# JUDGMENT OF THE COURT (Second Chamber)

15 July 2004 *

In Case C-381/01,

**Commission of the European Communities,** represented by E. Traversa, acting as Agent, with an address for service in Luxembourg,

applicant,

v

**Italian Republic,** represented by I. M. Braguglia, acting as Agent, and by G. de Bellis, avvocato dello Stato, with an address for service in Luxembourg,

defendant,

supported by

**Republic of Finland,** represented by T. Pynnä, acting as Agent, with an address for service in Luxembourg,

* Language of the case: Italian.

and by

**Kingdom of Sweden,** represented by A. Kruse, acting as Agent,

interveners,

APPLICATION for a declaration that, by failing to levy value added tax on aid paid under Council Regulation (EC) No 603/95 of 21 February 1995 on the common organisation of the market in dried fodder (OJ 1995 L 63, p. 1), the Italian Republic 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 (OJ 1977 L 145, p. 1),

THE COURT (Second Chamber),

composed of: C.W.A. Timmermans, President of the Chamber, C. Gulmann (Rapporteur), J.-P. Puissochet, J.N. Cunha Rodrigues and N. Colneric, Judges,

Advocate General: L.A. Geelhoed,
Registrar: L. Hewlett, Principal Administrator,

having regard to the Report for the Hearing,

after hearing oral argument from the parties at the hearing on 16 October 2003, at which the Commission was represented by E. Traversa, K. Simonsson, I. Koskinen and K. Gross, acting as Agents, the Italian Republic by G. de Bellis, the Republic of Finland by T. Pynnä and the Kingdom of Sweden by A. Kruse,

having heard the Opinion of the Advocate General at the hearing on 27 November 2003,

gives the following

## Judgment

1 By application lodged at the Court Registry on 4 October 2001, the Commission of the European Communities brought an action under Article 226 EC for a declaration that, by failing to levy value added tax ('VAT') on aid paid under Council Regulation (EC) No 603/95 of 21 February 1995 on the common organisation of the market in dried fodder (OJ 1995 L 63, p. 1), the Italian Republic 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 (OJ 1977 L 145, p. 1, 'the Sixth Directive').

## Legal background

*Community legislation on VAT*

2 Article 2(1) of the Sixth Directive subjects to VAT 'the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such'.

3 Article 11(A)(1)(a) of the Sixth Directive provides:

'The taxable amount shall be:

(a) in respect of supplies of goods and services ..., 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.'

*Community legislation on aid for dried fodder*

4 Article 3 of Regulation No 603/95 provides that aid is granted at EUR 68.83 per tonne for artificially heat-dried fodder and at EUR 38.64 per tonne for sun-dried fodder.

5 Article 4, as amended by Council Regulation (EC) No 1347/95 of 9 June 1995 (OJ 1995 L 131, p. 1), establishes, for each marketing year, a maximum guaranteed quantity of products in respect of which aid may be granted. It also divides those quantities between the Member States.

6 Article 5 provides that:

'Where the amount of dried fodder for which aid is claimed ... in any marketing year exceeds the [maximum guaranteed quantity] referred to in Article 4 ..., the aid to be paid in that year shall be calculated as follows:

— for the first 5 % by which the [maximum guaranteed quantity] is exceeded, the aid shall be reduced in all Member States by an amount which is proportionate to that excess,

— for any excess beyond 5 % additional reductions shall be made in any Member State in which production exceeds the [national guaranteed quantity] increased by 5 % proportionate to this excess.

...'

7 Article 6(2) makes any advance payment subject to the condition that the dried fodder has left the processing undertaking.

8 Article 8 provides:

'The aid provided for in Article 3 shall be granted, on application from the party concerned, in respect of dried fodder having left processing undertakings and meeting the following conditions:

(a) the maximum moisture content must fall between 11 and 14 % and may vary with the form of presentation of the product;

(b) the minimum crude protein content in dry matter must not be less than:

— 15 % in the case of the products listed in Article 1(a) and the second indent of Article 1(b),

— 45 % in the case of the products listed in the first indent of Article 1(b);

(c) the dried fodder must be of sound, genuine and merchantable quality.

