JUDGMENT OF THE COURT
1 DECEMBER 1965[1]

Commission of the European Economic Community v Italian Republic[2]

Case 45/64

Summary

1. Obligations of Member States — Failure to fulfil such obligations — Measures adopted by the Commission — Subject-matter — Grounds
(EEC Treaty, Article 169)

2. Policy of the EEC — Tax provisions — Export of products to another Member State — Internal taxation — Taxation imposed directly or indirectly on the products — Concept — Repayment — Legality
(EEC Treaty, Article 96)

3. Policy of the EEC — Tax provisions — Export of products to another Member State — Internal taxation — Repayment — Flat rate system — Legality — Proof — Onus of proof

1. In the case of a failure of a Member State to fulfil its obligations under the Treaty, the various measures adopted by the Commission in the administrative stage of the procedure and that before the Court must relate to the same failure and be based on the same grounds.
2. As used in Article 96, the expression 'directly' must be understood to refer to taxation imposed on the finished product, whilst the expression indirectly' refers to taxation imposed during the various stages of production on the raw materials or semi-finished products used in the manufacture of the product.
Duties which are not imposed directly or indirectly on exported products cannot be the subject of the repayment provided for in Article 96.
3. In the application of Article 96, it is for a Member State which employs a flat rate system of repayments of internal taxation to establish that such a system remains within the mandatory limits of the Article, both as regards the nature of the taxation to be repaid and the amount of such repayment on each of the products affected by the measure in question.

In Case 45/64

COMMISSION OF THE EUROPEAN ECONOMIC COMMUNITY, represented by its Legal Adviser, Giuseppe Marchesini, acting as Agent, with an address for

1 — Language of the Case: Italian.
2 — CMLR.

service in Luxembourg at the offices of Henri Manzanarès, Secretary of the Legal Department of the European Executives, 2 place de Metz,

applicant,

v

ITALIAN REPUBLIC, represented by Adolfo Maresca, Minister Plenipotentiary, Deputy Head of the Diplomatic Legal Department of the Foreign Ministry, acting as Agent, assisted by Pietro Peronaci, Deputy State Advocate-General, with an address for service in Luxembourg at the Italian Embassy, 5 rue Marie-Adèlaïde,

defendant,

Application for a ruling that, by allowing certain products of the engineering industry exported to other Member States to benefit from a repayment of internal taxation which contravened Article 96 of the Treaty establishing the European Economic Community either by reason of the nature of the tax or of the method of repayment, the Italian Republic has failed to fulfil an obligation under the said Treaty,

THE COURT

composed of: Ch. L. Hammes, President (Rapporteur), L. Delvaux, President of Chamber, A. M. Donner, A. Trabucchi and R. Lecourt, Judges,

Advocate-General: J. Gand
Registrar: A. Van Houtte

gives the following

JUDGMENT

Issues of fact and of law

I — Facts

The facts may be summarized as follows:

1. By Law No 103 of 10 March 1955, extended until 31 December 1963 by Law No 284 of 18 March 1958, the Italian Republic allowed a refund on the export of certain products of the engineering industry of the fixed and other customs duties imposed on the iron and steel products used in their manufacture.

2. As the Commission of the EEC believed that evidence existed that in practice the refunds were extended to other taxes imposed on raw materials or semi-finished products incorporated

in the products of the Italian engineering industry, or even imposed independently of such use, discussions took place between the Commission and the Italian Government in late 1961 and early 1962.

3. Following these discussions, the Italian Government reduced by 35% the amount of the refunds made on products exported to the other Member States of the Community. It also declared that it was prepared to determine as soon as possible that part of the refund relating to taxes other than turnover tax and to agree on a timetable for its gradual abolition.

4. After a fresh exchange of correspondence and further discussions, followed by an additional reduction of 10% of the amount of the refunds, the Commission set in motion the procedure laid down in Article 169 of the EEC Treaty by requesting the Italian Government, by letter of 6 June 1963, to submit its observations on the alleged infringement of Article 96.

5. The observations of the Italian Government were conveyed to the Commission by letter dated 11 July 1963 from its Permanent Representation at Brussels. They were not considered satisfactory, although a further reduction of 10% had been made on 1 July 1963.

