REPORT FOR THE HEARING
delivered in Case 3/86 *

I — Facts and procedure

A — *The relevant provisions*

1. The Community rules

Article 25 (1) of the Sixth Council Directive, of 17 May 1977, on the harmonization of the laws of the Member States relating to turnover taxes provides for the possibility of applying to farmers a flat-rate scheme intended to offset the value-added tax charged on purchases of goods and services made by the 'flat-rate farmers'.

Pursuant to Article 25 (3), Member States may fix the flat-rate compensation percentages, which must be notified to the Commission before their application. Such percentages are to be based on macroeconomic statistics for flat-rate farmers alone for the preceding three years. They may not have the effect of obtaining for flat-rate farmers refunds greater than the value-added tax charges on inputs.

It is also provided therein that Member States may fix varying flat-rate compensation percentages for forestry, for the different subdivisions of agriculture and for fisheries.

Finally, Article 25 (5) states that flat-rate percentages shall be applied to the price, exclusive of tax, of the agricultural products and services supplied by the flat-rate farmers to taxable persons other than a flat-rate farmer.

2. The national rules in question

By virtue of Article 34 of Decree No 633 of the President of the Republic of 26 October 1972 introducing value-added tax (*Official Journal of the Italian Republic* No 292, 11.11.1972), Italy established a flat-rate system for farmers. In the context of this system, the legislature made use of the possibility provided for in Article 25 (3) of the Sixth Directive by laying down a series of flat-rate compensation percentages, which varied according to the different subdivisions of agriculture and groups of products.

By a Ministerial Decree dated 25 February 1983 (*Official Journal of the Italian Republic* No 58, 1.3.1983), the flat-rate percentage was set at 14% with effect from 1 March 1983 for beef, pork and unconcentrated and unsweetened fresh milk. This rate is lower than the 15% flat-rate reimbursement applied previously to those three categories of products under Law No 889 of 22 December 1980 (Ministerial Decree of 5 January 1981).

* Language of the Case: Italian.

B — *The background to the case*

By a letter dated 21 December 1981, the Commission informed the Italian Government that the flat-rate scheme for farmers introduced in Italy on the basis of Article 34 of Presidential Decree No 633 did not comply with Article 25 (5) of the Sixth Directive, since it did not exclude from the scheme supplies of goods and services made to other flat-rate farmers. It also stated that the flat-rate compensation percentage of 15%, which was applied to beef, pork and fresh milk, represented a flat-rate compensation clearly greater than the input taxes paid and that the calculations provided by the Italian authorities were not relevant. Finally, the Commission pointed out that the statistics related only to one year, whereas the Sixth Directive provided for a reference period of three years, and that they took into consideration all farmers although only the macro-economic statistics relating to flat-rate farmers should be used. In its letter, the Commission invited the Italian Government to submit its observations, in accordance with Article 169 of the EEC Treaty, to submit its observations within a period of two months.

The Italian Government replied by two notes dated 26 June and 8 November 1982 respectively, transmitted by the Italian Permanent Representative to the European Communities. It conceded therein that the calculations carried out in respect of the three-year period 1978-80, broken down by subdivision, revealed that there had been 'a slight overestimate of the flat-rate compensation percentage of the input VAT in the beef and pork sectors.' The Italian Government stated its readiness to reduce the rate of compensation for that subdivision. It also stressed that the characteristics of Italian stock-rearing holdings were very different from those of other Member States of the Community, owing to the high level of production costs and thus of VAT inputs. The Italian Government pointed out that there were in Italy a very large number of extremely small farms, whose low level of production was intended for family consumption and was not marketed. Small stock-rearing holdings having for example one head of beef-cattle and one pig scarcely used any production factors subject to VAT and the production factors appertaining to rearing on a macro-economic scale did not therefore relate to the whole of the sector but only to a fraction of it.

Having found after one year that the Italian Government had not reduced the flat-rate compensation percentage laid down for the three products in question and that a definitive and precise view as to the calculations relating to rearing was not possible in the absence of statistical data broken down by sector and based on official documentary evidence, the Commission, on 25 March 1985, issued a reasoned opinion, inviting the Italian Republic to adopt the necessary measures in order to comply with the said opinion within one month from notification thereof.

To date, the Italian Government has not replied to this reasoned opinion. However, in the context of the technical consultations which the Italian authorities have been conducting with the Commission concerning the calculations and methodology applicable as regards own resources, they communicated by a note dated 12 July 1985 from the Italian Permanent Representative fresh calculations for the years 1979

to 1982 relating to flat-rate compensation in the agricultural sector. The Commission reacted to the communication of these new calculations by a letter dated 18 September 1985 addressed to the Italian Permanent Representative.

