JUDGMENT OF THE COURT (Fifth Chamber)
25 October 2001 *

In Case C-78/00,

Commission of the European Communities, represented by E. Traversa, acting as Agent, with an address for service in Luxembourg,

applicant,

v

Italian Republic, represented by U. Leanza, acting as Agent, assisted by G. De Bellis, avvocato dello Stato, with an address for service in Luxembourg,

defendant,

APPLICATION for a declaration that, by providing that the category of taxable persons whose tax position for 1992 is in credit be belatedly issued with Government bonds instead of refunds of value added tax, the Italian Republic has

* Language of the case: Italian.

failed to fulfil its obligations under Articles 17 and 18 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), as amended by Council Directive 95/7/EC of 10 April 1995 amending Directive 77/388/EEC and introducing new simplification measures with regard to value added tax — scope of certain exemptions and practical arrangements for implementing them (OJ 1995 L 102, p. 18),

THE COURT (Fifth Chamber),

composed of: S. von Bahr (Rapporteur), President of the Fourth Chamber, acting as President of the Fifth Chamber, D.A.O. Edward, A. La Pergola, M. Wathelet and C.W.A. Timmermans, Judges,

Advocate General: J. Mischo,
Registrar: R. Grass,

having regard to the report of the Judge-Rapporteur,

after hearing the Opinion of the Advocate General at the sitting on 7 June 2001,

gives the following

Judgment

1 By application lodged at the Registry of the Court on 2 March 2000 the Commission of the European Communities brought proceedings under Article 226 EC seeking a declaration that, by providing that the category of taxable persons whose tax position for 1992 is in credit be belatedly issued with Government bonds instead of refunds of value added tax ('VAT'), the Italian Republic has failed to fulfil its obligations under Articles 17 and 18 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), as amended by Council Directive 95/7/EC of 10 April 1995 amending Directive 77/388/EEC and introducing new simplification measures with regard to value added tax — scope of certain exemptions and practical arrangements for implementing them (OJ 1995 L 102, p. 18, 'the Sixth Directive')

Community law

2 Article 17(1) and (2) of the Sixth Directive provide 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 within the territory of the country 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), 6(3) and 28a(6);

(d) value added tax due under Article 28a(1)(a).'

3 Article 18(4) of the Sixth Directive 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.'

Italian legislation

4 Article 11(1) of the Decreto-legge No 16, Disposizioni in materia di imposte sui redditi, sui trasferimenti di immobili di civile abitazione, di termini per la definizione agevolata delle situazioni e pendenze tributarie, per la soppressione della ritenuta sugli interessi, premi ed altri frutti derivanti da depositi e conti correnti interbancari, nonché altre dispozioni tributarie (Decree-Law No 16 on provisions relating to tax on income, on the transfer of residential property, on time-limits for the simplified resolution of current tax positions and proceedings, for the abolition of withholding tax on interest, bonuses and other income from deposits and interbank current accounts, and other fiscal provisions), of 23 January 1993 (GURI No 18 of 23 January 1993, p. 3, 'Decree-Law No 16/93'), which became Law No 75 of 24 March 1993 (GURI No 69 of 24 March 1993, p. 3), provides:

'Taxable persons who, during 1992, imported goods and services from other Member States the value of which exceeded 10% of their total transactions for that year, and who declared a VAT credit of not less than ITL 100 million, may not carry that credit forward and deduct it [from their liability to VAT] in subsequent years. ...'

5 Article 11(2) of Decree-Law No 16/93 provides:

'Articles 10(1) and (2) [which govern the discharge of credits arising from the settlement of annual income tax and VAT returns by issuing Government bonds

to the taxable persons concerned] apply to the discharge of the credits referred to in Article 11(1) ...

In that case, the application [for a refund of excess 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 *Gazzetta ufficiale* by 30 November 1993 at the latest.'