6. After further negotiations, the Commission issued on 11 December 1963 the reasoned opinion provided for in the first paragraph of Article 169 of the EEC Treaty. This opinion gives reasons for the belief of the Commission that the Italian Republic had failed to fulfil its obligations under Article 96 and invites it to terminate by 31 December at the latest the grant of repayment of internal taxation on exported products of the engineering industry.

7. By note of 18 December 1963, the Italian Permanent Representation conveyed to the Commission the text of a draft Law intended to replace Law No 103, which had been approved by the Italian Council of Ministers and submitted to Parliament.

8. Because of the similarity which it found between the draft Law and Law No 103, the Commission informed the Italian Government by letter of 28 January 1964 that it considered as contrary to its reasoned opinion the introduction of legislation intended to perpetuate the grant of repayments which it regarded as incompatible with the Treaty.

9. The draft Law in question was, however, approved by the two Chambers of the Italian Parliament. Law No 639 on the refund of customs duties and indirect internal taxation other than the Imposta Generale sull'Entrata (turnover tax) on the export of certain industrial products was promulgated on 5 July 1964 and published in the Gazzetta Ufficiale of 5 August 1964. It came into force on that date, with retroactive effect to 1 January 1964.

10. As it considered that no break in continuity and no substantial difference existed between the repayments provided for by Law No 103, which were criticized in the reasoned opinion of 11 December 1963, and those provided for in the new Law No 639, the Commission, acting in pursuance of the second paragraph of Article 169 of the EEC Treaty, brought the matter before the Court of Justice by an application lodged on 13 October 1964 alleging the failure of the Italian Republic to fulfil its obligations under Article 96 of the Treaty.

II — Conclusions of the parties

The *applicant* claims that, after dismissing as unfounded the objection of inadmissibility raised by the defendant and the objection on the substance for lack of proof, the Court should: declare that, by permitting the refund of taxes which according to Article 96 of the Treaty

of Rome cannot be repaid, the Italian Republic has failed in its obligations under that Article;
order the defendant to pay the costs.
The *defendant* contends that the Court should:
declare that the application is inadmissible or, alternatively, dismiss it as to the substance;
order the Commission to pay the costs.

III — Submissions and arguments of the parties

The submissions and arguments of the parties may be summarized as follows:

A — *Admissibility*

1. The *defendant* maintains that the application is inadmissible on the ground that the subject-matter of the administrative stage and of the stage contested before the Court are different.
The administrative procedure concerns Law No 103 of 1955, whilst the application to the Court concerns Law No 639 of 1964; there has been a misunderstanding of Article 169 of the Treaty as regards the latter in that the Italian Government submitted no observations on this Law nor was any reasoned opinion given on it by the Commission.
The *applicant* replies first of all that the procedure laid down in Article 169 is deprived of all effect if it is accepted that a Member State has complied with a reasoned opinion when, on the expiry of a legislative provision which created the situation prohibited by the Treaty and criticized by the opinion, it wholly or partially recreated this situation by means of a later provision. There is, in this case, no substantial difference between the repayments provided for by Law No 103 on the one hand and by Law No 639 on the other, either as regards the products which benefited from them or the taxes capable of repayment. As regards the progressive reductions of the amount of the repayments provided for in Law No 639, they merely follow those which had been payable within the framework of Law No 103 and involve no change in the earlier system.
Secondly, the applicant maintains that it criticized the Italian Republic both in the reasoned opinion and in the application on the ground of the actual functioning of the system of refunds, that is, it criticized the *practice* of national administrations of granting repayments which are incompatible with Article 96, either by reason of the nature of the taxes repaid or of the method employed in the repayment, independently of the legislative measure on which the practice in question is based.
Thirdly, the applicant observes that the reasoned opinion of December 1963 invited the Italian Republic to terminate by 31 December at the latest the grant of repayments which were incompatible with the obligations in Article 96; by introducing a legislative provision with retroactive effect to 1 January 1964 continuing the scheme of repayments beyond the date fixed the defendant clearly refused to comply with the terms of the reasoned opinion.
Finally, the applicant maintains that, in its letter of 16 December 1963 with which it sent the Italian Government the reasoned opinion of 11 December, it anticipated subsequent events by stating that 'its intention and duty was to prevent the continued infringement of Article 96, either by a measure continuing the regulation in force or by the introduction of a similar measure in the future'.
In short, the applicant considers that the infringement of the Treaty referred to the Court is identical to that criticized in the reasoned opinion; thus there cannot be any infringement of Article 169 and the objection of inadmissibility must be dismissed as unfounded and for lack of proof.