C — *Written procedure*

The Commission brought these proceedings by an application lodged at the Court Registry on 9 January 1986.

The written procedure followed the normal course. Upon hearing the report of the Judge-Rapporteur and the views of the Advocate General, the Court decided to open the oral procedure without any preparatory inquiry. The parties were requested to reply in writing to certain questions which they did within the period laid down.

II — Submissions of the parties

The Commission claims that the Court should:

Declare that, by introducing and maintaining in force a flat-rate scheme which is incompatible with Article 25 (3) and (5) of the Sixth Directive, Council Directive 77/388/EEC of 17 May 1977, as regards the unlimited nature of that scheme and the rate of VAT refunds paid to producers of beef, pork and fresh milk, the Italian Republic has failed to fulfil its obligations under the EEC Treaty and the Sixth Directive;

Order the Italian Republic to bear the costs.

The Italian Republic contends that the Court should:

Dismiss the Commission's application;

Order the applicant to pay the costs.

III — Submissions and arguments of the parties

The Commission claims that the Italian Republic has not complied with the Sixth Directive in three respects. First, it used macro-economic statistics which were not in conformity with Article 25 (3) of the Sixth Directive; secondly, it set the flat-rate compensation percentages for beef cattle, pigs and milk at too high a level; and thirdly, it did not exclude from the flat-rate compensation system the goods and services supplied to flat-rate farmers.

A — *The complaint relating to the use of macro-economic statistics not in conformity witih Article 25 (3) of the Sixth Directive*

The Commission observes first that, under Article 25 (3) of the Sixth Directive 'percentages shall be based on macro-economic statistics for flat-rate farmers alone for the preceding three years.' The practice followed by the Italian authorities is to use macro-economic statistics relating to the whole agricultural sector in order to calculate the charges on inputs of flat-rate

farmers, which inevitably results in an over-estimation of the percentage of input tax paid by flat-rate farmers. As the operations of farmers subject to the normal system are not deducted, the taxes of flat-rate farmers are added to the taxes of farmers who have opted for the normal system because they are subject to a VAT rate relatively higher than the flat-rate reimbursement rate.

It is true that of 3 million farmers only 75 000 are not flat-rate. But, what is important is not the number of farmers but their turnover. Those 75 000 are the farmers with the highest turnover. They have opted for the ordinary system precisely because it was more favourable to them than the flat-rate system, as their inputs are higher, particularly on account of the degree of mechanization which involves greater investment in equipment and, therefore, a proportionally higher input charge.

Since agricultural accounts form a coherent whole, it is not permissible to readjust 'inputs' upwards without producing supporting documents, as in the calculations submitted by the Italian authorities, or for the production sold to be taken into consideration in the outputs and not the final product, as required by the method contained in Annex C to the Sixth Directive.

Moreover, one cannot consider that the taking into consideration of macro-economic statistics relating to non-flat-rate undertakings is a kind of compensation for the 'underdevelopment' of certain sectors of production on account of the statistical survey mechanisms which do not enable a significant proportion of means of production to be determined. According to the Commission, it has not been shown that there was a lack of statistical data in this field and, in any event, this factor cannot justify the Italian Government's attitude.

On the other hand, the Commission refutes the suggestion that the reasoned opinion or the application contain new submissions not raised in the letter of formal notice. They were not new submissions but additional items of evidence extracted from the replies given by the Italian Government. These two replies appear in the letter from the Italian Permanent Representative of 26 June 1982 and a letter from the Italian Minister for Agriculture of 15 February 1984.

In the first letter, the Italian Government acknowledged that its authorities had conceded 'the existence of a slight over-valuation of the flat-rate compensation for VAT inputs in respect of the beef and pork sectors.' The Commission merely repeated this sentence in its application: it proves that the overvaluation dates back to 1982.

As regards the second letter, the Commission states that the Minister affirms therein that the reduction in the flat-rate percentage 'involves Italian stock-farmers in a loss of income of some LIT 116 000 million. The economy of the whole sector would collapse if the reduction in farmers' income was not offset by an easing of pressure on the Italian market from products from other countries whose stock-farmers benefit from specific support measures'. From that, the Commission infers that the Italian Government concedes that the overvaluation is nothing other than a

form of aid to the stock-rearing sector, granted by means of an incorrect application of the provisions of the Sixth Directive.

