the tax returns for 1992 submitted by the taxable persons referred to in Article 11(1) of Decree-Law No 16 of 23 January 1993, which became, after amendment, Law No 75 of 24 March 1993, applies — which have not been refunded at the date of entry into force of the present decree, the Minister for the Treasury may issue further Government bonds for free circulation, taking effect on 1 January 1996 for a period of 10 years, and up to a maximum amount of ITL 400 billion ...'

6. I would recall that the Community system of value added tax (hereinafter 'VAT') is structured entirely around the principle that every taxable person is entitled to deduct, from the tax which he is liable to pay in respect of the transactions he has effected, the tax that he himself has paid to his suppliers on acquiring the goods or services necessary for him to pursue his activity, and that this distinguishes VAT in a fundamental way from systems of turnover tax under which the taxes paid at the different stages of the commercial chain become aggregated.

7. This principle is expressed in Articles 17 and 18 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 [2] (hereinafter 'the Sixth Directive').

8. Article 17(1) and (2) of the Sixth Directive read as follows:

'1. The right to deduct shall arise at the time when the deductible tax becomes chargeable.

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) value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person;

(b) value added tax due or paid in respect of imported goods;

(c) value added tax due under Articles 5(7)(a) and 6(3).'

9. As regards Article 18(4) of the Sixth Directive, it provides:

'Where for a given tax period the amount of authorised deductions exceeds the amount of tax due, the Member States may either make a refund or carry the excess forward to the following period according to conditions which they shall determine.

However, Member States may refuse to refund or carry forward if the amount of the excess is insignificant.'

10. As it considered that the abovementioned provisions of Italian legislation constituted an infringement of those articles of the Sixth Directive, the Commission brought infringement proceedings against the Italian Republic by application registered at the Registry of the Court on 2 March 2000 under number C-78/00, now submitted for our examination.

11. In its application, it claims that the Court should declare that, by providing

2 — OJ 1977 L 145, p. 1.

that the category of taxable persons whose tax position for 1992 is in credit be belatedly issued with Government bonds instead of receiving VAT refunds, the Italian Republic has failed to fulfil its obligations under Articles 17 and 18 of the Sixth Directive and that it should order the Italian Republic to pay the costs of the proceedings. For its part, the Italian Republic contends that the application should be dismissed.

12. Let us consider, first, what, precisely, is the infringement of the Sixth Directive with which the Commission charges the Italian Republic, for it appears, from a reading of the correspondence exchanged between the two parties during the pre-litigation phase, that there may have been some ambiguity on this point.

13. Initially, the Commission claimed that, given the conditions under which it was effected, the issue of bonds to taxable persons entitled to claim a VAT credit for 1992 constituted a breach of the rule that it is to the period following the one in respect of which the amount of authorised deductions exceeds the tax required to be paid to the revenue that the excess must be carried forward.

14. In that respect, it claimed not only that, according to the provisions of the Italian legislation, the bonds were to be issued only in 1994 and not in 1993, but also, and perhaps above all, that in fact the bonds were in a number of cases issued after significant delays.

15. On the other hand, it did not dispute in clear terms the making of refunds by issuing bonds. It was only later that the Commission explicitly claimed that the issue of Government bonds could not be regarded as a refund within the meaning of Article 18(4) of the Sixth Directive, continuing to rely on the late issue of those bonds only as a circumstance aggravating the infringement.

16. However, that clarification was made sufficiently early to preclude objection to the action on the ground of discrepancy between the letter of formal notice, the reasoned opinion and the application.

17. Admittedly, the Italian Government does not fail to rely in its argument, on the merits, on what might appear to be changes in the Commission's position, but it does not contest the admissibility of the action, and the arguments it advances in its defence relate rather to the question whether, having chosen to exercise the power granted to it by Article 18(4) of the Sixth Directive to opt for a refund of VAT credits rather than allowing them to be carried forward to the following financial year, it was entitled to effect that refund by issuing Government bonds.

18. What are the arguments in the present case?

19. According to the Commission, which relies on the judgment in *Molenheide and Others*, [3] where a Member State opts to refund a VAT credit, the refund must be immediate and must consist in putting liquid funds at the disposal of the taxable person.

20. Admittedly, the Member States may determine the conditions according to which a refund is effected, but only to the extent that the requirements of immediacy and of liquidity are not put at risk.