Further conditions, in particular regarding fibre, carotene content, may be stipulated ....'

9 Article 9(c) provides:

'The aid provided for in Article 3 shall be granted only to [processing] undertakings ... which:

...

(c) fall into at least one of the following categories:

— undertakings which have concluded contracts with producers of fodder for drying,

— undertakings which have processed their own crops or, in the case of groups, those of their members,

— 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; these legal or

natural persons shall be buyers approved by the competent authorities of the Member States in which the fodder is harvested ... .'

10 Article 11(2) states:

'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.'

**The administrative procedure and the action**

11 On 4 November 1998, having found that the Italian Republic was not levying VAT on aid paid under Regulation No 603/95 and taking the view that this was contrary to Article 11(A)(1)(a) of the Sixth Directive, the Commission sent the Italian Republic, in accordance with the procedure laid down in Article 169 of the EC Treaty (now Article 226 EC), a letter of formal notice calling on it to submit its observations within two months.

12 Since it did not receive a reply to that letter, the Commission, on 30 July 1999, sent a reasoned opinion to the Italian Republic and required it to take the measures necessary to comply with the opinion within two months.

13 The Italian Government replied by letter of 28 September 1999. It challenged the basis of the Commission's complaints, stating inter alia that Community subsidies to undertakings processing fodder are not directly linked to the price of drying operations and therefore are not to be included in the taxable amount for VAT, as defined in Article 11(A)(1)(a) of the Sixth Directive.

14 Against that background, the Commission decided to bring this action.

15 By order of the President of the Court of Justice of 29 April 2003, the Republic of Finland and the Kingdom of Sweden were granted leave to intervene in support of the form of order sought by the defendant, pursuant to Article 93(7) of the Rules of Procedure, that is to say solely by way of observations during the oral procedure.

**Substance**

*Arguments of the parties*

16 The Commission submits that the supplies involved in two of the three possible ways in which undertakings processing fodder may carry out their activities are subject to VAT, namely:

— the purchase of green fodder from producers followed by the onward sale of the processed product to third parties;

— the conclusion with producers of special-order contracts for green fodder without transfer of ownership in the fodder and the subsequent return of the processed product to the producers.

17 In the case of processing undertakings which purchase fodder from producers in order subsequently to sell it on to third parties, contracts for the purchase and onward sale of goods are concluded; they are transactions which must clearly be regarded as supplies of goods for the purposes of the Sixth Directive and are consequently taxable.

18 In the case of special-order contracts, the fact that the processing undertaking returns the dried fodder to the green fodder producer means that the supply must be regarded as the supply of a service, namely the drying of fodder. That supply of a service is thus, as such, taxable on the basis of the Sixth Directive.

19 Under Article 11(A)(1)(a) of the Sixth Directive, taxable supplies should give rise to a charge to VAT on aid paid under Regulation No 603/95.

20 The Commission points out that under the terms of Article 9 of Regulation No 603/95, '[t]he aid provided for in Article 3 shall be granted only to undertakings processing the products ...'. Those undertakings are thus the beneficiaries of the subsidies in the legal sense of the term and the Community legislature intended to denote them in referring, in Article 11(A)(1)(a) of the Sixth Directive, to 'the consideration which ... is to be obtained by the supplier'. Regulation No 603/95 does

not mention any other beneficiary, in the legal sense of the term, of the aid for marketing dried fodder.

21 The Commission acknowledges that a subsidy granted to a particular category of undertakings may have beneficial economic effects for operators situated, in the production cycle, both upstream from the subsidised undertakings (in this case the producers of green fodder) and downstream from them (in this case livestock farmers). In the case of special-order contracts, the Community legislature itself requires, in Article 11(2) of Regulation No 603/95, that the processing undertaking pay to the producers the aid received from the intervention agency.