The Italian Government maintains first that, prior to harmonization, a specific regime applied in Italy to agriculture as a whole, which enabled the farmer to keep the VAT received on sales by way of flat-rate compensation for VAT paid on purchases. In fact, all Italian farmers already applied a flat-rate VAT compensation system. Only a small number of taxable persons (75 000 farmers out of a total of 3 million) submitted VAT declarations for the year 1978 and the preceding years. Therefore, the non-deduction of transactions carried out by them could not have resulted in an overvaluation of the input tax paid by flat-rate farmers. Moreover, it would have been quite difficult to isolate the figures relating to farmers operating under the normal system without running the risk of errors undercalculating production.

On the other hand, replying to the Commission's argument that the farms with the greatest business volume chose the normal VAT system (and not the flat-rate system), the Italian Government argues that this fact demonstrates that the flat-rate system does not entail, as the Commission claims, refunds higher than charges borne by way of VAT inputs. That also showed that in the sectors concerned a certain number of farms are subject to VAT input charges considerably higher than the compensation percentage of 14% fixed for the flat-rate scheme, for otherwise those holdings would also have opted for the flat-rate scheme.

Finally, the Italian Government considers that, as is clear from the Commission's letter of formal notice, the latter criticized it only for having used macro-economic statistics relating to all farmers and not only to farmers subject to the flat-rate VAT scheme. It follows that the other complaints made on this point in the application are inadmissible.

Having said that, the Italian Government gives details about the two letters of 26 June 1982 and 25 February 1984, to which the Commission referred.

The first letter states that, following calculations made by the Italian authorities, the VAT flat-rate compensation percentage fixed at 15% by Ministerial Decree of 5 January 1981, was lowered to 14% by Ministerial Decree of 25 February 1983. The slight overvaluation of the flat-rate compensation percentage was thus remedied.

As regards the second letter of 15 February 1984 from the Minister for Agriculture to the Vice-President of the Commission, the Minister did not confirm the existence of an 'over-compensation', as the Commission claims. No such admission was made. This letter merely confirms the Italian Government's willingness to seek a political, comprehensive and amicable solution to the dispute and, that being the case, it allowed a reduction of 1.5% in the average flat-rate VAT figure for farmers and decided to pay to the Community the corresponding amount of own resources, namely LIT 20 000 million per percentage point of the reduction.

B — *The complaint that the flat-rate compensation percentages for beef, pork and milk production were set at too high a level*

The Commission considers the arguments put forward by the Italian Government to justify the flat-rate figures applied to cattle and pig farming and the production of milk to be unconvincing as they do not prove that the value-added is minimal. Moreover, even if the value-added was in fact minimal, the existence of a large over-compensation for the sectors in question appears from the rate of compensation itself, which is of the order of 14%, whereas most of the rates applied to inputs vary from 2 to 10%. Besides, the Italian authorities themselves acknowledged a slight overvaluation of the flat-rate percentage for livestock farming, in the letter from the Italian Permanent Representative dated 26 June 1982.

The Commission points out in this respect that the rationale of Article 25 (3) is that it is for national authorities to supply to the Commission the necessary data, together with supporting evidence.

The Commission considers that the Italian Government is making abstract and unsubstantiated assertions when it states that the production of Italian farmers was not sufficient to satisfy domestic demand and had no margin for expansion capable of enabling it to close the gap in relation to domestic demand. The compensation rate of 14% therefore had no effect on the expansion of production which remained stable. In fact, if the situation of Italian farmers is as described, it cannot be maintained at current levels except by the injection of external financing, that is to say, thanks to the flat-rate reimbursement rate of 14%, at least half of which actually represents a disguised aid to this sector and therefore an abuse of the flat-rate reimbursement scheme. It was for that reason that the Minister for Agriculture asserted, in his letter of 15 February 1984, that the economy of the whole sector would collapse without the resources provided by a high flat-rate refund.

On the other hand, when the Italian Government asserts that it is impossible to conduct statistical surveys concerning the production of small livestock farms as that would result in higher figures relating to VAT input paid, it is merely admitting by implication that the level of flat-rate refunds is higher than would be the case if only the known statistical data were taken into consideration. Moreover, the alleged statistical difficulties cannot provide an excuse since, on the one hand, the other Member States operate correctly and, on the other, those very statistics are supplied accurately to the Statistical Office.