21. However, one cannot consider these as having been guaranteed to a taxable person who is issued with a Government bond maturing at five or ten years.

22. If he wishes to have the amount owed to him by the Italian State available for the purposes of his business, such a taxable person will have to find a purchaser for the bond issued to him, without being sure that that purchaser will buy the bond at nominal value, but, certainly, in addition, having to pay the commission claimed by the financial intermediary who will act in the transaction.

23. In fact, according to the Commission, the transaction effected by the Italian Republic has all the characteristics of a mandatory loan.

24. Of course, the Italian Government takes an entirely different view. First of all, it states that it did not effect any reduction in the VAT credits which taxable persons could claim. Their credit was recognised in its entirety. It submits, next, that, having opted for a refund rather than a carry forward, it simply used the power granted to it by Article 18(4) of the Sixth Directive to determine the mode of the refund.

25. In that regard, it argues that choice of mode must be understood as meaning something other than the choice between a bank cheque, a bank or postal transfer or payment in cash.

26. According to it, many other modes of refund can be envisaged, provided that they do not result in any loss to the taxable person entitled to a VAT credit.

3 — Joined Cases C-286/94, C-340/95, C-401/95 and C-47/96 [1997] ECR I-7281, paragraph 45.

27. However, in that regard, no criticism may be made in respect of the mode of refund adopted by the Italian Republic in the exercise of its sovereign power.

28. Although the bonds were issued only with effect from 1 January 1994, the taxable persons have benefited up to that date from the interest provided for by the Italian legislation relating to the refund of tax. The bonds themselves carried interest at a higher rate, being above inflation by a significant amount and reaching, for example, 7.8% in 1998.

29. Until 1999, that rate of interest proved to be always above the rate provided for tax refunds. In any case, the bonds could be negotiated without any difficulty, as they were admitted to the official list, and, taking account of the rate of interest they attracted, could in principle be negotiated even above their nominal value, so that if the taxable person so wished he could at any time obtain in exchange for his bonds liquid funds in an amount at least equal to the value of his former VAT credit.

30. Finally, the Italian Government states that the Commission, in focusing its criticisms on the delay with which the bonds were issued, in fact accepted that it is perfectly permissible under Article 18(4) of the Sixth Directive to discharge a VAT credit by issuing Government bonds by way of refund, provided that the issue of the bonds was not subject to any delay that caused economic loss to the taxable person.

31. It accepts that, in the present case, certain delays occurred, but states that they related to certain substantive difficulties and errors at the administrative level and this cannot in principle call in question the transaction it effected.

32. What weight is to be given to these arguments?

33. Let me say at once that a question of principle can receive only an answer of principle and that, in consequence, I do not see any interest in discussing the gains or losses actually made by Italian taxable persons to whom Government bonds were issued in refund of their VAT credits.

34. The only question that needs to be answered by the Court is whether that issue is in itself permissible having regard to the rules laid down by the Sixth Directive.

35. My reply to that simple question is very clearly no. If one refers to the text of Article 18(4) of the Sixth Directive, one finds that where, at the end of a tax period, the taxable person finds he has a tax credit, the right to deduct must lead either to a carry forward of the excess to the following period or to a refund, at the option of the Member State concerned.

36. It is out of the question that the Community legislature could have intended to create two possibilities producing very different results for taxable persons. This would plainly be the case if, where a Member State opts for a refund, the taxable person had to wait years to have the amount due to him at his disposal in the form of liquid funds, whereas the taxable person authorised to carry forward to the following period would see his credit being discharged by set-off very rapidly.

37. There remains to be determined the latest time at which the refund must take place. In this regard, the Commission refers to the judgment in *BP Supergas*, [4] in which the Court stated that 'the right of deduction provided for in Article 17 et seq. of the Sixth Directive is an integral part of the VAT scheme and in principle may not be limited. The Court has consistently held... that the right of deduction must be exercised immediately in respect of all the taxes charged on transactions relating to inputs'.

38. The 'right to deduction' must therefore be exercised 'immediately', but can one draw from this any conclusions as to the time at which the 'refund' of an excess of VAT must be given by the Member State?

39. In paragraph 45 of its judgment in *Molenheide*, cited above, the Court referred to 'the national authorities' obligation to make an immediate refund under Article 18(4) of the Sixth Directive'.