22 However, neither the possibility that a subsidy will benefit other operators nor the obligation to pay all or part of a subsidy to other operators in any way alters the legal aspects of the problem. The beneficiary of the aid, in the legal sense of the term, namely the processing undertaking, must be distinguished from the indirect beneficiary of the subsidy in the economic sense of the term.

23 The Commission argues that the Community legislature, in employing in Article 11 (A)(1)(a) of the Sixth Directive the concept of 'subsidies directly linked to the price', intended to include in the taxable amount for VAT all aid having a direct impact on the amount of consideration obtained by the supplier. Those subsidies must have a direct link, or even a causal link, with the supply of precisely quantified or quantifiable goods or services: aid is granted to the extent to which those goods or services are actually sold on the market. That is the case here.

24 The Italian Government contends, as regards the special-order contracts, that the aid does not benefit the processing undertaking but the producer, in accordance with Article 11(2) of Regulation No 603/95, by virtue of which special-order contracts must include a clause laying down an obligation on processing undertakings to pay the producers the aid specified in Article 3 of that regulation which they receive. In those circumstances, the aid paid is not subject to VAT.

25 As regards the case in which the processing undertaking buys green fodder from the producer in order subsequently to sell it on, after processing, to third parties, the aid will be subject to VAT only if it can be proved that the purchasers of the dried fodder profit from the aid. There is no such proof.

26 During the oral procedure, the Finnish and Swedish Governments supported the form of order sought by the Italian Government.

*Findings of the Court*

27 By providing that the taxable amount for VAT encompasses, in the cases specified by it, subsidies paid to taxable persons, Article 11(A)(1)(a) of the Sixth Directive is intended to subject the full value of goods or services to VAT and hence to prevent payment of a subsidy entailing a lower return from the tax.

28 In accordance with its terms, that provision applies where the subsidy is directly linked to the price of the transaction in question.

29 For that to be the case, the subsidy must first be paid specifically to the subsidised operator to enable it to supply particular goods or services. Only in that case can the subsidy be regarded as consideration for the supply of goods or services and therefore be taxable. It must be noted, in particular, that the beneficiary is recognised as having a right to receive the subsidy, since a taxable supply has been made by it (Case C-184/00 *Office des produits wallons* [2001] ECR I-9115, paragraphs 12 and 13).

30 It is also necessary to verify 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. It must also be ascertained whether, objectively, 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 (*Office des produits wallons*, paragraph 14).

31 The consideration represented by the subsidy must, at the very least, be identifiable. It is not necessary for the subsidy to correspond exactly to the diminution in the price of the goods or services supplied. It is sufficient if the relationship between the diminution in price and the subsidy, which may be at a flat rate, is significant (*Office des produits wallons*, paragraph 17).

32 In conclusion, 'subsidies directly linked to the price' for the purposes of Article 11(A)(1)(a) of the Sixth Directive include only subsidies which constitute the whole or part of the consideration for a supply of goods or services and which are paid by a third party to the seller or supplier (*Office des produits wallons,* paragraph 18).

33 It must be held that in the present case the conditions for the aid at issue to be subject to VAT are not met in respect of either of the two categories of transaction referred to by the Commission, namely (i) the sale by a processing undertaking, after drying, of fodder purchased from producers of green fodder and (ii) the special-order contracts concluded by a processing undertaking with a producer of green fodder.

Sale, after drying, of fodder purchased from producers

34 It is the Commission's contention that the sale of dried fodder by a processing undertaking which has purchased the raw material from producers of green fodder constitutes a supply of goods within the meaning of the Sixth Directive.

35 The aid is paid to the processing undertaking, which may freely use it.

36 However, it is not directly linked to the price of the taxable transaction for the purposes of Article 11(A)(1)(a) of the Sixth Directive.

37 It is not paid specifically to enable the processing undertaking to supply dried fodder to a purchaser.

38 In this instance the parties agree that there is no shortage of dried fodder on the world market. Nor is it in dispute that the objective of the aid scheme is, first, to encourage production within the Community, despite the fact that production costs are higher there than on the world market, in order to ensure an internal source of supply and, second, to produce high-quality fodder. In that regard, the 11th recital in the preamble to Regulation No 603/95 mentions '[encouraging] a regular supply of green fodder to processors and [enabling] producers to benefit from the aid scheme' and the 10th recital states that criteria relative to the minimum quality of dried fodder entitled to aid should be determined — criteria which are set out in Article 8 of Regulation No 603/95.