In fact, therefore, the Italian Government, is seeking not to justify the method of calculation adopted, as it ought to do, but to demonstrate that it is not excessive by analysing its effects, in particular the absence of any increase in production or supply. Yet that is contrary to the Sixth Directive which provides for a precise method of calculation. The fact that there has been no increase in production does not have an unequivocal significance and, as regards the decline in the rate of supplies, this is due to the increase in consumption (with production remaining the same, *per capita* consumption went up from 23 to 26 kg during the years 1981, 1982 and 1983).

Finally, the Commission disputes on a number of grounds the Italian Government's argument that evidence of over-compensation in the sector in question cannot properly be deduced from the data compiled and transmitted by the Italian Government for own resources purposes. In the first place, the Commission points out that there is a very close connection between the compensation percentage and the determination of own resources corresponding thereto; this connection is on account of the calculation referred to in Annex C of the Sixth Directive: when own resources are calculated the compensation rates are automatically calculated at the same time.

If confirmation of this point were needed, it is sufficient to recall that the Sixth Directive was not adopted simply for harmonization purposes, but that it also seeks to ensure that own resources from VAT are calculated by the application of a common rate or fixed basis of assessment in a uniform manner and in accordance with Community rules. One of the rules relating to the uniform basis of assessment is Article 25 which is in issue in this case. If the basis of assessment is established incorrectly (as is the case in Italy) the calculations relating to own resources are automatically distorted. If attempts are made to correct the latter, it is inevitable that the correct tax base is reverted to (see Article 25 (12)).

Secondly, the Commission disputes the Italian Government's assertion that the acknowledgement of a general over-compensation had been made in the context of a settlement. It considers that the additional payments were made on a provisional basis and the Commission accepted them subject expressly to checking the statistics (as is borne out by the correspondence on this point).

Thirdly, the argument based on the Twentieth Directive, which enables the Federal Republic of Germany to use VAT to grant a certain special aid corroborates the Commission's position, as the provisions of that Directive show that the method of calculation must be the same, namely that set out in Annex C to the Sixth Directive.

According to the Italian Government, the flat-rate percentage of 14% applicable to the sector is not too high, nor does it afford farmers refunds which are higher than the value-added tax inputs. This rate is in perfect accordance with the actual conditions in Italy and the Commission has not demonstrated the contrary.

In Italy, production of, in particular, milk, beef and pork is not sufficient to satisfy domestic demand. Most agricultural holdings carry on both stock rearing and arable farming and, even if beef and pork farming often achieves negative results, it continues to be carried on.

Very many owners of small farms employ means of production which are practically impossible to record in statistical surveys relating to the livestock sector. But those means of production exist and, if they could be isolated for the livestock sector, they would lead to a clear increase in figures for inputs in this sector.

Greater attention should therefore be directed to the reality of the holding than to the statistics in order to establish whether the compensation rate adopted for the

stock-rearing and milk sector is contrary to Article 25 (3) of the Sixth Directive.

In this connection, the Italian Government emphasizes that the comparison of production from stock-rearing before and after the introduction of the flat-rate VAT scheme reveals no increase in production, which shows that Article 25 (3) of the Sixth Directive has not been infringed. The Italian Government points out, by way of example, that in 1979, the first year of application of the flat-rate VAT scheme at the rate of 15% in the beef sector, the rate of 'self-supply' remained stable in relation to 1978 and in 1980 it even declined. This development would be inexplicable if the 15% flat-rate percentage had constituted a rate of refund higher than VAT inputs.

Moreover, the 75 000 agricultural holdings with the biggest turnover opted for the ordinary VAT scheme, from which it may be inferred that for this type of holding, the aggregate amount of input VAT is already greater than the amount of VAT on the supply of goods and services on the output side. That is the reason for choosing the ordinary scheme, which allows the farmers to recover the difference in input VAT (not recoverable on the other hand in the context of the flat-rate scheme, for which those holdings would no doubt have opted if that scheme had, as the Commission maintains, permitted refunds greater than the VAT inputs).

According to the Italian Government, it is not correct to assert that over-compensation stems from the fact that the flat-rate percentage is 14% whereas the 'majority of rates applied to input transactions vary from 2 to 10%' (see application at p. 9). In fact, and by way of example, the rate of VAT for input transactions in respect of 'energy' is always greater than 10% and the VAT rate for input transactions in respect of 'beef cattle' is 18%.

Finally, the Italian Government considers that evidence of over-compensation in the sector in question cannot be inferred from the statistics compiled and communicated by the Italian authorities for the purpose of own resources, for three reasons.

