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Opinion of Mr Advocate General Saggio delivered on 18 March 1999. - Commission of the European Communities v Kingdom of Spain. - Failure of a Member State to fulfil obligations - Imports and acquisitions of armaments - Sixth VAT Directive - National legislation not complying therewith. - Case C-414/97.

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Opinion of the Advocate-General

1 The action in this case is for a declaration that, by exempting from value added tax (hereinafter `VAT') intra-Community imports and acquisitions of arms, ammunition and equipment exclusively for military use, the Kingdom of Spain infringed 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 (hereinafter the `Sixth VAT Directive'), (1) and that therefore it failed to fulfil its obligations under the EC Treaty.

Legislative framework, facts of the case and procedure

2 The aforementioned directive - as amended by Council Directive 91/680/EEC of 16 December 1991, supplementing the common system of value added tax and amending Directive 77/388/EEC, with a view to the abolition of fiscal frontiers (2) - provides in Article 2(2) and Article 28a that imports of goods (into the territory of the Community) and intra-Community acquisitions of goods are to be subject to VAT. Article 14 of the same directive then lists the exemptions laid down for the importing of certain goods into the territory of the Community and Article 28c(B) those allowed for intra-Community acquisitions of goods. Article 28(3)(b) also provides that, during the transitional period, the Member States may `continue to exempt the activities set out in Annex F under conditions existing in the Member State concerned' at the time when the Sixth Directive entered into force, that is on 1 January 1978. Points 23 and 25 of that Annex list, among others, the operations relating to aircraft used by State institutions and warships. Paragraph 4 of the same article states that `the transitional period shall last initially for five years, as from 1 January 1978.' (3) Finally, paragraph 3a of the same article, introduced by Directive 91/680, already mentioned above, authorised Spain to exempt the operations described in points 23 and 25 of Annex F from VAT. (4)

3 On 1 January 1986, in order to comply with the conditions for accession to the Community and in particular those stated in Article 395 of the Treaty of Accession, (5) Spain introduced value added tax into its own legal system, by Law No 30/85 of 2 August 1985, (6) but without stating any specific exemption for intra-Community imports and acquisitions of armaments. In addition, in the Act of Accession no exemptions were stated, in favour of Spain, for operations relating to the aforementioned goods. Exemptions to that effect were, however, introduced unilaterally by Spain by Law No 6 of 14 May 1987. (7) Under that law, concerning budgetary appropriations for

investments and operating costs of the armed forces, intra-Community imports and acquisitions `of arms, ammunition and equipment exclusively for military use' which were necessary to carry out the programme to modernise the material, equipment and armaments of the armed forces for the period 1986/1994 were exempt from VAT. (8) That law entered into force on 14 May 1987, but was effective as from 1 January 1986.

4 By notice of 7 February 1990, the Commission initiated an infringement procedure against Spain, charging it with having exempted from VAT, by the aforementioned law of 1987, a number of intra-Community acquisitions and imports of military equipment, contrary to Article 2(2) of the Sixth Directive. The Spanish authorities replied by letter of 7 May 1990. In a reasoned opinion sent on 6 August 1996, the Commission charged Spain with breach of its obligations under the Sixth Directive for having introduced those exemptions. As Spain did not comply with the opinion within the time prescribed, the Commission brought this action on 5 December 1997.

The merits of the case

Arguments of the parties

5 The Commission submits that, under the Sixth Directive, intra-Community imports and acquisitions are subject to VAT, save for the operations listed in Articles 14 and 28c and subject to the exemptions stated in Article 28(3)(b). This last provision gives the Member States the right to continue to exempt certain operations, mentioned in Annex F of the directive, during the transitional period. The only other exemptions allowed are, according to the Commission, those which may be provided for by the Acts of Accession of the new States to the European Community. According to the Commission, none of these exemptions applies in this case. On one hand, neither Article 14 nor Article 28c deals with operations similar to those in point in Spanish Law No 6/87, nor, on the other hand, could Article 28(3)(b) - which, as has already been stated, concerns the possibility of maintaining some exemptions existing in the Member State concerned at the time the directive entered into force - legitimise the exemptions in question since the aforementioned law which introduced them was enacted in May 1987 and therefore after the Act of Accession entered into force. The Commission points out that the situation would have been different if a clause had been inserted in the Act of Accession allowing Spain such a possibility.