40. In that regard, however, it is to be remembered that according to Article 18(4) of the Sixth Directive the problem of carrying forward or refunding the excess arises only where 'for a *given tax period* the amount of authorised deductions exceeds the amount of tax due'. [5]

41. Although a right to deduction arises therefore 'immediately' and many times in the course of a given period, the right to carry forward or to a refund of the excess may be exercised only at the end of the period in question. The two must not be confused.

4 — Case C-62/93 [1995] ECR I-1883, paragraph 18.

5 — Emphasis added.

42. The fact remains that, from the end of a given 'tax period', the Member States must either allow the excess to be carried forward to the following period or grant a refund. As the set-off of the credit carried forward against new VAT debts will take place gradually in the course of the new period, one might imagine that the refund too could be effected in several stages in the course of the same period. However, it must be completed by the end of that period.

43. Consequently, it cannot be accepted that tax credits relating to the financial year 1992 may be 'refunded' by the issue, from 1 January 1994, of Government bonds that mature at the end of five to ten years.

44. The only certainty attaching to such a bond (if, of course, one excludes the possibility that the State may become bankrupt, which, however, history has taught us is not entirely theoretical) is that of a refund at the fixed date of maturity, preceded by the periodic payment of interest at a fixed rate. That certainty is the antithesis of the liquidity of a monetary payment in the legal tender of the State in which the payment is made, occurring at the latest at the end of the following tax period.

45. Admittedly, as the Italian Government assures us, the fact that such bonds are admitted to the official list also confers on them a certain form of liquidity in practice. However, that liquidity is far from being always perfect. The stock exchange is a market where the only person who can sell is a person who finds a buyer, and admission to the official list does not itself constitute a guarantee that, whatever the number of bonds he wishes to dispose of, every seller will always find a buyer willing to acquire them. Even less is it a guarantee that that potential buyer will be prepared to pay a price equal to the nominal value of the bond.

46. Every person who is in the least aware of the functioning of the stock market knows that the price of debt, that is to say, of bonds, varies as a function of changes in interest rates. A bond at 3% will not find any buyer at its nominal value if the interest rate on new issues is 5%. The purchaser of an old bond at 3% will only be disposed to pay a price that assures him a return of 5% in real terms, that is to say, a price far below the nominal value. Conversely, a bond carrying interest at the rate of 10% will sell above its nominal value if new issues offer an interest rate of only 5%.

47. Once the holder of a bond decides to dispose of it before its maturity, he is confronted with a risk which may be favourable to him one day, but which may of course also be unfavourable to him the next.

48. When Article 18(4) of the Sixth Directive refers to a refund, it certainly does not intend that this should include among the modes of refund one which confronts the creditor with a risk, whatever it might be.

49. I would add that negotiating a bond on a stock exchange necessarily gives rise to costs, as it presupposes the involvement of an intermediary, who must be remunerated. Therefore, it is only if the purchaser pays a price higher than the nominal value that the seller of a bond can hope to realise a net sum equal to the nominal value.

50. In response to the Italian Government's assertion that the issue of Government bonds to a taxable person poses no problems as regards liquidity, interested parties concerned could raise an insidious, but perfectly relevant, question, namely whether it would be possible for them to present, by way of payment to discharge the various taxes for which they are liable by virtue of their activity, bonds that have been issued to them, rather than paying by cheque or bank transfer.

51. In my opinion, there is hardly any doubt as to the answer that they would obtain from the Italian treasury. *A fortiori*, since the Italian authorities have not yet followed the path marked by the French revolutionaries who decreed a mandatory exchange rate for the assignat, one can hardly imagine that they could act in that way in order to pay their suppliers or their employees, even though, having regard to the Sixth Directive, they could legitimately rely on their VAT credit to ensure that their finances balanced.

52. I would also observe that the emphasis placed by the Italian Government on the 'good deal' obtained, according to it, by the taxable persons to whom bonds created from 1994 were issued, consequent on the changes in interest rates in Italy, reveals that the Italian Government is trying, as far as possible, to avoid any discussion on the level of principle, a level on which its position is untenable.

53. What also appears to me to be revealing is the fact that the Italian Government, in a note of 19 February 1999 from the office of the Minister for the Treasury, the Budget and the Economic Programme, produced to the Court, states, in order to explain that the transaction effected in application of the Decree-Laws of 1993 and of 1995 cited above could not in any way be regarded as a carry forward beyond the period following the financial year of the right to deduction and, on the contrary, discharged in its entirety the debt of the Italian Treasury in respect of VAT to the taxable persons concerned, that what is concerned is a 'mode of refund which consisted in substituting for the debt created by the tax credit of the taxable person another debt represented by the Government bond'.

