Conclusions
OPINION OF ADVOCATE GENERAL
GEELHOED
delivered on 27 November 2003(1)

Case C-381/01

Commission of the European Communities
v
Italian Republic

Case C-495/01

Commission of the European Communities
v
Republic of Finland

Case C-144/02

Commission of the European Communities
v
Federal Republic of Germany

Case C-463/02

Comission of the European Communities
v
Kingdom of Sweden

(Failure to fulfil obligations, Article 11 of the Sixth Directive (77/388/EEC) – Failure to impose VAT on subsidies granted pursuant to Council Regulation No 603/95 on the common organisation of the market in dried fodder – Concept of subsidies directly linked to the price)

I – Introduction

1. In these four cases, which I shall deal with together, the Commission of the European

Communities seeks a declaration from the Court that a Member State – the Italian Republic in Case C-381/01, the Republic of Finland in Case C-495/01, the Federal Republic of Germany in Case C-144/02 and the Kingdom of Sweden in Case C-463/02 – has failed to fulfil its obligations under Article 11 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) Pursuant to Council Regulation (EC) No 603/95 of 21 February 1995 on the common organisation of the market in dried fodder, (3) flat-rate aid is granted to processing undertakings for dehydrated and sun-dried fodder crops. At issue in all four cases is whether the flat-rate aid for dehydrated and sun-dried fodder crops should be subject to value added tax.

II – Facts and procedure

2. In November 1998 the Commission, having concluded that failure to charge VAT on aid granted under Regulation No 603/95 constituted an infringement of Article 11(A)(1)a of the Sixth Directive, sent letters of formal notice to the Italian Republic, the Federal Republic of Germany, the Republic of Finland and the Kingdom of Sweden, inviting them to submit observations within two months. The Member States responded to the Commission's position, expressing their objections. Reasoned opinions from the Commission followed in July, August and September 1999, in which the Member States were invited to take the necessary measures within two months of the notification.

3. On 4 October 2001, 21 December 2001, 17 April 2002 and 23 December 2002 the Commission brought proceedings before the Court of Justice of the European Communities under the second paragraph of Article 226 EC against the Italian Republic, the Federal Republic of Germany, the Republic of Finland and the Kingdom of Sweden respectively. In each case it sought a declaration that the Member State, by failing to charge VAT on aid granted under Council Regulation (EC) No 603/95, had failed to fulfil its obligations under Article 11 of the Sixth Directive, and to order it to pay the costs. The Member States ask the Court to dismiss the applications, and to order the Commission to pay the costs. (4)

III – Legal framework

A – *The rules governing the grant of aid to the dried fodder sector and their application in the past*

4. On 22 May 1978 the Council of the European Communities adopted Regulation (EEC) No 1117/78. (5) That regulation, together with Regulation (EEC) No 1417/78 (6) of 19 June 1978 (based on Regulation (EEC) No 1117/78) and Regulation No 1528/78 (7) of 30 June 1798, provided for the payment of aid for the production of dried fodder from plants grown in the Community.

5. It is apparent from the recitals in the preamble to Regulation No 1117/78 that when it was adopted, dried fodder production in the Community was noticeably less than the demand for it, especially in the case of animal fodder. In order to encourage production, a system of flat-rate aid for producers was instituted, accompanied by a system of supplementary aid intended to ensure that producers would always be able to sell the fodder they produced at a predetermined guide price. The supplementary aid was to be equal to a certain percentage of the difference between the world market price and the guide price. The details of the scheme are set out in Articles 3, 4 and 5 of Regulation No 1117/78.

6. The predictable consequence of the unlimited production aid was overproduction of dried (green) fodder within the Community. This led, in 1995, to the common organisation of the market in dried fodder being amended by Regulation (EC) No 603/95 and Regulation (EC) No 785/95. (8) The latter sought to restrict subsequent flat-rate aid granted for the production of dried fodder to a maximum amount set out in Regulation No 603/95. The supplementary aid was abolished altogether. (9) In addition, the regulation in question draws a distinction between sun-dried and dehydrated fodder. As processing costs for sun-dried fodder are lower than for dehydrated fodder, the flat-rate aid for the former is substantially lower than for the latter.

7. Articles 4 and 5 of Regulation No 603/95 establish a mechanism designed to limit the subsidised production of dried fodder; its principal characteristics are as follows:

–a maximum guaranteed quantity (MGQ) of sun-dried and dehydrated fodder is established for each marketing year;
–the MGQ is then divided between the Member States, each being allocated a national guaranteed quantity (NGQ);
–if in any marketing year the MGQ is exceeded, the flat-rate aid payable is calculated as follows:
– for the first 5% by which the MGQ is exceeded, the aid is reduced in all Member States by an amount which is proportionate to that excess;

– for any excess beyond 5% additional reductions are made in any Member State in which production exceeds the NGQ increased by 5%, proportionate to this excess.