According to the Commission, the possibility allowed to Spain under Directive 91/680 of exempting the operations mentioned in points 23 and 25 of Annex F to the Sixth Directive (operations concerning warships and aircraft) does not totally eliminate Spain's failure to fulfil the Community obligations deriving from the enactment of Law No 6/87. The granting of such a possibility in any event left the failure of Spain to fulfil its obligations unaltered and undiminished in respect of the period from the entry into force of Law No 6/87 to the date on which the Spanish Government obtained authorisation to allow the aforementioned limited exemption.

6 The Spanish Government contends, primarily, that the exemptions from VAT for operations relating to military equipment contained in Law No 6/87 are compatible with Community law since they constitute safeguard measures under Article 223(1)(b) of the EC Treaty because they are `necessary for the protection of the essential interests of their security' and refer to `the production of or trade in arms, munitions and war material'. The purpose of the exemptions in the Spanish Law of 1987 was to guarantee the attainment of the essential objectives of the overall strategic plan (Plan Estrategico Conjunto), ensuring the effectiveness of the Spanish armed forces in relation to their duties of national defence, and also in carrying out the commitments undertaken by Spain as part of NATO. In support of its contention the Spanish Government referred to the preamble to Law No 6/87, which states that the main objective of the law in question is to `define and allocate the necessary financial resources to achieve the process of reinforcing and modernising ... the armed forces, creating the economic and financial basis of the overall strategic plan'. The Spanish Government also argues that the abolition of the exemption from VAT for armaments would, contrary to the Commission's assertion, have considerable financial

consequences and points out in this respect that the increase in costs which this abolition would have involved would have been about ESP 3 million for 1998.

The Commission disputes that contention, stating that it cannot be taken into consideration in these proceedings as it had not been made in the pre-litigation phase. It then submits, on the merits, that the imposition of VAT on imports of armaments would not prejudice Spanish interests because the burden for the State would be quite modest and because, in any case, even though they were required to do so, the Spanish authorities did provide any evidence of the damage which the imposition of VAT on the operations in question could have caused to the essential interests of national security.

7 The Spanish Government then submits that, in any case, the exemptions from VAT contained in Law No 6/87 must be regarded as legitimate under Article 28(3)(b) of the Sixth Directive, which allows Member States to continue to exempt the operations stated in Annex F from VAT under the conditions applicable under their law at the time when the Directive entered into force, and that is on 1 January 1978. Article 28(3)(b) must also apply in favour of those States which, like Spain, became Members of the Community after that date, as otherwise there would be discrimination in treatment between `old' and `new' Member States in the conditions of competition which are the inspiration behind the Community rules on fiscal harmonisation and this would give considerable competitive advantages to the `old' Member States, without any justification. According to Spain, therefore, the new Member States must also be able to make use of the right described in Article 28(3)(b) of the Sixth Directive, even if it is not specifically laid down in the Treaty of Accession.

8 Finally the Spanish Government points out that the exemptions in question were introduced into its domestic legal system by Law No 44 of 7 July 1982, (9) which exempted imports of materials for the armed forces from equalisation tax, and that the national legislation (Law No 30/1985, mentioned above) which introduced VAT following the accession of Spain to the Community carried over, as from its entry into force, that is from 1 January 1986, this favourable regime. The exemptions from VAT for operations concerning military equipment therefore already existed in Spain at the time when it joined the Community and for that reason, under Article 28(3)(b), they must be regarded as complying with the Directive as from 1 January 1986.

The existence of the failure to fulfil obligations

9 Under Article 2(2) of the Sixth Directive all imports of goods into the territory of the European Community are to be subject to VAT, (10) with the exception of those exempted under Article 14 of the same Directive. Under Article 28a, all intra-Community acquisitions which are imported for a valuable consideration into the country by a taxable person acting as such are also subject to VAT, with the exception of the operations exempted in accordance with the aforementioned Article 28c(B). There can be no doubt that the imports and acquisitions of military equipment, to which Spanish Law No 6/87 applies, fall within the scope of the Sixth Directive.

10 That point having been settled, it must first be established whether those operations may - in accordance with the Spanish Government's primary submission - be considered to be justified under the safeguard clause in Article 223(1)(b) of the EC Treaty, and second, whether, as contended by that Government in the alternative, those operations can be brought within one or more of the cases in which the Directive allows States to provide for exemptions and therefore be considered lawful within those limits.

11 With regard to the alleged application of the safeguard clause in Article 223(1)(b) of the EC Treaty to the imports and acquisitions of arms, referred to in Spanish Law No 6/87, I would recall that this provision states that `every Member State may take the measures it considers necessary for the protection of the essential interests of their security which are connected with the production of or trade in arms, munitions and war material.'