The *defendant* replies that Law No 639, which introduces independent rules and a sliding-scale for export repayments, created a situation fundamentally different from that previously existing. The important factor in laws granting tax advantages is the amount of such advantages; as the rate of repayments provided for by Law No 103 was different from that provided for by Law No 639, these two Laws are different and the second cannot be regarded as an extension of the first.

Moreover, as regards the implementation of Law No 103, the defendant disputes the applicant's statement that the Italian administrations had used it in order to grant to exporters refunds not envisaged by the Treaty.

Lastly, the defendant observes that the administrative stage provided for in Article 169 is of legal importance from the point of view both of the procedure and of the actual subject-matter. It is for this reason that a letter accompanying the reasoned opinion must be considered as being without legal effect and that, when the subject-matter of the administrative stage was a situation created by a legislative measure which was *ex hypothesi* contrary to the Treaty, the Commission cannot refer directly to the Court the situation resulting from a new Law which, as in this case, is fundamentally different from the earlier Law.

2. The *defendant* raises a second objection to the admissibility of the application, on the ground that the Commission did not allow the Italian Government an opportunity to submit its observations on the reasoning set out in the reasoned opinion and, even less, on those set out in support of the application. After stating that certain indirect taxes (registration, stamp and mortgage duties and charges on licences and concessions, motor vehicles and advertising) are not covered by Article 96 as they must be regarded as direct taxes, the Commission maintained in the reasoned opinion that these same taxes cannot be the subject of any repayment as it is impossible to identify them and to calculate their respective effects on production costs. Finally, in its application the Commission explained the non-repayable nature of the charges on the ground that they belong to a special category of indirect taxes on businesses.

The *applicant* replies that, unlike the reasoned opinion, its obligation to give the State concerned an opportunity to submit its observations does not imply the need to give a detailed, and even less a definitive, legal justification. It is enough that the State be given sufficient information to establish that the Treaty has been infringed, that is, the act or omission constituting the infringement and the rules of Community law which have allegedly been infringed.

The applicant maintains, moreover, that the defendant is distorting the arguments actually put forward by the Commission. In its letter of 6 June 1963, the Commission maintained essentially that the duties in question are imposed on the undertaking and not on the exported products as such; the reasoned opinion takes up this view and points out that it is impossible to separate and specify the effects of such duties on production costs. The arguments of the Commission have not been modified; the legal nature of the infringement has not been changed. The Italian Government's rights of defence have in no way been prejudiced.

The *defendant* replies that the arguments of the Commission are based on an incorrect interpretation of the first paragraph of Article 169. Such an interpretation enables the Commission to criticize a Member State for an alleged infringement of an obligation arising out of a certain rule of the Treaty on the basis of reasoning x, to issue a reasoned opinion on the basis of reason y and to refer the matter to the Court on the basis for example of reason z. According to the defendant, such an argument is inadmissible.

B — *The substance of the case*

1. On the duties benefiting from a refund and the legality of certain repayments

The *applicant* maintains that the refund was extended to registration, stamp and mortgage duties as well as to charges on licences and concessions, motor vehicles and advertising. Such refunds are of a purely fiscal nature and thus contravene Article 96. It puts forward the following points:

(a) The Italian Government has expressly acknowledged that one element in the amount of the refund concerns indirect taxes other than customs duties and turnover tax (I.G.E.).
(b) The Italian Government has never justified the existence of this element, either as regards the nature of the taxes involved or the equivalence between the tax burden actually borne and the amount of the repayment.
(c) The Italian Government has also recognized the need to abolish that part of the repayment which does not concern customs duties and thus to remove the illegality of such repayments as regards the Treaty.