8. These adjustments are intended to ensure that total expenditure is no higher than it would be if the MGQ were not exceeded.
9. Article 9 of Regulation No 603/95 provides that the flat-rate aid is to be granted to undertakings which engage in one of the following activities:
(a)undertakings which have concluded contracts with producers of fodder for drying;
(b)undertakings which have processed their own crops or, in the case of groups, those of their members;
(c)undertakings which have obtained their supplies from legal or natural persons providing certain guarantees to be determined, who have concluded contracts with producers of fodder for drying.
10. It is apparent from the eleventh recital of the preamble to Regulation No 603/95 that, in certain cases, the granting of aid is to be conditional on the conclusion of contracts between producers and processing undertakings (10) this is in order to encourage a regular supply of green fodder to processors, and to enable producers to benefit from the aid scheme.
11. If the processing undertaking engages in activity (a), it is under an obligation to pay the producers the aid which it receives for the quantities processed under the contracts. (11) Regulation No 603/95 does not specify how the aid is to be passed on to the producers. In the case of activity (b) processor and producer are one and the same; they cannot be distinguished one from the other. If the processing undertaking performs activity (c), the subsidy granted goes to the processing undertaking itself.
12. Before the subsidy is granted, the dried fodder must have left the undertaking (see Article 8 of Regulation No 603/95). Article 3(1) of Regulation No 785/95 defines more precisely when fodder ‘leaves the undertaking’; (12) Article 3(2) stipulates that dried fodder which has left a processing undertaking may not be readmitted within the precincts of the same or any other undertaking or any storage place.
B – *The content of the Sixth Directive, particularly Article 11(A)1a, and its drafting history*
13. The principle on which VAT is based is stated in the following terms in Article 2 of the First Directive: (13)
‘The principle of the common system of value added tax involves the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged.
On each transaction, value added tax, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of value added tax borne directly by the various cost components.’
14. The purpose of the deduction rules is to preserve fiscal neutrality – the central feature of the VAT system – by ensuring that the tax paid by the final consumer remains the same, irrespective of the number of links in the production chain for the product in question.
15. Under Article 2 of the Sixth Directive, (14) a supply of goods or services effected for consideration by a taxable person acting as such is subject to VAT. According to Article 4(1), a taxable person is a person who carries out an economic activity, whatever the purpose or result of that activity.
16. Article 11(A)(1)(a) of the Sixth Directive defines the taxable amount for VAT within the

territory of a country as follows:
‘in respect of supplies of goods and services other than those referred to in (b), (c) and (d) below, everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies including subsidies directly linked to the price of such supplies;
...’.
17. It is apparent from the history of the application of the Sixth Directive that determining what was covered in practice by the concept of ‘subsidies directly linked to the price of ... supplies’ has posed a major problem for the Community legislature.
18. In its First Report on the application of the common system of value added tax, submitted on 14 September 1983, the Commission noted: (15)
‘Article 11(A)(1)(a) of the Directive stipulates that subsidies received by a taxable person which are “directly linked to the price” of the supplies made by that person must be included in the taxable amount as components of the prices paid by third parties. While it is relatively easy to decide straight away that subsidies are “directly linked to the price” when their amount is determined either by reference to the selling price of the goods or services supplied, or in relation to the quantities sold, or again in relation to the cost of goods or services supplied to the public free of charge, it is extremely difficult to decide in the case of other types of subsidy such as deficit subsidies or operating subsidies, which are paid with the aim of improving a firm’s economic position and which are granted without specific reference to any price. The absence of any substantial difference between these two types of subsidy (those “directly linked to the price” are usually also aimed at improving a firm’s position), together with the fact that a Member State can convert a subsidy of the first type into a subsidy of the second type, illustrate the fragility of a distinction based on purely formal criteria (the manner in which the subsidy is granted) and thus the inadequacy of the Directive in this respect.’
19. In its Second Report on the application of the common system of value added tax, (16) the Commission noted that the expression ‘subsidies directly linked to the price’ could be interpreted only in a strict and literal sense and that a subsidy was to be included in the taxable amount only if the three following conditions were met:
(a)the subsidy constituted the consideration or part of the consideration;
(b)the subsidy was paid to the supplier;
(c)the subsidy was paid by a third party.
20. Finally: in interpreting the provisions of the Sixth Directive, as is apparent from the Court’s case-law, the following basic principles must be borne in mind. First, the concepts defining the scope of VAT must be construed broadly; exemptions, by contrast, must be interpreted narrowly. Secondly, the provisions of the directive must be interpreted strictly so as to promote equality of fiscal treatment, and thereby counter distortion of competition. Thirdly, the principle of fiscal neutrality must be kept in mind. By means of that principle the Community legislature seeks to ensure that there is completely neutral taxation of all economic activities, whatever their purpose or result, provided that the activities in question are as such subject to VAT. In fact, the principle of equality of fiscal treatment and the principle of fiscal neutrality are comparable concepts, though they are applied in different contexts – the former being used where more than one State is involved, while the latter refers to a situation arising within a Member State.

IV – Observations of the parties

A – *The Commission’s complaints*

21. The Commission considers that one of the most important characteristics of the aid granted to the processing undertakings is that it is based on the amount of dried fodder produced.
22. Next, the Commission refers to the various ways in which the processing undertakings can operate (see point 9).
23. It considers that undertakings which process their own crops or, in the case of groups, those of their members, not for consideration, do not engage in taxable transactions within the meaning of Article 2 of the Sixth Directive; their activities therefore fall outwith the scope of VAT,

and should not be taxed.

24. Conversely, buying fodder crops from producers, processing them and selling them on to third parties must be deemed to constitute a supply of goods within the meaning of the Sixth Directive. Processing the product for the producers and returning it to them as the processed product without any transfer of title having occurred must be deemed to constitute the provision of a service. Since the processing undertakings perform an economic activity it follows that they are taxable, so activities (a) and (c) should be subject to VAT.

25. The essential question then is whether aid granted pursuant to Regulation No 603/95 should similarly be subject to VAT.