On this point the Commission first raises the objection that the Spanish Government cannot request the application of this provision in these proceedings, as it did not make a similar request at any time during the pre-litigation procedure. In other words, according to the Commission, this issue raised by Spain is out of time and cannot therefore be taken into consideration here. The Commission's objection does not appear to me to be well founded as there is no ad hoc procedural provision which requires a correspondence between the arguments put forward in the pre-litigation phase and those put forward subsequently before the Court; furthermore, it does not appear to be possible for such a rule to be elaborated by case-law, because this would offend against the general principle of the free and full exercise of the rights of defence before the Court. It should be added that the case-law relied on by the Commission in support of its submission is not relevant. It refers to a different situation, which is not comparable, namely that of a State against which an action is brought under Article 169 of the EC Treaty and to which the rights of defence are guaranteed; it is only with reference to that specific situation that it states that `the action cannot be founded on any complaints other than those formulated in the reasoned opinion.' (11) In the case before us, however, application of the same principle would entail a converse reasoning, designed to limit, and not to reinforce, the rights of defence of the State in proceedings brought by it against the institution.

12 Moving on to examine the merits of the question whether the safeguard clause stated in Article 223(1)(b) applies to this case, we should remember first of all that the safeguard clauses in the EC Treaty must be interpreted restrictively given their function of derogation from the ordinary rules (12) and that, according to the ordinary rules on the burden of proof, States which contend for the application of that provision must demonstrate that the measures adopted are necessary for the protection of the national security interests. It must therefore be determined whether or not Spain has furnished proof that the exemptions stated in Law No 6/87 are necessary in order to attain that objective. In this case, it does not seem to me that this proof has been furnished. And even if, contrary to the Commission's assertion, the intention of the Spanish legislature to protect national interests in the matter of security by guaranteeing the process of reinforcing and modernising the armed forces were evident from the preamble to that law, it is hard to see why the exemptions from VAT would be necessary to attain that objective, in other words how it could be that the imposition of VAT on imports and acquisitions of armaments would entail for the finances of the State a burden of such dimensions as to jeopardise the objective in point. It should be observed that the revenue deriving from the VAT which would be charged on the operations in question would flow into the coffers of the State incurring the expenditure, with the exception of a trifling percentage which would be diverted to the Community coffers as own resources. (13) The calculation presented by Spain in its defence does not appear to take into consideration the fact that, while the amount relating to VAT on military equipment constitutes State expenditure relating to the Ministry of Defence, it ultimately, to a large extent, ends up in the pocket of the State itself and cannot therefore have any impact on the shaping of the decision in the present case.

13 It must therefore be concluded that the Spanish Government has not demonstrated that the abolition, in Law No 6/87, on the exemption from VAT of imports and acquisitions of armaments, ammunition and other military equipment constitutes a measure which can compromise the protection of the essential interests of the security of Spain, with the result that the exemptions contained in Spanish Law No 6/87 cannot be considered justified under Article 233(1)(b) of the EC Treaty. It is even unnecessary to add that, as the safeguard clause stated in Article 223(1)(b) of the EC Treaty has been found to be applicable to this case, there is no need, contrary to what is

stated by the Commission, to determine whether Spain has abused, in the sense contemplated in Article 222 of the Treaty, the powers referred to in that provision.

14 Next, as regards the possibility of bringing the operations concerning military equipment which are in point in Spanish Law No 6/87 within one of the exemptions which the Community legislation allows the Member States to introduce in whole or in part, it may be noted, as a preliminary point, that Articles 14 and 28c(b) of the Sixth Directive, which list the intra-Community imports and acquisitions which are exempt, cannot in any way be made to relate to the operations concerning military equipment in point in the Spanish law in question. The provision of the Directive which concerns the exemptions, and to which the Spanish Government essentially refers as a basis for demonstrating the legality of its own legislation relating to military equipment, is Article 28(3)(b), under which the Member States may continue to exempt the operations stated in Annex F during the transitional period, and these include, in points 23 and 25, those relating to aircraft used by State institutions and warships. The operations indicated concern, (a) `the supply, modification, repair, maintenance, chartering and hiring of aircraft, used by State institutions and also the supply, modification, repair, maintenance, chartering and hiring of equipment incorporated or used therein' and (b) `the supply, modification, repair, maintenance, chartering and hiring of warships.'