The *defendant* replies to these arguments as follows:

(a) It is not disputed that the repayments apply not only to customs duties, but also to indirect internal taxation other than I.G.E. These repayments are, however, perfectly legal as regards Article 96.
(b) The opinion of the Commission that the Italian Government had acknowledged the illegality of the repayment of such indirect taxes can only be based on a mistaken interpretation of certain documents submitted by the Italian Government.
(c) It is for the Commission rather than for the Italian Government to establish that the amount of the repayment exceeds the indirect taxation applied.
(d) The previous situation was radically altered as a result of further reductions in the amount of such repayments from 45% to 60% on 31 December 1963.

The *applicant* considers that the repayment of registration, stamp and mortgage duties, of charges on licences and concessions as well as on motor vehicles and advertising contravenes Article 96 of the EEC Treaty. It puts forward the following arguments to support this assertion:

(a) The phrase 'internal taxation . . . imposed on them whether directly or indirectly', which appears in Article 96, must be interpreted in the light of the system of the Treaty and its aims. It is impossible to identify the adverbs 'directly' or 'indirectly' with the concept of direct and indirect taxes.
(b) Article 96 must be interpreted as authorizing the refund of taxes imposed on the finished product or on raw materials and semi-finished products at earlier stages of manufacture.
(c) However, Article 96 only authorizes the refund of taxes whose effect on the cost price may be determined exactly *in individuum.*
(d) Article 98 provides for the repayment, in exceptional circumstances, of taxes, whose effect on production costs cannot be determined *in individuum.* It is, however, subject to certain specific conditions and cannot be applied to indirect taxes in the true sense.
(e) The duties and charges, repayment of which is criticized in this case, are not imposed on the finished product or on the raw materials and semi-finished products involved in the process of manufacture, but on the undertaking and its production as a whole. A uniform assessment of the tax burden can only be imaginary, therefore, even as regards identical products. The situation is different, however, as regards certain other indirect taxes, such as taxes on manufacture and consumption; these are imposed on the product itself and their part in the cost price can be identified. It is for this reason that the Commis-

sion has not criticized their repayment.
The duties in question, whose structure and methods of levy prevent a precise determination of their effect on the cost of the products, thus clash with the basic principle of Article 96 according to which the amount of the repayment must not exceed the taxes actually paid. They cannot therefore be the subject of the repayment provided for in that provision. Nor can they benefit from the remissions or repayments provided for in Article 98, as this provision does not apply to indirect taxes in the true sense and its implementation requires the agreement of the Council.
The *defendant* considers for its part that registration, stamp and mortgage duties as well as charges on licences and concessions, motor vehicles and advertising constitute indirect taxes which clearly fall within the provisions of Article 96. That this Article imposes no limit as regards indirect taxation is confirmed by Article 98. The duties and charges criticized, like the other indirect taxes on which the Commission allows a repayment to be made, are applied by virtue of specific laws and at fixed rates; they are imposed on all products equally, as each producer makes provision for their effect in calculating his production costs.
The argument of the Commission that it has difficulty in checking the amount of the repayments made on these indirect taxes has no legal value; moreover, it is incorrect to state that such taxes are applied by virtue of legal provisions and thus by virtue of unquestionable authorities. Be that as it may, it is for the Commission to bring evidence of the infringement of the Treaty to which it refers.
The defendant also observes that the Commission has made no objections to the repayment of other indirect taxes; it is thus contradicting itself.
The defendant maintains that in any event the result of the 60% reduction in the amount of the repayments at 31 December 1963 and the additional reductions (65% at 1 July 1964, 75% at 1 January 1965) is to keep the reimbursements at issue largely within the limits allowed by Article 96.
To this statement by the Italian Government the *applicant* replies that the successive reductions in the rate of repayments were not made on the basis of any specific document and do not deal with the problem of the legality of the 'residual' amount. The Commission has not complained of the infringement of Article 96 on the basis of its quantitative variable aspects, but on the basis of general criteria which are characteristic of the Italian system of export repayments.