26. The Commission considers that three conditions must be met for a subsidy to be taxable:

(a)it must be paid to whoever supplies the goods or service;

(b)it must be paid by a third party, not the supplier of the goods or service;

(c)there must be a direct link between the subsidy and the price of the goods or service.

In the Commission's view all three conditions have been fulfilled.

27. First, the requirement that the subsidy be paid to whoever supplies the goods or service. It is the processing undertaking which supplies the goods or service, and which is also the beneficiary of the subsidy. That, the Commission suggests, may be inferred from the words at the beginning of Article 9 of Regulation No 603/95: 'The aid provided for in Article 3 shall be granted only to undertakings processing the products ...'.

28. In response to observations by the Member States to the effect that the aid also benefits producers, the Commission addresses what it sees as the fundamental distinction between a legal beneficiary and the potential economic significance of the aid. The subsidy granted may produce additional economic effects within the production cycle either for producers of green fodder, or for purchasers of dried fodder. When processing undertakings have concluded special-order contracts for the processing of fodder supplied by the producers, Community legislation requires the former to transfer the aid received to the latter. Neither the possibility that a subsidy may also benefit other undertakings, nor the processing undertaking's duty to transfer the aid received to other parties can alter the fact that the processing undertaking is the beneficiary of the aid. Admittedly, from an economic point of view, the group of beneficiaries is wider; from a legal point of view, though, only the processing undertakings (as the suppliers of goods and/or the providers of a service) are the beneficiaries of the subsidy.

29. The requirement that the products have left the processing undertaking has to be met before the subsidy is granted (Article 8 of Regulation No 603/95). Prompted by the observations made by the Member States, the Commission states that the concept of 'leaving the processing undertaking' is not the same as 'the supply of goods' within the meaning of Article 2 of the Sixth Directive. In practice, though, the two concepts tally. Accordingly the subsidy may be seen as consideration for the supply of goods or provision of a service; it is consequently taxable.

30. In response to the German Government's argument that under Article 3(1)(a) of Regulation No 785/95 the storage place for the dried fodder may be located outside the precincts of the processing undertaking, and that in consequence 'leaving the processing undertaking' could not be assimilated to the supply of goods, the Commission states that the essential criterion for the taxability of the subsidy for dried fodder is that the product in question should ultimately be sold, and that storage of the dried fodder is no more than a stage preceding its eventual sale.

31. The second condition is that the subsidy be paid by a third party, and not, therefore, by the supplier of the goods or services. The Commission considers that this condition, too, has been met. The competent body granting the subsidy is not the supplier of the goods or services.

32. The third condition is that, pursuant to Article 11(A)(1)(a) of the Sixth Directive, the aid is to be included in the taxable amount if it is directly linked to the price of the goods or service. That link must be precisely quantified or ascertainable: the aid is granted if, and to the extent that, the goods or service are sold on the market. Thus the subsidy is directly linked to the price.

33. At the hearing, the Commission explained that in practice, the subsidy enabled the processing undertakings to sell the dried fodder at the world market price. Without the aid the price

would be higher, because of the processing undertakings' high production costs. The aid is therefore a component of the price; that accords with the aim of Article 11(A)(1)(a) of the Sixth Directive, that a subsidy be taxable when it is a component of the consideration received for the sale of the goods or provision of the service.

34. The Commission asserts that even if it is not possible to identify the amount corresponding to the subsidy contained in the consideration for every individual transaction, the taxable amount consists of the consideration obtained plus the total amount of aid received for the supply of dried fodder, or for drying green fodder.

35. The Commission observes further that in its view there is no significance in the fact that the same amount of aid is granted for supplying dried fodder, and for drying green fodder. After all, the economic objective is the same in both cases: to ensure sufficient Community production of dried fodder at a price acceptable to purchasers. It is therefore logical for the same amount of aid to be granted in both cases, and for such aid to be taxed.

36. Nor do rules which require the amount of the aid to be adjusted in the event of the MGQ being exceeded negate the existence of a direct link between aid and price. (17) The purpose of the aid is to support the production of dried fodder. The fact that the effect of the aid is limited as a result of account being taken of predetermined production levels does not preclude the aid having a direct effect on the price.

37. It is likewise not significant that the payment of the subsidy forms no part of the contract for the sale of dried fodder between a processing undertaking and a purchaser. Subsidies from public funds are granted by a competent body to a beneficiary in a context governed by public law. By their very nature they cannot be a subset of any conditions of sale agreed between parties; such matters are governed by private law.

38. The above analysis thus bears out the Commission's view that there is a direct relationship between subsidy and price. It follows that the subsidy must be included in the taxable amount. That view, the Commission believes, is confirmed in the judgment in *Office des produits wallons*. (18)

B – *Observations by the Member States*

39. The Member States contest the Commission's view that the processing undertaking must be deemed to be the sole beneficiary of the aid. It is apparent from Article 11(2) of Regulation No 603/95 that where contracts are special-order contracts for the processing of fodder supplied by the producers, there is an obligation on processing undertakings to pay the producers the aid which they receive for the quantities processed under the contracts. The provision in question thus also refers to the producers as beneficiaries of the aid granted. Contrary to what the Commission asserts, the processing undertaking is not the sole legal beneficiary.

40. Admittedly, Article 9 of Regulation No 603/95 provides that the aid shall be granted only to undertakings processing fodder. However, the sole purpose of that provision is to simplify administrative procedures. The processing undertaking acts as an intermediary, and is not entitled to retain the aid if it processes fodder for the producers.