39 Against that background, it does not seem that the aid scheme is a scheme for promoting consumption. It is not intended to encourage third parties to buy dried fodder on account of prices which, because of the aid, are lower than the world market price, a situation in which a taxable amount for VAT restricted to the price paid would not correspond to the full value of the goods supplied. It is intended to enable those third parties to obtain supplies of fodder within the Community at a price which is comparable to the world market price and at which they could in any event obtain supplies outside the Community if, in the absence of aid, the supply of fodder within the Community were non-existent or proved insufficient. The VAT charged on that price therefore reflects the full value of the product on the market.

40 On those grounds alone and without any need to consider whether the other conditions for including the aid in the taxable amount are met, it must be held that the Commission's complaint concerning the sale, after drying, of fodder purchased from producers is unfounded.

Special-order contracts

41 As the Commission points out, the purpose of a special-order contract is the supply of a drying service, which is carried out by the processing undertaking on behalf of the producer of green fodder.

42 However, Article 11(A)(1)(a) of the Sixth Directive requires that the subsidy, in order to be taxable, be paid to the supplier of the goods or services, so that he may freely use it.

43 In the case of special-order contracts, the aid which the processing undertaking receives is not paid for its benefit.

44 Admittedly, Article 9 of Regulation No 603/95 provides that 'the aid ... shall be granted only to undertakings processing the products ...'.

45 However, the 15th recital in the preamble to Regulation No 603/95 states, in relation to special-order contracts, that the aid should be passed back to the producer and Article 11(2) of the regulation imposes an obligation on processing undertakings to pay the producers the aid which they receive for the quantities processed under the contracts entered into.

46 Thus, the processing undertaking may not use the aid freely. It merely functions as an intermediary between the body which distributes the aid and the fodder producer. In that regard, the Commission's test, based on the idea of the 'legal beneficiary' of a subsidy, regardless of the economic benefit of the latter, cannot be accepted.

47 In those circumstances, the aid cannot be regarded as consideration, for the processing undertaking, for its supply of a service and it does not enable the undertaking to supply the service at a lower price.

48 The price of the drying service must therefore include the normal processing costs, with the result that the VAT charged on that price reflects the full value of the supply.

49 The aid passed on to the producer reduces the cost to the latter of dried fodder. However, the reduction does not take effect when the price of the taxable supply is paid. It takes effect after the event, following payment of a price reflecting the full value of the supply.

50 If the aid finally paid to the producer of green fodder were also included in the taxable amount, the consequence would be overtaxation of the drying operation, which is at odds with the objective of Article 11(A)(1)(a) of the Sixth Directive.

51 On those grounds alone and without any need to consider whether the other conditions for including the aid in the taxable amount are met, it must be held that the Commission's complaint concerning special-order contracts is unfounded.

52 In conclusion, since neither of the claims advanced by the Commission is founded, the action must be dismissed.

## Costs

53 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. The Commission has been unsuccessful. The Italian Republic is none the less to bear its own costs, since it has not applied for costs to be awarded against the applicant.

54 The Republic of Finland and the Kingdom of Sweden, which intervened in support of the form of order sought by the defendant, must bear their own costs, in accordance with Article 69(4) of the Rules of Procedure.

On those grounds,

THE COURT (Second Chamber)

hereby:

**1. Dismisses the action;**

**2. Orders the Italian Republic to bear its own costs;**

3. **Orders the Republic of Finland and the Kingdom of Sweden to bear their own costs.**

Timmermans Gulmann Puissochet

Cunha Rodrigues Colneric

Delivered in open court in Luxembourg on 15 July 2004.

R. Grass C.W.A. Timmermans

Registrar President of the Second Chamber