6 Decreto-legge No 250, Differimento di taluini termini ed altre dispozioni in materia tributaria (Decree-Law No 250 on the extension of certain time-limits and other fiscal provisions) of 28 June 1995 (GURI No 150 of 29 June 1995, p. 10 ('Decree-Law No 250/95'), which became Law No 349 of 8 August 1995 (GURI No 196 of 23 August 1995, p. 3), extended those particular procedural requirements for the refund of excess VAT by the issue of Government bonds. Article 3a(1) of that Decree-Law provides as follows:

'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 — which have not been refunded at the date of entry into force of the present decree, the Ministry 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 ...'

Facts and pre-litigation procedure

7 The Commission considered that Decree-Laws Nos 16/93 and 250/95 simultaneously infringed the principle of the right to deduct VAT on inputs enshrined in Article 17 of the Sixth Directive and the obligation, under Article 18(4) of that directive, to make a refund '[w]here ... the amount of authorised deductions exceeds the amount of tax due', and so instituted the procedure for failure to fulfil obligations by sending the Italian authorities a formal letter of notice on 22 December 1997, inviting them to submit their observations within two months.

8 In its letter of formal notice the Commission stated, *inter alia*, that it had been informed that numerous Italian taxable persons subject to Decree-Laws Nos 16/93 and 250/95 had not received a refund of surplus VAT accumulated during 1992, and that they had thus been denied their right to deduct.

9 By letter of 2 April 1998 the Italian authorities replied to that letter of formal notice, claiming that the Italian legislation on the refunding of excess VAT by the issue of Government bonds complied with Article 18(4) of the Sixth Directive.

10 The Commission did not share that view and, by a further letter of formal notice dated 10 August 1998, invited the Italian authorities to submit their observations.

11 In reply to that second formal letter, the Italian authorities sent the Commission four letters dated 27 January, 3 February, 26 February and 12 April 1999.

12 In the letters of 3 and 26 February 1999, the Italian Government explained, *inter alia*, that bonds issued pursuant to Article 11 of Decree-Law No 16/93 had been made available to taxpayers on eight occasions between 26 April 1994 and December 1998. Bonds issued pursuant to Article 3a of Decree-Law No 250/95 had been made available to taxpayers on four occasions between 13 September 1996 and 29 May 1998.

13 The Italian Government's arguments still did not convince the Commission, and on 9 July 1999 that institution addressed a reasoned opinion to the Italian Republic requesting it to comply with the opinion within two months of its notification.

14 The Italian authorities did not comply with that opinion within the time allowed. It is in those circumstances that the Commission commenced the present action.

The alleged failure to fulfil obligations and the findings of the Court

Arguments of the parties

15 The Commission considers that, in issuing 5-year and 10-year Government bonds to taxable persons, the Italian Republic has infringed, *inter alia*, the provisions of

Article 18(4) of the Sixth Directive on the treatment of excess VAT. The Commission claims that that provision allows the excess arising from the difference between the amount of authorised deductions and the amount of tax due to be carried forward to the following tax period only. To carry the excess forward to periods other than that immediately following the period concerned breaches the principle laid down by that provision, deprives the taxable persons concerned of the normal exercise of the right to deduct, and seriously undermines one of the fundamental principles of the common system of VAT, namely the immediate exercise of the right to deduct.

16 In the Commission's view the obligation on national tax authorities to make an 'immediate' refund of the excess VAT to the taxable person is linked to the taxable person's 'immediate' right to deduct. The Commission relies in this respect on Joined Cases C-286/94, C-340/95, C-401/95 and C-47/96 *Molenheide and Others* [1997] ECR I-7281, paragraph 45.

17 The Commission considers that the 'conditions' each Member State may lay down for making a refund, pursuant to Article 18(4) of the Sixth Directive, concern the forms the refund may take, subject to the obligation to make liquid funds available to persons whose VAT account is in credit by the amount of the excess. Thus, that refund can be made by means of a credit transfer to the current account of the taxable person, by sending that person a cheque, or other equivalent method.