41. The Member States contend that it is important to know who the beneficiaries of the aid are, since that is a significant factor when determining whether there is a direct link between the subsidy and the price of the product. (19)

42. The Member States discern no suggestion whatsoever in Regulation No 603/95 that the aid must benefit the purchaser of the dried fodder, by reducing the price. (20) Hence the aid does not affect the price of the dried fodder; it achieves its purpose at an earlier stage, enabling producers of fresh fodder to seek a higher price for their products. In the case of special-order contracts for the processing of fodder supplied by the producers, it is the producers themselves who benefit directly from the aid. Where this is the case, the processors may not include the aid which they have already received (and passed on) in the price which they charge for drying the green fodder. The aim of the subsidy is therefore to reduce production costs.

43. The Member States list further reasons why, in their view, there is no link between the subsidy and the price at which dried fodder is sold.

–Entitlement to aid arises once the fodder has left the processing undertaking, and various quality requirements have been met. The granting of aid is not dependent on a taxable transaction occurring (the supply of the dried fodder to a purchaser).
–Through the subsidy, the Community seeks to provide processors with regular supplies, and to safeguard producers' incomes; the aim is not to ensure that dried fodder is supplied to purchasers at a price acceptable to them.
–The aid is calculated on the basis of the amount of dried fodder which has left the undertaking. The price received by the processing undertaking for the dried fodder fluctuates with the market price, but the aid remains constant.
–The same amount of aid is paid for supplying dried fodder, and for processing green fodder, though the costs incurred are not the same.
–Regulation No 603/95 sets a limit on the subsidy received. The Member States argue that such a cap precludes any direct link between subsidy and price, since the final amount of aid to be granted is not ascertainable at the time the chargeable event occurs. (21)

44. At the hearing, the Finnish Government explained why it considers that there is no direct link between subsidy and price. Like the Commission, it points out that the subsidy enables the processors to sell the dried fodder at the world market price. If no subsidy were granted, production costs would rise, the Finnish processing undertakings would have to charge more, and purchasers of dried fodder would buy from competing undertakings selling at the world price. Hence the Finnish processors are not in a position to raise their prices. Since the processors sell their fodder at a price which remains the same with or without the subsidy, any link between product and subsidy is at most indirect. The subsidy does not in practice influence the market price – it merely compensates for the high production costs.

V – Assessment

A – *General*

45. Mindful – inter alia – of the drafting history of the legislation in question, I proceed from the premiss that the taxation of subsidies is an exception.

46. It is only where a subsidy is 'directly linked to the price of ... supplies' that it is included in the taxable amount defined in Article 11(A)(1)(a) of the Sixth Directive. For all other subsidies the position is that they are not included in the taxable amount, and are hence not taxable under Article 11(A)(1)(a) of the Sixth Directive. Were this not so, VAT would fall to be imposed on other forms of subsidy such as investment subsidies or operating subsidies – and that would not accord with the general system of VAT.

47. In the present case, on the basis of what I shall set out below, there can be no question of Article 11(A)(1)(a) of the Sixth Directive requiring VAT to be charged on the subsidy granted in the fodder sector. There are two reasons why this is so. The first is that taxing the subsidy would jeopardise the neutrality of the VAT system; the second is that the requisite link between the subsidy and price obtained for the product is not present.

48. One might, with some justification, take the view that there is little point in imposing VAT on subsidies. By doing so a public authority simply takes back with one hand a percentage of the money which it has granted with the other. (22) This could only be justified if not charging VAT were to produce an unsatisfactory outcome. Such a situation might arise if, as a result of an untaxed subsidy being fully and directly reflected in the lower price of the transactions in question, the total amount of tax paid were reduced. Where a subsidy which has demonstrably affected the price of the transactions leads to the price of goods being reduced, the ensuing reduction in tax revenue may be offset by taxing the subsidy. Imposing VAT on the subsidy ensures that tax revenue is the same as it would be in a situation in which no subsidy was granted.

B – *Preliminary observation*

49. As a general rule, it is illogical to charge VAT on a subsidy unless the recipient of the subsidy is also the final consumer. The common system of value added tax has created a tax on consumption; it follows that a taxable person should charge and pay tax on the value of goods they have supplied or a service they have performed. That value is a subjective value since the

basis of assessment for goods or services is the consideration actually received and not a value assessed according to objective criteria, as the Court held in *Cooperatieve Aardappelenbewaarplaats*. (23)

50. If a taxable person receives a subsidy directly related to the price of the transactions involved, Article 11(A)(1)(a) of the Sixth Directive requires him to pay tax on it. I have already explained, at point 14, that the principle of the common system of value added tax is that the burden of the tax is in practice borne only by the consumer at the end of the chain. Accordingly, a taxable person who has paid tax on the subsidy received must be able to pass that charge on to the final consumer.

51. In a series of judgments beginning with Rompelman, (24) the Court has held that the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. Since the subsidy is received and the resulting VAT debt arises and is paid in the context of economic activities, there must be an opportunity to pass that charge on to the final consumer – only thus can the principle of the complete neutrality of value added tax be maintained.

52. However, if VAT is paid on the subsidy received, the consequence for the final consumer of applying the aforementioned principle is that he will then pay tax on the specific subjective value of the consideration actually received, that is, the actual value as determined inter alia by the subsidy (with its effect of reducing the price), plus the taxation paid on the subsidy. Thus one desired outcome is indeed achieved – the tax lost to the tax authority (because the actual subjective value of the consideration received is reduced by the subsidy) is duly offset by the taxation of the value of the subsidy. Against that is the fact that such a system would constitute a departure from the maxim laid down in *Cooperatieve Aardappelenbewaarplaats*, (25) that the basis of assessment on which VAT is levied is the consideration actually received.