In the first place, an acknowledgement of a general over-compensation for the purpose of own resources was made in the context of a settlement of the dispute relating to the years 1979 to 1982 (as is apparent from the letter from the Italian Permanent Representative of 30 October 1984). Secondly, Article 3 of the Twentieth VAT Directive (85/361/EEC of 16 July 1985) enables questions relating to the VAT compensation percentage to be separated from those relating to the allocation of own resources. This distinction demonstrates that the action taken by the Italian authorities in order to terminate the dispute relating to own resources cannot be cited as evidence of the existence of the over-compensation complained of.

The Italian Government therefore considers that the general statistics relating to national accounts can in no way demonstrate the existence of over-compensation in the sector in question.

Moreover, there is no real evidence of over-compensation to be found in the data in the

investigation whose findings are set out in a report of Standing Committee (Agriculture and Fisheries) of the Italian Chamber of Deputies. That investigation was conducted on the basis of a sample of agricultural holdings unrepresentative of the true position of agriculture in the country as a whole. It essentially concerned holdings in the north of Italy.

C — *The complaint based on the non-exclusion from the flat-rate compensation scheme of supplies of goods and services to flat-rate farmers*

The Commission points out that Article 25 (5) of the Sixth Directive excludes from the flat-rate compensation scheme products and services supplied to flat-rate farmers. Article 25 (6) gives to Member States, in the context of the application of the flat-rate scheme as defined in Article 25 (5), a choice between the two methods of 'payment of the flat-rate compensation', which may be made either by the purchaser or taxable customer (as is the case in Italy: the purchaser or the recipient pays to the flat-rate farmer, who keeps it by way of compensation, VAT of 14% which is then deducted from the tax owed by the former) or by the public authority (as is the case in France: the invoice does not include VAT which the purchaser does not pay to the flat-rate farmer and therefore does not subsequently deduct, but it is submitted to the competent authorities who, after checking it, effect payment of the flat-rate compensation).

Finally, Article 25 (8) refers to situations outside the scope of the flat-rate scheme defined in Article 25 (5).

However, Article 34 of Presidential Decree No 633 of 26 October 1972 does not exclude from this scheme goods and services supplied to flat-rate farmers within this scheme.

The Italian Government argues that Article 25 (5) of the Sixth Directive does not in itself limit the application of flat-rate percentages, but that its sole purpose is to give Member States the possibility of providing for another method of payment of the flat-rate compensation by the purchaser, by the recipient of the service or by the State.

It considers that a reading of paragraphs 5, 6 and 8 of Article 25 taken together enables the conclusion to be drawn that the machinery whereby the flat-rate farmer may obtain compensation for input tax is broadly as follows:

if the purchaser of goods delivered or the recipient of services supplied by the flat-rate farmer is a taxable person other than a flat-rate farmer, Member States may provide for the flat-rate compensation to the farmer to be paid either by the buyer or by the authorities (paragraphs 5 and 6);

if the buyer or the recipient is a flat-rate farmer or a non-taxable person, this possibility no longer exists and the flat-rate compensation is exclusively paid by the buyer or the recipient of the service (paragraph 8).

An examination of these provisions shows that Article 34 of Presidential Decree No 633 of 1972, by providing, on the one hand,

that the flat-rate compensation percentages are applied to operations carried out by the flat-rate farmer with any buyer and, on the other, that the compensation shall always be charged to the buyer, is in strict conformity with the principles set out in Article 25 of the Sixth Directive.

IV — Questions put to the parties

The Court asked the parties for the information and documents mentioned below.

A — 1. The Commission was invited to disclose the sources on which it based its finding that, from the statistics supplied by the Italian Government, it was possible to arrive indirectly at the conclusion that 'the rates of compensation for beef and pork and for fresh milk should be fixed at a rate not exceeding 7%, instead of the rate of 14% currently applied' and to explain in greater detail the calculations by which it came to that conclusion.

2. The Commission was also invited to supply a list of Member States which have set up the flat-rate scheme for farmers provided for in Article 25 of the Sixth Directive (77/388/EEC of 17 May 1977), and to state the flat-rate compensation percentages which they have laid down for beef, pork and fresh milk together with the rates of VAT paid on inputs by the flat-rate farmers. The Commission was requested to state to what extent such compensation percentages are influenced in the various Member States by the average rate of interest on credits granted by banks to their customers.