18 By contrast, the Commission claims, a Member State clearly exceeds the discretionary power it enjoys in setting the conditions for the refund of excess VAT where, instead of making a payment of liquid funds to the taxable person, it imposes on that person a bond maturing in 5, or even 10 years' time.

19 If the taxable person needed the money the State owed him in respect of VAT for his own working capital he would be obliged either to borrow a sum corresponding to the excess VAT from a bank, and therefore to pay high lending rates, certainly higher than the deposit rates that the Government bonds he had been given would yield, or to place those same bonds on the financial market at the risk of having to resell at a price lower than their face value, and of having to deduct the costs and broker's commission from the proceeds of sale.

20 Given that the final tranche of Government bonds issued under Article 3a of Decree-Law No 250/95 will not mature until 1 January 2006, the failure to fulfil obligations will persist until that date unless the Italian authorities decide to refund those bonds before maturity. In the Commission's view, the fact that only a few hundred taxable persons hold such bonds does not in the least alter the existence, or the seriousness, of the failure.

21 The Commission points out that the Italian Ministry of the Treasury's belated issue of Government bonds only aggravates the breach of Articles 17 and 18 of the Sixth Directive.

22 The Italian Government repeats the arguments it developed at the pre-litigation stage. Thus, it maintains that the issue of Government bonds from 1 January 1994 in lieu of a refund in cash does not carry the excess VAT forward to subsequent tax periods, but is a genuine refund carried out in accordance with the 'conditions' that the Italian Republic has deemed it appropriate to 'determine' pursuant to Article 18(4) of the Sixth Directive.

23 According to the Italian Government Article 18(4) of the Sixth Directive does not require the Member State to use a particular means of payment, such as cash, to make a refund of the excess VAT, because that provision expressly provides for the option of effecting the refund in question according to the 'conditions' determined by the Member State itself. The term 'conditions', says the Italian Government, has a wide meaning which covers conditions of both form and content of the refund. The Italian legislature has, by this provision, laid down in its absolute discretion that the Italian Republic, in this case, makes a refund of excess VAT by the issue of Government bonds rather than by the payment of an equivalent sum of money.

24 The Italian Government maintains that if certain taxable persons were belatedly refunded their excess VAT, that was not due to the law or to legal problems but to failings or administrative errors in a limited number of cases on the part of the services responsible for issuing the bonds. Taxable persons were able to bring administrative and judicial proceedings against the bodies concerned to remedy those errors.

25 The Italian Government asserts that the person whose VAT account is in credit by the amount of an excess has suffered no damage as a result of the conditions for the refund of excess VAT in question since the bonds he received bear interest and are negotiable, thus allowing him to realise his credit immediately. The Italian Republic has derived no particular financial advantage from the bond issue, since that refund condition had the effect of substituting, for the debt corresponding to the taxable person's fiscal credit, another debt represented by the Government bonds.

26 In any case, the Italian Government contends in its statement in defence, it is impossible, or excessively difficult, for it to comply with the reasoned opinion.

Findings of the Court

27 In order to assess the compatibility of the national rules in question with the Sixth Directive it is first necessary to note the relevant characteristics of the common system of VAT as they apply in the present case.

28 Article 17 of the Sixth Directive provides that taxable persons are entitled to deduct the VAT they have already paid, on goods purchased and services received as inputs, from the VAT which they are liable to pay. This right to deduct is, according to settled case-law, a fundamental principle of the common system of VAT established by the relevant Community legislation (see, in particular, *Molenheide*, cited above, paragraph 47).

29 Pursuant to Article 18(2) of the Sixth Directive, the taxable person shall effect the deduction by subtracting from the total amount of tax due for a given tax period the total amount of tax in respect of which, during the same tax period, the right to deduct has arisen.