2. The method of repayment and the legality of the system of average rates

The *applicant* maintains that all the repayments are made in the form of a sum calculated according to the weight in kilogrammes of the products which benefit from them and that they are fixed without reference to the various charges applied or applicable to the products in question. It maintains that this system of repayment on the basis of fixed average rates for products or groups of products contravenes Article 96. This complaint refers to all taxes capable of repayment within the framework of this provision.
The inevitable result of the practice of making flat rate repayments on the basis of average rates is that the amount of certain repayments exceeds that of the actual tax burdens.
Although the special provisions of Article 97 provide for the fixing of average rates, this only applies to one tax and to one method of levy which is in no way involved in this case.
In this respect the *defendant* points out, first, that the Commission has made no objection to the introduction of a flat rate for the repayment of indirect taxes other than those concerned in the present dispute.

Secondly, it maintains that the sovereignty of Member States enables them to choose the procedure which, according to their legal system, appears most suited to the exercise of their power under Article 96; a review by the Commission can only concern the final result.
The defendant points out that many provisions of the Treaty (in particular Article 97) allow the use of flat rate systems; the Commission cannot criticize the Italian Government for employing such a system once it is not excluded by Article 96.
Finally, the defendant maintains that the rates fixed as a result of the reduction made on 31 December 1963 in any event prevent the applicant's claiming that certain repayments contravene the Treaty.

IV — Procedure

The procedure followed the normal course.
On hearing the report of the Judge-Rapporteur and the opinion of the Advocate-General the Court decided that there was no need to hold any preparatory inquiry.
Before the opening of the oral procedure the applicant produced certain documents at the request of the Court.
The parties presented oral argument and their replies to the questions of the Judge-Rapporteur at the hearing on 30 September 1965.
The Advocate-General delivered his his opinion at the hearing on 19 October 1965.

Grounds of judgment

A — Admissibility

The first objection

The defendant claims that the application is inadmissible on the ground that it concerns Law No 639 of 5 July 1964 and that, in breach of the first paragraph of Article 169 of the Treaty, this Law was not the subject of observations by the Italian Republic or of a reasoned opinion by the Commission.

Thus there is no identity of subject-matter between the administrative stage, which concerned Law No 133 of 10 March 1955, and the stage before the Court which concerns Law No 639 which is fundamentally different from the former.

It emerges from the documents in the file that in both the administrative stage of the proceedings and that before the Court the Commission criticized the actual application by the Italian Government of the system of repayments on exports, without limiting the complaints which it thought itself entitled to make to the legislative measures capable of constituting the legal basis of the said system.

Moreover, in its reasoned opinion issued on 11 December and conveyed to the defendant on 16 December 1963, the Commission invited the Italian Republic to terminate by 31 December 1963 at the latest the grant of a repayment which, for the reasons set out therein, contravened Article 96 of the Treaty.

The purpose of the reasoned opinion was therefore, first, to establish that the Italian Government had failed to fulfil an obligation under the Treaty and, secondly, to warn the defendant not to continue such alleged infringement beyond the date indicated, either by a measure continuing the existing legislation or by similar future legislation.

This objection must therefore be rejected.

The second objection

The defendant maintains that the application is inadmissible because of a second infringement of Article 169, consisting in the fact that it was not given an opportunity to present its observations on the true nature of the failure complained of or, as a result, upon the grounds for the reasoned opinion and the basic issues of the application.

In this respect it should be stated that in the letter of 10 June 1963 by which it invited the Italian Government to submit its observations the Commission clearly indicated that it considered the system of repayments on exports operated by the Italian Government to contravene the Treaty, first, because it allowed repayment of certain categories of taxes which, contrary to Article 96, are imposed on the undertaking and not on the products exported and, secondly, because in determining the amount of the repayment it employs a procedure which involves the fixing of flat rates by products or groups of products, whilst Article 97 limits the use of such a method to turnover taxes calculated by a cumulative multi-stage system.

The reasoned opinion and the application made by the Commission are based on the same grounds and issues.

The Commission has thus given the Italian Republic an opportunity to submit its observations and has fairly and correctly applied the first paragraph of Article 169 of the Treaty.

This objection, therefore, must also be rejected.

B — The substance of the case

The first submission

It is not disputed between the parties that in calculating the amount of the repayment allowed on the export of products of the Italian engineering industry there are included registration, stamp and mortgage duties, charges on licences and concessions, motor vehicles and advertising.