3. The Commission was also invited to explain in what manner the figures appearing in the investigation conducted by the Chamber of Deputies on the costs of production, processing and distribution of agricultural products reveal over-compensation in favour of beef and pig farmers.

B — 1. The Italian Republic was invited to produce:

(a) the macro-economic statistics relating to flat-rate farmers alone in the beef, pork and milk sectors for the years 1978, 1979 and 1980;

(b) the total amounts, also as regards flat-rate farmers alone, for the sectors and years mentioned, of:

(i) final production, including own consumption,

(ii) inputs and gross fixed-asset formation,

(iii) the VAT paid on the operations mentioned under (ii) above.

2. The Italian Republic was also invited to give details of the rates of VAT applied to the different input operations carried out by flat-rate farmers and to indicate the average percentage of each type of operation in relation to the total value of input operations carried out by such farmers.

3. Finally, the Italian Republic was invited to supply statistics for beef and pig farming, giving the respective percentages of stock rearing based on the acquisition of animals from outside the farm on the one hand, and the complete rearing of animals, on the other hand.

By a letter dated 7 April 1987, the Italian Government gave to the Court the following information.

Question B — 1

(a) macro-economic statistics relating solely to flat-rate farmers in the 'beef, pork and fresh milk' sectors in respect of the years 1978, 1979 and 1980:

(in LIT 1 000 million)

Year	Stock-farming overall		Beef, pork and milk sectors	
	Output	Input	Output	Input
1978	7 536.6	5 804.2	5 193.2	4 449.4
1979	8 748.3	6 575.7	6 092.4	5 140.6
1980	10 238.3	7 923.2	7 129.3	6 205.9

(b) Overall quantities for flat-rate farmers in respect of the 'beef, pork and fresh milk' sectors for the years mentioned below (in LIT 1 000 million):

(i) final production, including own consumption:

1978	5 193.2
1979	6 092.4
1980	7 129.3

(ii)

	production inputs	gross fixed-asset formation	total
1978	3 285.0	1 164.4	4 449.4
1979	3 735.3	1 405.3	5 140.6
1980	4 550.0	1 655.9	6 205.9

(iii) VAT paid on the operations mentioned under (ii):

1978	166.5	163.0	329.5
1979	225.5	198.1	423.6
1980	328.5	208.8	537.3

Question B — 2

Rate of VAT (average) applied to the different operations:

(%)

	production inputs	gross fixed-asset formation	average weighted value
1978	5.4	14	7.41
1979	6.84	12.14	8.28
1980	7.21	12.6	8.43

Question B — 3

The Italian Government states that it has no documentation enabling it to show, as regards beef and pig farming, the respective percentages of holdings rearing animals acquired from outside the farm, on the one hand, and the complete rearing of animals on the other. It adds however that Italian farmers buy annually mostly from EEC countries, between 2 and 2.4 million head of beef cattle (calves) to be kept in holdings for slaughter. They also import on average between 500 000 and 900 000 pigs, of which 20 to 30% are to be kept in holdings.

By letter dated 29 April 1987, the Commission replied to the questions put to it by the Court; its answers may be summarized as follows:

Question A — 1

The macro-economic statistics used by the Commission in order to ascertain that the compensation percentage should not be greater than 7% are those which were supplied to it by the Italian Government in the context of checking procedures relating to own resources. Those figures, which relate to the whole of the agricultural sector, disclose the outputs and inputs of farmers together with the amount of VAT applied to them. In order to determine the compensation percentage in respect of each year, the Commission, in accordance with the provisions of Article 25 (3) of the Sixth Directive, took into account the statistics relating to inputs and outputs in the last three years.

The correct compensation percentage determined for 1979 may be arrived at by means of the method of calculation set out diagrammatically below (the amounts being expressed in LIT 1 000 million):

(a) Z is the rate of refund for the agricultural sector, determined in accordance with the formula

$$\frac{X \times 100}{Y}$$

where X represents the amount of VAT imposed on the inputs of flat-rate farmers during the previous three years, and Y is the amount of outputs relating to those three years:

X = total VAT on inputs for the years 1976, 1977, 1978 = 2 040.80

Y = total outputs for the years 1976, 1977, 1978 (without VAT) = 52 529.0

Z = rate of refund for the whole of the agricultural sector for 1979 =

$$\frac{2\,040.80 \times 100}{52\,529.0} = 3.88\%$$

(b) Z' is the rate actually refunded in respect of the agricultural sector, determined in accordance with the formula

$$\frac{X' \times 100}{Y'}$$

where X' represents the amount of VAT actually refunded in 1979 and Y' the outputs for that year:

X' = amount of VAT reimbursed on outputs for 1979 = 1 434.30

Y' = net VAT output in 1979 = 24 187.00

Z' = rate actually refunded for the whole of the sector for 1979 =

$$\frac{1\,434.30 \times 100}{24\,187.00} = 5.93\%$$

(c) K is the difference between the two rates (Z' — Z = K), which represents the percentage of over-compensation for the agricultural sector as a whole in 1979:

(Z' — Z) = 5.93% — 3.88% = 2.05% (= K)

(d) K' is the amount of VAT refunded in excess and is determined in accordance with the formula

$$\frac{Y' \times K}{100} = K'$$

Y' = net VAT output for the year 1979

K = rate of over-compensation

K' = amount of VAT refunded in excess =

$$\frac{24\,187.00 \times 2.05}{100} = 495.830$$

(e) R is the VAT actually refunded to the beef, pork and milk sectors for 1979 and is determined by the addition of the production statistics for 1979:

R = 390 940 + 114 000 + 353 682 = 858 662

R' is the VAT which ought to have been refunded to the sector mentioned above and is determined by means of the formula R — K' = R' (R — K') = 858 662 — 495 830 = 362 832 (= R')

(f) the correct rate for the beef, pork and milk sectors to be applied for 1979 is determined in accordance with the formula:

$$\frac{R' \times 100}{1979\ \text{output}} = \frac{362\,832 \times 100}{6514.7} = 5.57\ \%$$

By using these formulae, the Commission produced the following calculations in respect of the years 1980, 1981 and 1982.

1980

X = 2 574.30

Y = 61 971.80

Rate of refund $\frac{X \times 100}{Y} = 4.15\ \%$ (= Z)

VAT refunded (X') = 1 736.1

Output for the year (Y') = 28 517.8

Rate of refund $\frac{X' \times 100}{Y'} = 6.08\%$ (= Z')

Over-compensation (Z' — Z) = 1,93% (= K)

Amount of excess VAT refunded

$$\frac{(Y' \times K)}{100} = \frac{28\,517.8 \times 1.93}{100} = 550.393$$

(= K')

VAT refunded for the beef, pork and milk sectors in 1980 = 446.502 + 184.908 + 409.573 = 1 040.983

VAT to be refunded (1 040.983 — 550.393) = 549.352

Beef output, etc. for 1980 = 3 133.2 + 1 607.9 + 2 874.2 = 7 615.3

Rate of VAT = $\frac{549.352 \times 100}{7\,615.3}$ = 7.21%

1981

X = 3 181.20

Y = 72 999.00

Rate of refund

$\frac{X \times 100}{Y}$ = 4.35% (= Z)

VAT refunded (X') = 2 149.2

Output for year (Y') = 32 226.0

Rate of refund $\frac{X' \times 100}{Y'}$ = 6.66% (Z')

Over-compensation (Z' — Z) = 2.31% (= K)

Excess amount of VAT refunded

$\frac{(Y' \times K)}{100} = \frac{32\,226 \times 2.31}{100}$ = 744.420 (= K')

VAT refunded in respect of beef, pork and milk in 1981 = 569.190 + 284.820 + 470.250 = 1 324.260

VAT to be refunded (1 324.260 — 744.420) = 579.840

Beef output, etc. for 1981 = 3 794.6 + 1 898.8 + 3 135.0 = 8 828.40

Rate of VAT = $\frac{579.840 \times 100}{8\,828.40}$ = 6.56%

1982

X = 3 967.90

Y = 84 930.80

Rate of refund $\frac{X \times 100}{Y}$ = 4.67% (Z)

VAT refunded (X') = 2 492.0

Output for the year (Y') = 36 214.0

Rate of refund $\frac{X' \times 100}{Y'}$ = 6.88% (=Z')

Over-compensation (Z' — Z) = 2.21% (=K)

Excess amount of VAT refunded

$\frac{(Y' \times K)}{100} = \frac{36\,214.0 \times 2.21}{100}$ = 800.329 (= K')

VAT refunded for the beef, pork and milk sectors in 1982 = 640.370 + 345.150 + 573.750 = 1 559.270

VAT to be refunded (1 559.270 — 800.329) = 758.941

Beef output, etc. for 1982 = 4 269.1 + 2 301.4 + 3 825.0 = 10 395.5

$$\text{Rate of VAT} = \frac{758.941 \times 100}{10\,395.5} = 7.30\%$$

Question A — 2

The Commission supplied a list of Member States which have set up a flat-rate scheme for farmers together with an introduction describing the two main types of flat-rate scheme applied in the Community.