30 As the Court has consistently held, the characteristics of the common system of VAT set out above show that the deduction system is meant to relieve the trader entirely of the burden of VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way. In the absence of any provision empowering the Member States to limit the right of deduction granted to taxable persons, that right must be exercised immediately in respect of all the taxes charged on transactions relating to inputs (see, in particular, Case 50/87 *Commission* v *France* [1988] ECR 4797, paragraphs 15 and 16).

31 Where, for a tax period, the amount of deductible tax exceeds the amount of tax due and the taxable person cannot effect the deduction in accordance with Article 18(2) of the Sixth Directive, Article 18(4) of that directive provides that the Member States may either make a refund or carry the excess forward to the following period according to conditions which they shall determine.

32 It appears from the express terms of Article 18(4) of the Sixth Directive, and in particular from the phrase 'according to conditions which they shall determine', that the Member States have a certain freedom to manœuvre in determining the conditions for the refund of excess VAT.

33 Nevertheless, since the refund of excess VAT is one of the fundamental factors ensuring the application of the principle of neutrality of the common system of VAT, the conditions determined by the Member States cannot undermine that principle by making the taxable person, in whole or in part, bear the burden of the VAT.

34 It follows that the conditions for the refund of excess VAT that a Member State sets must enable the taxable person, in appropriate conditions, to recover the entirety of the credit arising from that excess VAT. This implies that the refund is carried out within a reasonable period of time by a payment in liquid funds or equivalent means. In any case, the method of refund adopted must not entail any financial risk for the taxable person.

35 However, it appears from the information provided by the Commission, and unchallenged by the Italian Government, that the Italian Republic decided to refund the excess VAT to which a certain number of taxable persons was entitled for 1992 by the issue of 5-year and 10-year Government bonds running from 1 January 1994. Those bonds were only distributed to the taxable persons concerned progressively from April 1994 to December 1998.

36 The Italian rules in question, which do not provide for a payment in liquid funds or by equivalent means within a reasonable time but for the issue of Government bonds, are clearly incompatible with the system for the refund of excess VAT provided by the Sixth Directive.

37 The circumstance advanced by the Italian Government, that only a relatively small number of taxable persons was affected by the national rules in question, is irrelevant to the finding of a failure to fulfil obligations.

38 Furthermore, the problem raised by the Italian Government, that it would be difficult, if not impossible, for it to comply with Community law if the Court considers that the national rules in question infringe the provisions of the Sixth Directive, also has no bearing on the outcome of the dispute. In accordance with settled case-law, a Member State may not seek to rely on provisions, practices or circumstances in its internal legal order in order to justify failure to comply with the obligations and time-limits laid down in a directive (see, in particular, Case C-473/99 *Commission* v *Austria* [2001] ECR I-4527, paragraph 12).

39 In those circumstances the Court finds that, by providing that the category of taxable persons whose tax position for 1992 is in credit be belatedly issued with Government bonds instead of refunds of the excess VAT, the Italian Republic has failed to fulfil its obligations under Articles 17 and 18 of the Sixth Directive.

Costs

40 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Commission has applied for costs and the Italian Republic has been unsuccessful, the latter must be ordered to pay the costs.

On those grounds,

THE COURT (Fifth Chamber)

hereby:

1. Declares that by providing that the category of taxable persons whose tax position for 1992 is in credit be belatedly issued with Government bonds instead of refunds of the excess value added tax the Italian Republic has failed to fulfil its obligations under Articles 17 and 18 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, as amended by Council Directive 95/7/EC of 10 April 1995 amending Directive 77/388/EEC and introducing new simplification measures with regard to value added tax — scope of certain exemptions and practical arrangements for implementing them;

2. Orders the Italian Republic to pay the costs.

von Bahr Edward La Pergola

Wathelet Timmermans

Delivered in open court in Luxembourg on 25 October 2001.

R. Grass P. Jann

Registrar President of the Fifth Chamber