53. Hence Article 11(A)(1)(a) of the Sixth Directive should be construed as an exception to the general principles of the common system of value added tax. As such it should be interpreted and applied restrictively and strictly.

54. A consequence of restrictive interpretation is that the provision should only be applied to subsidies directly reflected in the price of the transaction. In *Office des produits wallons* (26) the Court has given some guidance on this point; I shall discuss this in more detail below at points 71 to 76.

55. Strict interpretation means taxing the subsidies granted only to the extent that they are reflected in the price of the transaction. After all, if a subsidy which has the effect of reducing a price is taxed in full, but is then only reflected in part in the price paid by the final consumer, the result is that the competent tax authority receives more VAT than it loses as a result of the subsidy. Such overcompensation is at odds with the tenor of the exception constituted by Article 11(A)(1)(a) of the Sixth Directive, the sole aim of which is to compensate for the amount of tax actually lost as a result of the subsidy.

56. Moreover, in such a situation the taxable person is overtaxed, since he must pay VAT on the increased consideration (assuming the subsidy is partially reflected in the end price), and on the fully-taxed subsidy. *Ex hypothesi* he is liable for more VAT than if no subsidy had been granted in the first place.

57. To ensure that any VAT imposed on subsidies accords with the general scheme of the tax, including the limited exception contained in Article 11(A)(1)(a) of the Sixth Directive, it is therefore necessary to ascertain precisely whether, and if so to what extent, the subsidies are reflected in the price of the product at the stage of final consumption. In other words, the tax authorities involved must be able to show that they have suffered a loss as a result of the subsidy, and must then be able to show plausibly what the extent of such a loss would have been.

C – *VAT: a neutral system*

58. A flat-rate subsidy is granted for the production of dried fodder; as Article 9 of Regulation No 603/95 indicates, the subsidy is based on the processing of green fodder into dried fodder. As I have briefly indicated above, at point 9, the subsidy may fall to be granted in three situations:

–where there is integrated production: the processor processes his own production, or that of his members;
–where the processor acts as a ‘contract worker’: the producer’s green fodder is processed (dried) for him and subsequently returned to him;
–where the processor buys in green fodder from the producers, processes it and then sells it on.

59. The Commission’s premiss is that in the first of these three situations no VAT can be imposed: the processing of the green fodder does not constitute an independent economic activity, and no supplies of goods or services chargeable to VAT occur within an integrated production unit. It is therefore not possible to impose VAT on the processing of green fodder to dry fodder. The defendants subscribe to this analysis; so do I. No goods are supplied, no services performed: no VAT can be charged.

60. On the second situation there is disagreement. The Commission considers that the subsidy is paid to the processing undertaking in order to support the service performed for the producer. The processor is the legal beneficiary of the subsidy. The fact that Regulation No 603/95 requires that the subsidy be passed on to the producer is merely a reflection of the economic effects that a subsidy can produce within a chain of production. Thus a service is performed for the producer, and the subsidy granted for this must therefore be taxed.

61. In arguing thus, however, the Commission creates the legal fiction that the subsidy is paid to the processing undertaking as an incentive to provide the service (the processing). That is not in fact the case.

62. The subsidy is granted for dried fodder which has left the processing undertakings and which meets certain quality requirements. (27) Additionally, Article 11(2) of Regulation 603/95 provides that the processing undertaking is under an obligation to pay the producers the aid which it receives for the quantities processed under the contracts. Since the regulation itself states expressly that the producers are the beneficiaries of the aid, it follows that the processing undertaking itself cannot be the beneficiary. The processing undertaking merely functions as an intermediary which passes the subsidy on to the producer. The requirement that the fodder must have left the processing undertaking in order to qualify for the aid supports that contention. Moreover, there is no suggestion in the regulation that the subsidy is granted for the provision of the service of processing the green fodder. After all – as is apparent from what I have already stated – the subsidy is granted to benefit the producer by reducing production costs. There is no basis whatsoever in Regulation No 603/95 for the legal fiction postulated by the Commission; accordingly it cannot be accepted.

63. I would add here that the Commission itself, in its Second Report on the application of the common system of value added tax, (28) stated that the subsidy should be included in the taxable amount only if (among other conditions) the subsidy is paid to the supplier of the goods or service. In this situation, the subsidy, as required by Regulation 603/95, accrues to the original producer and not to the processing undertaking. Moreover, the subsidy is not paid to the subsidised producer for the supply of particular goods or the provision of a particular service; rather it is granted after a service has been performed for the subsidised producer, and in order to reduce his production costs.

64. The Community legislature could have chosen to grant the subsidy to the processing undertaking in order to promote the processing of fodder. The full subsidy would then have had to go to the processing undertaking. However, it is apparent from the preamble to the old regulation (No 1117/78) that the legislature opted expressly to grant the subsidy to producers to promote the production of green fodder.

65. It follows that the Commission cannot maintain that the subsidy is paid to the processor in order to encourage the processing of fodder. Its contention that the subsidy could be taxed at the processing undertaking is therefore untenable.

66. Finally, the third situation: here, it is suggested, the subsidy could be taxed on the basis of Article 11(A)(1)(a) of the Sixth Directive. The processing undertaking processes the green fodder having purchased it from the primary producers, and subsequently sells it as dried fodder to third

parties, who will pay a price for it. In addition, the processing undertaking receives a subsidy which may be reflected in a lower selling price.