Under the one scheme, the input VAT paid on the means of production is offset by the sale prices of products. The farmers sell their products at a price which includes the tax and keep the relevant amount.

Under the other scheme, the input VAT is refunded (on a flat-rate basis) by the fiscal authorities: the farmers sell their products at a tax-free price, that is without adding the VAT, and then obtain, on submitting a request to the competent fiscal authorities, a refund corresponding to the flat-rate amount applicable to the value of their sales.

In both cases, the farmers do not make any direct payments of VAT to the fiscal authorities.

In reply to the second part of the above question, the Commission points out that there is no correlation between the average interest rate on loans granted by banks and flat-rate compensation percentages since those credits are exempt from VAT in the whole of the Community. The amounts of interest in question are amalgamated with the production costs and, therefore, are reflected in the sale prices of products.

Question A — 3

The Commission remarks that the study carried out by the Italian Chamber of Deputies is a revealing indication of over-compensation, as it highlighted the percentages of the different costs of production for beef, pork and milk and enabled a distinction to be made between costs affected by VAT and those which are exempt from it. It analyses that study and concludes that it is a logical demonstration of the over-compensation, at the same time admitting that missing from it is the information relating to the inputs and outputs of the sectors in question which the Commission used as the basis of the calculation set out in its reply to Question A — 1.

Observations of the Commission and the Italian Government on the reply of the other party to the Court's questions

By a letter dated 26 May 1987, the Commission submitted the following observations on the Italian Government's reply to the Court's questions:

1. The Italian Government's replies are laconic and lack any reference to sources, whereas the Commission has always

supplied detailed information, together with the sources relied on.

2. The percentages given in the final column 'average weighted value' in the reply to Question B — 2 (Rate of VAT 'average) applied to the operations') are a long way away from the 14% which the Italian Government refunds on a flat-rate basis to farmers and, on the other hand, extremely close to the percentage deemed admissible by the Commission (7% maximum).

A rudimentary processing of the statistics supplied by the Italian Government in its reply to Question B — 1, whereby the amount of VAT paid given in the final column of point (iii) (b), is divided by the value of the 'outputs' appearing in the table under (a), enables the exact amount of the flat-rate refund to be ascertained, as a result of which the figures obtained are even closer to the average of 7% advocated by the Commission (6.34% for 1978, 6.95% for 1979 and 7.53% for 1980).

The percentages given by the Commission (5.57% for 1979 and 7.21% for 1980) are lower still, since the Italian figures probably relate to the single year taken into consideration whilst the Commission's, in accordance with the Sixth Directive, take account of statistics relating to the preceding three years.

3. The Commission is somewhat surprised by the Italian Government's reply to Question B — 3.

It merely draws the Court's attention to its reply to Question A — 3 which contains the statistics requested of the Italian Government concerning bovine animals, which were supplied by the Italian Statistical Office.

By a letter received at the Court Registry on 29 May 1987, the Italian Government made the following observations on the Commission's replies to the Court's questions.

1. The basic data used by the Commission in order to make its calculations in its reply to Question A — 1 are in fact those communicated by Italy on the basis of official statistics which relate to the state of national accounts covering agriculture as a whole; as those data are not separate, it is not possible to ascertain the turnover of flat-rate farmers by isolating it from that of farmers subject to the normal VAT scheme.

Nevertheless, the data in question were obtained not, as the Commission asserts, as a result of acknowledging the criticisms made by the audit board in the context of verification procedures relating to own resources, but by updatings decided on the basis of meticulous adjustments carried out for certain items of official statistics in respect of which the figures did not entirely convey a true picture of Italian agriculture.

2. The calculation method adopted by the Commission in order to determine the rate of compensation for each year under consideration cannot be regarded as correct in view of, in particular, the procedure followed for calculating the VAT which ought to have been refunded in the sub-

division 'beef, pork and milk', namely deducting from the amount of VAT actually refunded in that subdivision the additional amount of VAT refunded, by way of over-compensation, to the agricultural sector as a whole.

3. The Italian Government is not in a position to submit observations on the flat-rate schemes adopted by other Member States as it has no information in this respect but it considers that the list of flat-rate VAT amounts drawn up by the Commission and relating to the three products of the subdivision 'Beef, pork and milk' is incomplete.

J. C. Moitinho de Almeida
Judge-Rapporteur