The Spanish Government contends that the provision under discussion should be interpreted widely, so as to include all the operations in point in Spanish Law No 6/87 in the exemption from VAT of the operations mentioned in points 23 and 25. I cannot support that contention, as the items mentioned in points 23 and 25 concern operations regarding military equipment which are well defined and, which because of their content can fall within the ambit of only some of the operations on military equipment that are exempted by the Spanish law, specifically only those that concern aircraft used by State institutions and warships. A wide interpretation of these exemptions would conflict with the rule of ordinary law according to which provisions containing exceptions (the provisions on exemption from VAT are in this category) are to be interpreted strictly. The Court has repeatedly stated that `the terms used to describe the exemptions ... of the Sixth Directive are to be interpreted strictly since these constitute exceptions' to a general principle. (14) In addition, the Spanish Government does not provide any analytical demonstration with regard to relating the exceptions stated in points 23 and 25 to the legislation in Law No 6/87.

As regards the temporal scope of the exception stated in Article 28(3)(b), an exception which, given the wording of the provision, would only be valid for exemptions existing in the State concerned at the time when the Sixth Directive entered into force, the Spanish Government argues that this provision should be interpreted widely, so as to allow the operations stated in points 23 and 25 of Annex F to be exempt from VAT even if similar exemptions did not exist under Spanish law at the time of Spain's accession to the Community. Such an interpretation would guarantee equal treatment of `old' and `new' Member States. That argument is not convincing. It should be emphasised that the `new' Member State has the right to introduce the exemptions in question even if it joined the Community after the Sixth Directive entered into force and even if that right was not contemplated in the Act of Accession, but provided that, from the date of accession, the legal system of the `new' State provides for exemptions similar to those appearing in Annex F to the Sixth Directive. (15) This interpretation does not give rise to discrimination between `old' and `new' States belonging to the Community, as the system applicable is the same for all States from the moment they become members of the Community.

15 The Spanish Government then tries to demonstrate, by means of various arguments, that the exemptions in point in Spanish Law No 6/87 which can be brought under points 23 and 25 of Annex F already existed at the time when Spain joined the Community and that, consequently, they are lawful from the point of view of Community law.

16 On this point, the Spanish Government refers first of all to Law No 44/82, already mentioned, which exempted imports of equipment for the armed forces from equalisation tax, pointing out that

Law No 30/85, which introduced VAT, implicitly carried over this favourable regime, as from 1 January 1986, the date of its entry into force. This, according to the Spanish Government, means that Article 28(3)(b) is applicable in this case in view of the (alleged) existence of the exemptions at the time when the new tax system came into effect. That argument cannot be accepted because, first, the exemption stated in Law No 44/82 concerns a tax which does not correspond to value added tax, and second, Article 28 contains a derogation from the ordinary VAT system and therefore can only be interpreted strictly.

17 On the same point, the Spanish Government appears to go on to argue that Spanish Law No 6/87 is retrospective to the time when Spain joined the Community and that, consequently, the exemptions contained in that law must be regarded as in existence from 1 January 1986 and that therefore Article 28(3)(b) is applicable to them. However, this argument is not convincing. It is based on an interpretation of the provision which is manifestly contrary to its purpose - to allow limited exemptions for a transitional period in order to enable a progressive adjustment of the national laws to the directive - and essentially amounts to according, irrationally, to the new Member States the power to circumvent requirements of the Directive.

18 Finally, the Spanish Government relies on Directive 91/680 which widely amended and supplemented the basic directive and, among other things, inserted in Article 28 a new paragraph, 3a, which specifically allows Spain to grant exemption from VAT to the operations described in points 23 and 25, that is to say, operations relating to aircraft and warships. The Spanish Government claims that, in this way, the exemptions specified in Spanish Law No 6/87 were rendered lawful in so far, of course, as they could be brought within the ambit of those set out in the aforementioned points in Annex F.

That argument can be accepted subject to a qualification as to the starting date of the legitimising effect. It should be held that the circumstance that, on the basis of Directive 91/680, Spain could have benefited from the exemptions stated in points 23 and 25 of Annex F does not fully eradicate Spain's failure to fulfil the obligations arising from the Sixth Directive, both because the exemptions laid down by the Spanish legislation can only partly be brought within the ambit of those which appear in the above points, and because in any case, for the whole of the period from the entry of Spain into the Community until Directive 91/680 entered into force, the Spanish authorities were not entitled to introduce into their legislation any exemption in relation to operations concerning military equipment, including the material specified in points 23 and 25.

19 In conclusion, my opinion is that the operations which Spanish Law No 6/87 exempts from VAT are lawful from the point of view of Community law only in so far as they concern aircraft and warships used for military purposes and only from the entry into force of Directive 91/680. Outside this limited sphere, the failure to fulfil obligations with which Spain is charged, as regards both the question of materials and the application ratio temporis of the exemption, continues to exist and must be the subject of a declaration to that effect.