According to the Commission, repayment of such duties and charges is not authorized by Article 96 of the Treaty, because they are imposed neither on the products as such nor upon the raw materials or semi-finished products used in their manufacture and because it was therefore impossible to calculate the effect of each one on the cost price of the products.

Article 96 authorizes Member States to make repayment of internal taxation on products exported to the territory of another Member State, provided that the amount of such repayment does not exceed the internal taxation imposed directly or indirectly on those products.

As used in Article 96, the expression 'directly' must be understood to refer to taxation imposed on the finished product, whilst the expression 'indirectly' refers to taxation imposed during the various stages of production on the raw materials or semi-finished products used in the manufacture of the product.

It is clear from the legal measure which introduces them and from the subject-matter and nature of the registration, stamp and mortgage duties and the charges on licences and concessions, cars and advertising that they are imposed upon the producer undertaking in the very varied aspects of its general commercial or financial activity rather than on the products as such, either at the various stages of their manufacture or at the final stage.

As they are not imposed directly or indirectly on the exported products, the registration, stamp and mortgage duties and the charges on licences and concessions, motor vehicles and advertising cannot be the subject of the repayment provided for in Article 96.

Thus, by including such duties and charges in the repayment enjoyed by exported products of the engineering industry, the Italian Republic is failing to fulfil one of its obligations under the Treaty.

The second submission

The Italian Republic is further accused of having infringed Article 96 of the Treaty by introducing a system of flat rate repayments.

The defendant considers that it is entitled to employ such a procedure, which is not prohibited by Article 96, and to choose the methods of repayment most suited to its legal system, as only the final result is open to review by the Commission.

It follows from Article 96 that the power of a State to resort to repayments of internal taxation is subject to the condition, on the one hand, that such repayments are imposed on the product itself and, on the other hand, that the repayment remains lower than or equal to the said taxation.

Apart from the categories of taxation referred to in the first submission of the application, the repayment at issue concerns the refund of internal taxation which is without question imposed on the products.

Thus it appears necessary to ascertain only whether the other condition imposed by Article 96 is fulfilled, namely whether it is really a question of repayment, in other words, whether the amount of the repayment is less than or equal to the amount of the taxation.

Such evidence must be given to permit the implementation of a measure which constitutes a true repayment of taxation and which is only justified on this ground and provided that this condition is fulfilled.

Further, since the Italian Republic introduced a flat rate system of its own free will, it is for that party to show that the system always remains within the mandatory limits of Article 96.

Therefore, as regards the various products in question, the Italian Republic should be asked to supply this information in writing to the Court, supported by figures.

C — Costs

Under the terms of Article 69 (2) of the Rules of Procedure the unsuccessful party shall be ordered to pay the costs.

The defendant has failed in its objections and as regards the first submission on the substance of the case.

It must therefore be ordered to pay half the costs forthwith.

The remainder of the costs shall be reserved.

On those grounds,

Upon reading the pleadings;
Upon hearing the report of the Judge-Rapporteur;
Upon hearing the parties;
Upon hearing the opinion of the Advocate-General;
Having regard to Articles 96 and 169 of the Treaty establishing the European Economic Community;
Having regard to the Protocol on the Statute of the Court of Justice of the European Economic Community;
Having regard to the Rules of Procedure of the Court of Justice of the European Communities;

THE COURT

hereby:

1. **Rules that, by granting repayment of internal taxation on the products of the engineering industry exported to the territory of other Member States in respect of registration, stamp and mortgage duties, charges on licences and concessions and on motor vehicles and advertising, the Italian Republic has failed to fulfil its obligation under Article 96 of the Treaty;**
2. **Orders that within three months from the date on which this judgment is given the Italian Republic shall show that the amount of the flat rate repayment of internal taxation imposed on the products of the engineering industry exported to the territory of other Member States does not exceed the amount of such taxation;**
3. **Orders that on the expiry of this period the oral procedure on the second submission of the application shall be reopened at the request of the party which first requests it;**
4. **Orders the defendant to bear half the costs, the remainder of which are reserved.**

Hammes Delvaux

Donner Trabucchi Lecourt

Delivered in open court in Luxembourg on 1 December 1965.

A. Van Houtte
Registrar

Ch. L. Hammes
President