67. It should be stated at once that it is very unlikely that the subsidy will be reflected in a lower selling price for the dried green fodder. In practice, the principal effect of the subsidy will necessarily be to increase the purchase price paid to the primary producer for the green fodder. After all, if the processor failed to pass on a substantial proportion of the subsidy to the primary producer in the form of a higher price, the latter might opt to have their products dried by a contract processor, so as to be entitled to receive the subsidy directly. Such an outcome is entirely compatible with the scheme and purpose of Regulation No 603/95, which seeks to promote the production of dried fodder, however the production chain is organised.

68. Thus the case argued by the Commission leads to an outcome which is unacceptable in terms of the scheme and purpose of Regulation No 603/95: how the production chain is organised would determine the fiscal treatment of the subsidy (not taxed in the first situation, taxed in the two others), even though the purpose of the subsidy is the same in all three situations, namely to encourage the production of fodder through financial support for the production process. Moreover, as I have already shown, in the second situation, the subsidy could not possibly be taxable, given the factual and legal position of the processor. Only in the third situation is it conceivable that the subsidy might be taxed. However, for that to be the case, the subsidy would have to be reflected in the selling price. I have already indicated that such a scenario is highly improbable; moreover it entirely disregards the fact that the subsidy paid to the processor is not intended to facilitate the sale of the processed product by lowering the price, but, quite the contrary, is designed to enable the processor to pay the primary producer a higher price.

69. An equally unacceptable outcome results when the Commission's case is considered alongside the common system of value added tax. It follows from the Commission's line of argument that the taxation of aid for the production of dried fodder will vary, depending on where processing occurs in the whole chain of production. The Commission is thus infringing the principle of neutrality, a central principle of the VAT system, according to which the total VAT payable at the final consumption stage must remain the same irrespective of the number of links in the chain of consumption. For that reason alone the Commission's claim must be dismissed.

D – *The need for a link between a subsidy and the price paid for the goods*

70. It is apparent from the Commission's Second Report on the application of the common system of value added tax (29) that the subsidy must constitute the consideration or part of the consideration. However, in *Office des produits wallons*, (30) the Court construed the concept of 'subsidies directly linked to the price of … supplies' more broadly.

71. The issue in that case was whether the subsidy paid by the Walloon Region to Office des produits wallons ASBL for the advertising and sale of local products should be subject to VAT. More specifically, the issue was whether VAT should be imposed on operating subsidies which were not paid directly for the supply of goods or services, but which might lead to the goods or services being made available at a lower price. The Court gave a number of indications as to how that question should be answered.

72. First, the subsidy must be paid specifically to the subsidised body to enable it to supply particular goods or provide particular services. Only in that case can it be deemed to constitute consideration for the supply of goods or services, and therefore be taxable. (31)

73. Secondly, the price of the goods or services must, in principle, be determined not later than the time of the taxable event.

74. Thirdly, it must be established that the undertaking to pay the subsidy made by the person who grants it has as its corollary the right of the beneficiary to receive it, since a taxable supply has been made by the latter. That link between the subsidy and the price must appear clearly following analysis of the actual circumstances underlying the payment of that consideration. On the other hand, it is not necessary for the price of the goods or services – or a part of the price – to be ascertained. It is sufficient for it to be ascertainable.

75. The Court's broader interpretation is grounded in the view that the subsidy must have the

effect of reducing the price. The Court stated: ‘The price payable by the purchaser must be fixed in such a way that it diminishes in proportion to the subsidy granted to the seller or supplier of the goods or services, which therefore constitutes an element in determining the price demanded by the latter. ’ (32)

76. As may be inferred from my introductory comments, I consider that the scope of the concept of ‘subsidies directly linked to the price of ... supplies’ must be interpreted in such a way that tax can be imposed on subsidies only to the extent that these are reflected in the price of the transaction. When considering the possible imposition of VAT on subsidies, the limited exception contained in Article 11(A)(1)(a) makes it necessary to ascertain precisely whether, and if so to what extent, the subsidies are reflected in the price at the stage of final consumption.

77. It is apparent from the regulations described in points 4 to 12 inclusive above that the purpose of granting the flat-rate aid is to promote the production of green fodder. That subsidy granted to the fodder sector may be classified as a production subsidy. Unlike a price subsidy, a production subsidy is not intended to have a direct effect on the selling price. (33) The subsidy is granted on the basis of the amount of processed fodder, and not as a contribution towards the price of the service. True, the subsidy is confined to a given maximum production quantity, but that fact does not detract from its purpose of promoting the production of fodder in the Community on a lasting basis by bringing down production costs.

78. It is apparent from the legislation setting up the system for granting aid for the production of dried fodder in the Community set out above at points 4 to 12 inclusive that Community production of fodder failed to match demand, as production costs in the Community were too high for it to be offered for sale at the world market prices effective at the time.

79. The flat-rate subsidy had the effect of reducing production costs, which enabled Community producers to produce cost-effectively at the (world) market prices. This is evidenced by the rapid growth in the share of the Community market accounted for by Community green fodder production. These developments even obliged the Community legislature to limit the amount of production subsidised, in order to prevent overproduction.

80. It is thus clear that while the subsidy did have an effect on the amount produced in the Community, it was not directly reflected in market prices. This is partly because of the nature of the (world) market for fodder which, as is the case for many agricultural products, is characterised by a large number of small suppliers. They are not strong enough to influence the market in their respective products through their individual market conduct. Individual producers who receive a flat-rate subsidy will not be able to pass it on to final consumers. For them, the ruling market price is a given; it is the price at which they have to offer their goods for sale, subsidy or no subsidy.