20 For all the above reasons, the action brought by the Commission against the Kingdom of Spain must succeed.

Costs

21 The Kingdom of Spain is the unsuccessful party. 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. As the Commission has asked for costs, the Kingdom of Spain must be ordered to pay them.

22 In view of the foregoing, I propose that the Court:

- declare that, by exempting from value added tax intra-Community imports and acquisitions of arms, ammunition and equipment exclusively for military use, other than the aircraft and warships

mentioned in points 23 and 25 of Annex F to Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment, and the provisions of Articles 2(2), 28a, 14 and 28c(B) of that directive, the Kingdom of Spain has failed to fulfil its obligations under that directive and the EC Treaty;

- order the Kingdom of Spain to pay the costs.

(1) - OJ 1977 L 145, p. 1.

(2) - OJ 1991 L 376, p. 1.

(3) - The transitional period was extended and consequently the Member State which exempted the operations described in Annex F were able to continue to do so.

(4) - The right to grant this exemption was given to Spain `while awaiting a decision from the Council, which, under Article 3 of Directive 89/465/EEC', (OJ 1989 L 226, p. 21), `must decide on the abolition of the transitional derogations stated in paragraph 2' of Article 28.

(5) - The Treaty of Accession of the Kingdom of Spain and the Portuguese Republic to the European Communities was signed on 1 June 1985 (OJ 1985 L 302) and entered into force on 1 January 1986.

(6) - BOE of 9 August 1985. Article 20 of that law extends the VAT system to all imports of goods. That article states that, `for the purposes of the tax, an import is defined as the introduction of goods into the territory of the Spanish peninsula or the Balearic islands, whatever the use for which they are intended or the status of the importer.'

(7) - BOE of 19 May 1987.

(8) - This period was extended until 1998 by Law No 9 of 15 October 1990.

(9) - BOE of 21 July 1982.

(10) - According to the Court (Case 15/81 Schul [1982] ECR 1409, paragraph 14) the generating fact for VAT on imports `is the mere entry of goods into a Member State, whether or not there is a transaction and irrespective of whether the transaction is carried out for valuable consideration or free of charge, be it by a taxable person or a private person.' This is confirmed by Case 39/85 Bergeres-Becque v Service Interregional des Douanes [1986] ECR 259, paragraph 7.

(11) - Case C-207/96 Commission v Italy [1997] ECR I-6869, paragraphs 17 and 18. See also Case C-306/91 Commission v Italy [1993] ECR I-2133, paragraph 22; Case 274/83 Commission v Italy [1985] ECR 1077, and Case 51/83 Commission v Italy [1984] ECR 2793, paragraph 5.

(12) - See judgment in Case 13/68 Salgoil [1968] ECR 602, in which the Court, referring to Articles 36, 224 and 226 of the EC Treaty, states that `although these provisions attach particular importance to the interests of Member States, it must be observed that they deal with exceptional cases which are clearly defined and which do not lend themselves to any wide interpretation.'

(13) - See Council Decision 94/728/EC,Euratom of 31 October 1994, relating to the system of own resources of the European Communities (OJ 1994 L 293, p. 9). In Article 2(4) of this decision it is stated that `the uniform rate ... shall correspond to the rate calculated as follows: application of ... 1.08% in 1998, 1.00% in 1999 to the VAT assessment based for the Member States' and that `the rate of 1.00% laid down for 1999 shall remain applicable until the ... Decision is amended'.

(14) - Case C-2/95 SDC [1997] ECR I-3017, paragraph 20. See also Case 348/87 Stichting Uitvoering Financiële Acties [1989] ECR 1737, paragraph 13. This principle was stated with reference to the exemption laid down in Article 13 of the Sixth Directive for services carried out for valuable consideration, but it is clearly applicable also to the exemptions stated in Article 28(3)(b) (see Opinion of Advocate General Cruz Vilaça in Case 122/87 Commission v Italy [1988] ECR 2685, paragraph 22).

(15) - In Case 73/85 Kerrutt [1986] ECR 2219, paragraph 17, the Court precluded `by its wording, the introduction of new exemptions or the extension of the scope of existing exemptions after the date of entry into force of the Directive.' In addition, in Case C-35/90 Commission v Spain [1991] ECR I-5073, paragraph 9, without distinguishing between `old' and `new' Member States, the Court stated that `the extension of the transitional scheme of exemptions from VAT beyond the period originally provided for cannot justify the right of Member States to grant exemptions which they were not authorised to grant'; this is because such a right, according to the Court, `would compromise the object of Article 28(3)(b) which is to enable a progressive adjustment of the national laws in the areas in question'.