JUDGMENT OF THE COURT (Sixth Chamber)
25 June 1997 *

In Case C-45/95,

Commission of the European Communities, represented by Enrico Traversa, of its Legal Service, acting as Agent, with an address for service in Luxembourg at the office of Carlos Gómez de la Cruz, of the same Service, Wagner Centre, Kirchberg,

applicant,

v

Italian Republic, represented by Umberto Leanza, Head of the Department for Legal Affairs in the Ministry for Foreign Affairs, acting as Agent, assisted by Maurizio Fiorilli, Avvocato dello Stato, with an address for service in Luxembourg at the Italian Embassy, 5 Rue Marie-Adélaïde,

defendant,

APPLICATION for a declaration that, by enacting and maintaining in force legislation which does not exempt from value added tax supplies of goods used wholly for an exempted activity or in any event excluded from the right of deduction, the Italian Republic has failed to fulfil its obligations under Article 13B(c) of the Sixth Council Directive (77/388/EEC) of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1),

* Language of the case: Italian.

THE COURT (Sixth Chamber),

composed of: G. F. Mancini, President of the Chamber, P. J. G. Kapteyn, G. Hirsch (Rapporteur), H. Ragnemalm and R. Schintgen, Judges,

Advocate General: D. Ruiz-Jarabo Colomer,
Registrar: L. Hewlett, Administrator,

having regard to the Report for the Hearing,

after hearing oral argument from the parties at the hearing on 14 November 1996,

after hearing the Opinion of the Advocate General at the sitting on 10 December 1996,

gives the following

Judgment

1 By application lodged at the Court Registry on 24 February 1995, the Commission of the European Communities brought an action under Article 169 of the EC Treaty for a declaration that, by enacting and maintaining in force legislation which does not exempt from value added tax ('VAT') supplies of goods used wholly for an exempted activity or in any event excluded from the right of deduction, the Italian Republic has failed to fulfil its obligations under Article 13B(c) of the Sixth Council Directive (77/388/EEC) of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1; 'the Sixth Directive').

Community law

2 Article 13B(c) of the Sixth Directive provides:

'B. *Other exemptions*

Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse:

...

(c) supplies of goods used wholly for an activity exempted under this Article ... when these goods have not given rise to the right to deduction, or of goods on the acquisition or production of which, by virtue of Article 17(6), value added tax did not become deductible;

...'

3 Article 17(6) states:

'Before a period of four years at the latest has elapsed from the date of entry into force of this Directive, the Council, acting unanimously on a proposal from the Commission, shall decide what expenditure shall not be eligible for a deduction of value added tax. Value added tax shall in no circumstances be deductible on expen-

diture which is not strictly business expenditure, such as that on luxuries, amusements or entertainment.

Until the above rules come into force, Member States may retain all the exclusions provided for under their national laws when this Directive comes into force'.

The Community rules referred to in that provision have not yet been adopted.

Italian law

4 In Italian law, Article 2 of Decree No 633 of the President of the Republic of 26 October 1972 imposing value added tax ('the Presidential Decree') provides:

'(Supplies of goods)

Transactions for value involving the transfer of property or the creation or transfer of a right *in rem* to use and enjoy assets, of whatever kind, constitute supplies of goods.

The following also constitute supplies of goods: ...

The following are deemed not to be supplies of goods: ...

(h) supplies of goods obtained or imported by the supplier without a right of deduction under the second paragraph of Article 19.'

5 The first paragraph of Article 19 of the Presidential Decree governs the right of taxable persons to deduct from the amount of tax payable on their transactions the input tax paid on 'goods and services imported or obtained in the course of carrying on a business or being engaged in a trade or profession'. Under the second paragraph of that article, VAT paid on the purchase of certain types of goods, such as cars, other self-propelled vehicles and pleasure craft, is not deductible.

6 Article 10 of the Presidential Decree, which contains a detailed and exhaustive list of 'exempt transactions', does not lay down any exemption for the supply of goods which have been used by a taxable person wholly for an exempted activity and in respect of which a right to deduct input tax did not therefore arise.

Procedure

7 By letter of 19 November 1992, the Commission informed the Italian Republic that, in its view, Article 13B(c) of the Sixth Directive had not been correctly implemented by Articles 2, 10 and 19 of the Presidential Decree and accordingly gave it formal notice to submit its observations within a period of two months.

8 In a letter of 31 March 1993, the Italian Government acknowledged that Article 13B(c) of the Sixth Directive had been only partially transposed into national law.

9 Despite the reasoned opinion sent to it on 19 July 1994 Italy maintained those provisions in force. The Commission therefore brought this action.