81. Any effect produced by the subsidy on selling prices is at most indirect. If the total amount of fodder produced with the subsidy were so considerable as to lead to a significant change in supply and demand on the world market, the world market price would be forced down. I consider such a scenario highly improbable, and in any case not determinative for the case brought by the Commission. The subsidy will in any case never be completely reflected in the selling price. Moreover, capping the subsidy is an attempt to forestall precisely the effect described – an effect which would have made the relationship between production costs and selling price even more disadvantageous for Community producers.

82. This is all borne out by the nature of the limitation mechanism in Regulation No 603/95, whereby producers receive an advance payment during the marketing year, the final account following once the marketing year is over. The resulting uncertainty makes it inherently improbable that producers would incorporate the production subsidy directly in their selling prices (if indeed they were in a position to do so at all).

83. In its observations the Commission states that it is apparent from the selling price of the dried fodder that there is a direct causal link between that price and the aid granted, since the aid enables the processing undertakings to market the dried fodder at the world price. Without the aid the price would be higher, in view of the processors’ high production costs.

84. It follows from what I have already said that the Commission’s position is an untenable one.

The mechanism incorporated in Regulation No 603/95 is designed to influence, not the price of the fodder, but the production costs of the producers, so that they can produce at the market price. The result of the subsidy was an increase in the amount produced in the Community capable of being sold at the current price. Without the subsidy, therefore, there would be, not higher market prices, but simply less fodder produced in the Community. Any ensuing shortages could simply be supplied by third-country producers able to sell at world-market prices – as indeed was the case prior to 1978.

85. I conclude that the Commission has not even begun to demonstrate a direct causal link between the production subsidy and the prices at which the dried fodder was ultimately sold. As to the requirement (described above at points 55 to 57 inclusive) that for Article 11(A)(1)(a) to apply it is necessary to show how much the subsidy affected the price paid by the final consumer – the Commission never reaches that point at all.

86. For these reasons as well, the Commission's application must be dismissed.

VI – Conclusion

87. On the basis of the foregoing, I suggest that the Court should:

(a)dismiss the Commission's actions against the Italian Republic (Case C-381/91), the Republic of Finland (Case C-495/01), the Federal Republic of Germany (Case C-144/02) and the Kingdom of Sweden (Case C-463/02);

(b)pursuant to Article 69(2) of the Rules of Procedure, order the Commission to pay the costs of the proceedings;

(c)pursuant to Article 69(4) of the Rules of Procedure, order the Republic of Finland, the Kingdom of Sweden and the Federal Republic of Germany to bear their own costs as interveners.

1 – Original language: Dutch.

2 – OJ 1977 L 145, p. 1.

3 – OJ 1995 L 63, p. 1.

4 – The Italian Republic is supported by the Kingdom of Sweden and the Republic of Finland. The Republic of Finland is supported by the Federal Republic of Germany and the Kingdom of Sweden. The Federal Republic of Germany is supported by the Kingdom of Sweden and the Republic of Finland. The Kingdom of Sweden is supported by the Republic of Finland.

5 – Council Regulation (EEC) No 1117/78 of 22 May 1978 on the common organisation of the market in dried fodder (OJ 1978 L 142, p. 1), amended by Regulation No 3496/93 (OJ 1993 L 319, p. 17).

6 – Council Regulation (EEC) No 1417/78 of 19 June 1978 on the aid system for dried fodder (OJ 1978 L 171 , p. 1), amended by Regulation (EEC) No 1110/89 (OJ 1989 L 18, p. 1).

7 – Commission Regulation (EEC) No 1528/78 of 30 June 1978 laying down detailed rules for the application of the system of aid for dried fodder (OJ 1978 L 179, p. 10).

8 – Commission Regulation (EC) No 785/95 of 6 April 1995 laying down detailed rules for the application of Council Regulation (EC) No 603/95 on the common organisation of the market in dried fodder (OJ 1995 L 79, p. 5).

9 – Article 4 of Regulation No 603/95 lays down the maximum quantities of dried fodder eligible for aid. Amended by Council Regulation (EC) No 1347/95 of 9 June 1995 amending Regulation (EC) No 603/95 on the common organisation of the market in dried fodder (OJ 1995 L 131, p. 1). The text as amended reads as follows: (Article 4(1)): 'A maximum guaranteed quantity (MGQ) per marketing year of 4 412 400 tonnes of dehydrated fodder for which ... aid ... may be granted is hereby established'; (Article 4(3)): 'A maximum guaranteed quantity (MGQ) per marketing year of 443 500 tonnes of sun-dried fodder for which. … aid ... may be granted is hereby established'.

10 – To qualify for aid, the processing undertakings must have obtained the fodder from producers, groups of producers or buyers approved by the competent authorities of the Member States.