54. For my part, I cannot accept that the Community system of VAT can accommodate what is akin to a conjuring trick, since the Italian Republic would have refunded its creditors by contracting a long-term debt towards them.

55. This type of transaction perhaps falls within the 'sovereign power' of the Italian legislature, to take up an expression used by the Italian Government in one of its notes to the Commission, but only as regards taxes completely beyond the reach of Community law.

56. In conclusion of this analysis of the legality under the Sixth Directive of the transactions effected by the Italian Republic, I cannot but agree with the Commission that what is in fact involved is a mandatory loan.

57. What is issued to the holder of a credit entitling him to an immediate payment in money is another credit entitlement, in place of that payment, which the Italian legislature has decided discharges the debt of the Italian Treasury in respect of VAT.

58. According to the Commission, such a substitution, if between two private persons, would have to be regarded as a novation.

59. For my part, I consider that the transaction effected by the Italian Republic would lend itself rather to being regarded as a surrender in lieu of payment.

60. However, be that as it may, as a matter of private law, such a transaction obviously requires the agreement of the creditor.

61. Even supposing that that is not the case in Italian public law, that law cannot prevail over Community law, which, as I think I have shown, prohibits such a method of refunding VAT credits.

62. Having rejected from the outset all discussion on the practical effect, for taxable persons, of the Decree-Laws of 1993 and of 1995, cited above, since in my opinion the existence of the failure to fulfil obligations is wholly unrelated to that effect, I shall not dwell on the considerations put forward by the Commission as regards the particular gravity of the failure, to do with the fact that the bonds were issued only belatedly. As the action for failure to fulfil obligations is an objective

action, and as the Court does not in any way have to impose any sanction, in respect of which the gravity of the infringement could be important, it appears to me that, even though the circumstance referred to by the Commission is in fact such as to make the failure of the Italian Republic to fulfil its obligations even more obvious, the Court need not mention it in the operative part of its judgment.

63. The gravity of the infringement would, admittedly, be a factor to be taken into account if the Court were led to exercise the powers granted to it by Article 171(2) of the EC Treaty (now Article 228(2) EC), but that is not the case in the present proceedings.

64. There remains one final point for me to examine. This consists of the considerations put forward by the Italian Republic as regards the difficulties with which it would be confronted if the Court were to allow the Commission's application.

65. I shall be extremely brief on this point, inasmuch as it is clear that such considerations can, according to settled case-law, in no way be taken into account in an action based on Article 169 of the EC Treaty (now Article 226 EC). Either there is a failure to fulfil obligations, and the Court can merely find accordingly, or there is none, and the action must be dismissed. Once the failure to fulfil obligations is declared by the Court's judgment, it is for the Member State to consider what measure it will adopt to bring that failure to an end. If it considers this to be impossible, it must inform the Commission. It will then be for the Commission to consider whether there is reason to bring a new action under Article 171(2) of the EC Treaty and, if such an action is brought, it will be the Court that decides whether the Member State has infringed its obligations in not satisfactorily complying with the judgment and whether there is reason to impose the payment of a lump sum or to order a penalty payment.

66. However, as with the gravity of the infringement, these are considerations that do not have any place in the present proceedings.

67. Before concluding, I would like to observe also that, although it was not raised in any of the documents in the written procedure, the transaction effected by the Italian Republic constitutes a breach not only of the Sixth Directive.

68. Since the issue of Government bonds in place of the refund provided for by the Sixth Directive applied to only some taxable persons entitled to a VAT credit in respect of import transactions effected from other Member States, it appears to me to be obvious, having regard to the case-law of the Court, that there is an infringement of

Article 95 of the EC Treaty (now, after amendment, Article 90 EC). VAT is an internal taxation falling within the scope of that provision, which is infringed directly by the discrimination applied, as regards the modes of refunding overpaid tax, between importers and other operators.

Conclusion

69. In conclusion, I propose that the Court should:

— declare that, by providing that in the case of a category of taxable person whose tax position for 1992 is in credit, such persons be issued with Government bonds instead of receiving VAT refunds, the Italian Republic has failed to fulfil its obligations under Articles 17 and 18 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;

— order the Italian Republic to pay the costs of the proceedings.