10 In its application, the Commission raises two objections alleging incorrect transposition of Article 13B(c) of the Sixth Directive in so far as it (i) requires the Member States to exempt 'supplies of goods used wholly for an activity exempted under [that] article ... when these goods have not given rise to the right to deduction' and (ii) requires exemption of 'supplies ... of goods on the acquisition or production of which, by virtue of Article 17(6), value added tax did not become deductible'.

11 In its defence, the Italian Government disputes that the provision has not been correctly transposed into Italian law.

Incorrect transposition of the first part of Article 13B(c) of the Sixth Directive

12 The first part of Article 13B(c) requires the Member States to exempt supplies of goods used wholly for an activity exempted under Article 13 where those goods have not given rise to a right of deduction such as that provided for in Article 17(3)(c).

13 It is common ground that, as the Commission maintains, the Italian Republic has not exempted such supplies of goods and that they are not among the 30 or so categories of exempt transaction listed in Article 10 of the Presidential Decree.

14 The Italian Government contends, however, that a taxable person who buys goods used wholly for an exempt activity normally acquires them for his own use, so that the subsequent supply of those goods is hypothetical. In addition, since the goods would be second-hand, the amount of double taxation would be small in any event.

15 That argument cannot be accepted. Even if the amount of VAT due in the event of double taxation would in fact be insignificant, which the Commission disputes, that cannot absolve Italy from properly implementing Article 13B(c) of the Sixth Directive whose very purpose is to avoid double taxation contrary to the principle of fiscal neutrality inherent in the common system of value added tax.

Incorrect transposition of the final part of Article 13B(c) of the Sixth Directive

16 The final part of Article 13B(c) requires the Member States to exempt the supply of goods in respect of which, by virtue of Article 17(6), VAT did

not become deductible when they were previously acquired or produced by the taxable person.

17 Italy does not deny that subparagraph (h) of the third paragraph of Article 2 of the Presidential Decree excludes from the scope of VAT, rather than exempts, the supply of certain goods which are not strictly business goods and whose acquisition did not give rise to a right of deduction in accordance with the second paragraph of Article 19 of the Presidential Decree, that provision of Italian law corresponding to Article 17(6) of the Sixth Directive.

18 However, it submits in essence that Article 13 of the Sixth Directive does not oblige the Member States to transpose the exemption therein literally, provided that its substance is respected. Subparagraph (h) of the third paragraph of Article 2 of the Presidential Decree, which excludes from the scope of VAT, rather than exempts, certain supplies of goods which are not strictly business goods, does not conflict with the objective set out in Article 17(6) of the Sixth Directive, the provision to which Article 13B(c) refers.

19 In regard to that argument, it must be pointed out that, while Article 13B(c) of the Sixth Directive enables the Member States to determine the conditions for the purpose of ensuring the correct and straightforward application of the exemptions laid down therein, it does not allow them to treat a transaction which is to be exempted as one which falls outside the scope of VAT. Such a transposition is in any event contrary to the correct and straightforward application of exemptions required by Article 13B(c) if it does not have the same effects as an exemption.

20 That is the case here. As the Advocate General has explained in paragraph 42 et seq. of his Opinion, the calculation of the deductible proportion provided for by Article 19 of the Sixth Directive and the third paragraph of Article 19 of the Presidential Decree and, therefore, the amount of VAT which a taxable person may deduct, differ according to whether the supplies of goods in issue are rightly exempted or, as subparagraph (h) of the third paragraph of Article 2 of the Presidential Decree provides, fall outside the sphere of application of VAT.

21 It must therefore be held that, by enacting and maintaining in force legislation which does not exempt from value added tax supplies of goods used wholly for an exempted activity or otherwise excluded from the right of deduction, the Italian Republic has failed to fulfil its obligations under Article 13B(c) of the Sixth Directive.

Costs

22 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Commission has not asked for the Italian Republic to be ordered to pay the costs, each party must bear its own costs.

On those grounds,

THE COURT (Sixth Chamber)

hereby:

1. **Declares that, by enacting and maintaining in force legislation which does not exempt from value added tax supplies of goods used wholly for an exempted activity or otherwise excluded from the right of deduction, the Italian Republic has failed to fulfil its obligations under Article 13B(c) of the Sixth Council Directive (77/388/EEC) of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment;**

2. **Orders the parties to bear their own costs.**

Mancini Kapteyn Hirsch

Ragnemalm Schintgen

Delivered in open court in Luxembourg on 25 June 1997.

R. Grass G. F. Mancini

Registrar President of the Sixth Chamber