11 – Article 11(2) of Regulation No 603/95 reads as follows: 'Where contracts as referred to in the first indent of Article 9(c) are special-order contracts for the processing of fodder supplied by the producers, they shall specify at least the area whose crop is to be delivered and include a clause

laying down an obligation on processing undertakings to pay the producers the aid specified in Article 3 which they receive for the quantities processed under the contracts.'
12 – 'For the purposes of this regulation, in order to obtain entitlement to the aid referred to in Article 3 of Regulation (EC) No 603/95, the products referred to in Article 2(1) shall be considered to have left the processing undertaking where: (a) they leave in the unaltered state: – the precincts of the processing undertaking, – where the dried fodder cannot be stored in those precincts, any storage place outside them offering adequate safeguards for the purposes of checking the fodder stored and which has been approved in advance by the competent authority, – in the case of mobile drying equipment, the equipment in which the dehydration is carried out and, if the dehydrated fodder is stored by the person having dried it, any storage place which satisfies the conditions of the second indent; or (b) they leave the precincts or any storage place referred to at (a) having been mixed within the processing undertaking with raw materials, other than those specified in Article 1 of Regulation (EC) No 603/95 and those used for binding, with a view to the manufacture of compound feed, and, at the time they leave the processing undertaking, are of sound and fair merchantable quality meeting the requirements for being placed on the market as feedingstuffs and have the following characteristics: …'
13 – First Council Directive (67/227/EEC) of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes (OJ, English Special Edition 1967, p. 14).
14 – Save where otherwise indicated, the provisions referred to below are from the Sixth Directive.
15 – First Report from the Commission on the application of the common system of value added tax, submitted in accordance with Article 34 of the Sixth Directive (77/388/EEC) of 17 May 1977, COM(83) 426 final, 14 September 1983, p. 37).
16 – Second Report from the Commission to the Council on the application of the common system of value added tax, submitted in accordance with Article 34 of the Sixth Directive (77/388/EEC) of 17 May 1977, COM(88) 799 final, 20 December 1988, p. 26.
17 – It is clear from the third recital of the preamble to Regulation No 603/95 that the aim of these rules is to limit Community dried fodder production.
18 – Case C-184/00 *Office des produits wallons* [2001] ECR I-9115.
19 – See also *Office des produits wallons* (cited above in footnote 18, paragraph 14). '[In order] to establish the existence of a direct link between the subsidy and the goods or services at issue ... it [is] necessary to verify at an early stage that the purchasers of the goods or services benefit from the subsidy granted to the beneficiary. The price payable by the purchaser must be fixed in such a way that it diminishes in proportion to the subsidy granted to the seller or supplier of the goods or services, which therefore constitutes an element in determining the price demanded by the latter'.
20 – See also the eleventh and twelfth recitals in the preamble to Regulation 603/95: 'Whereas, in order to encourage a regular supply of green fodder to processors and to enable producers to benefit from the aid scheme, the granting of aid should in certain cases be conditional on the conclusion of contracts between producers and processing undertakings; whereas the contracts should, on the one hand, promote regular supplies for the processing undertakings and, on the other, permit the producers to benefit from the aid; whereas, to this end, it should be laid down that the contracts include certain information.'
21 – The Member States consider that this view is confirmed by *Office des produits wallons* (cited in footnote 18), paragraph 13.
22 – See also Advocate General Jacobs' Opinion in Case C-384/95 *Landboden-Agrardienste* [1997] ECR I-7387, paragraphs 12 and 13.
23 – Case 154/80 [1981] ECR 445. A cooperative association ran a potato storage warehouse which its members paid an annual storage charge to use. In certain years the association decided not to levy the charge, since the cooperative already had sufficient funds available following an advantageous transaction involving real estate. As no charge was imposed, the value of the cooperative's shares declined, which affected the net worth of the shareholder members. Could the decline in the value of the members' shares in the cooperative be deemed to constitute consideration within the meaning of Article 8 of the Second Directive as being payment for the

service (storing the potatoes)? The Court held that it could not: no sum of money or consideration had actually been received for the storage provided.
24 – See, inter alia, Case 268/83 Rompelman [1985] ECR 655, paragraph 19; Case C-37/95 *Ghent Coal Terminal* [1998] ECR I-1, paragraph 15; Joined Cases C-110/98 to C-147/98 *Gabalfrisa and Others* [2000] ECR I-1577, paragraph 44, and Case C-98/98 *Midland Bank* [2000] ECR I?4177, paragraph 19.
25 – Cited in footnote 23.
26 – Cited at footnote 18.
27 – Article 8 of Regulation No 603/95.
28 – Cited in footnote 16.
29 – Cited in footnote 16.
30 – Cited in footnote 18.
31 – I must make it clear that the transactions referred to in Article 11(A) of the Sixth Directive are not transactions carried out for the benefit of the public authority which grants the subsidy. Article 11(A) deals with situations involving three parties – the public authority granting the subsidy, the body which receives it, and the purchaser of the goods or recipient of the service supplied by the subsidised establishment.
32 – ‘It is therefore for the referring court to establish the existence of a direct link between the subsidy and the goods or services at issue. That makes it necessary to verify at an early stage that the purchasers of the goods or services benefit from the subsidy granted to the beneficiary. The price payable by the purchaser must be fixed in such a way that it diminishes in proportion to the subsidy granted to the seller or supplier of the goods or services, which therefore constitutes an element in determining the price demanded by the latter. The court must examine, objectively, whether the fact that a subsidy is paid to the seller or supplier allows the latter to sell the goods or supply the services at a price lower than he would have to demand in the absence of subsidy.’
33 – Various other types of subsidy may be distinguished, such as operating subsidies, income subsidies and investment subsidies. There is an example of an income subsidy in the 'old' regulation, No 1117/78. Under that regulation, supplementary aid was granted to offset production costs and to enhance competitively vis-à-vis third countries. The new regulations, Nos 603/95 and 785/95, abolished the supplementary aid. The amount of the aid was defined as a percentage of the difference between the world market price and the previously-established guide price. One common feature of all these subsidies is that they are not directly linked to the price of any goods.