

## Banca Popolare di Cremona

By Philip Woolfe<sup>1</sup>  
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*Banca Popolare is a case which is more significant for what the ECJ did not say than for what it did. The Court declined to address the issue on which 15 Member States addressed it in oral submissions, namely whether the Community Courts can limit the effect of their rulings so as only to affect legal relations entered into after a future date. On the substance, the ECJ took a narrow and arguably formalistic approach to the scope of the prohibition on national turnover taxes. Nevertheless, two Advocate-Generals delivered Opinions dealing at some length with temporal limitation, ensuring that the issue will not be going away.*

### **The facts**

*Banca Popolare* involved an Italian regional tax known as IRAP, which is a tax on productive activities carried on by a taxable person within the territory of the region.<sup>2</sup> In essence, IRAP is calculated by deducting the “production costs” from the “value of production” (as defined by Italian legislation). It is not a levy solely on sales, in that the value of production is defined to include increases in the value of stocks, amortisation and depreciation.

In 1999, the Banca Popolare di Cremona requested reimbursement of sums it had paid by way of IRAP. It argued, amongst other things, that the tax was incompatible with Article 33 of the Sixth Directive and so was unlawful. Following various domestic proceedings, the Commissione Tributaria Provinciale (“the Italian Court”) found that IRAP has the following characteristics:

- IRAP applies, in general, to all commercial transactions involving production of or trade in goods, or provision of services, in the context of a trade or professional activity;
- IRAP is levied on the basis of the net value added by the taxpayer;
- IRAP is levied at every stage of the production or distribution process;
- the total amount of IRAP collected at the various stages from production up to the final consumer is equal to the rate of IRAP applied to the price charged to the final consumer.

### **The order for reference**

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<sup>1</sup> The views expressed in this note are those of the author only.

<sup>2</sup> See paragraph 6 of the Court’s judgment. The tax applied to all companies, partnerships, natural persons and farmers, subject to a list of certain exceptions for joint investment funds, pension funds and European economic interest groups.

The Italian Court referred the following question to the ECJ:

'Must Article 33 of [the Sixth Directive] be interpreted as meaning that it prohibits a charge to IRAP of the net value of production deriving from the regular exercise of an independently run activity whose object is the production of or trade in goods or the provision of services?'

According to a considerable line of ECJ case law, Article 33 of the Sixth Directive prohibits Member States from introducing or maintaining taxes, duties or charges in the nature of turnover taxes.<sup>3</sup>

It is clear law, and it was accepted by all parties, that a national tax will only be caught by the Article 33 prohibition if it exhibits the essential characteristics of VAT, but it may be caught even if it is not identical to VAT in every way.<sup>4</sup> There are four such characteristics:

- the tax applies generally to transactions relating to goods and services;
- it is proportional to the price charged by the taxable person in return for the goods and services which he has supplied;
- it is charged at each stage of the production and distribution process, including that of retail sale, irrespective of the number of transactions which have previously taken place; and
- it is imposed only on the value added at that stage.

The arguments as to the substantive issue in the case centred around how broadly these characteristics were to be interpreted. In particular, the breadth of the second and fourth of these characteristics was disputed.

### ***The Opinion of Advocate-General Jacobs***

Advocate-General Jacobs delivered his Opinion in *Banca Popolare* on 17 March 2005. He argued that IRAP, as described by the Italian Court, displayed all four of the essential characteristics of VAT. He reasoned that the Court should not take an unduly restrictive approach to the requirements, but rather should consider the economic reality of the tax. In particular, he argued that the question of whether the tax is proportional to the price charged should not depend on whether IRAP was in fact calculated as a proportion of the price of each individual supply.

Having concluded that IRAP was unlawful, Advocate-General Jacobs went on to consider the second, more controversial issue in the case, namely whether the ECJ should consider limiting the temporal effect of its judgment in the event that it agreed that IRAP was prohibited. When the Community Courts provide an interpretation of Community legislation, in general the effect of that ruling is that the legislation is treated as having always said what the Court now says it means. However, the Community Courts have in some circumstance applied a different approach, limiting the temporal effect of its ruling, so that parties may only rely on the new interpretation to call into question legal relations established after the date of its judgment, and not those established prior to that date.<sup>5</sup> The Court may choose to take that approach where two criteria are both met:

<sup>3</sup> The terms of Article 33 actually provide that "...this Directive **shall not prevent** a Member State from maintaining or introducing taxes on insurance contracts, taxes on betting and gambling, excise duties, stamp duties and, more generally, **any taxes, duties or charges which cannot be characterised as turnover taxes...**" (emphasis added). However, Article 33(1) has consistently been interpreted as applying such a prohibition. See Case 252/86 *Bergandi* [1988] ECR 1343, paragraphs 10 and 11; Joined Cases 93/88 and 94/88 *Wisselink and Others* [1989] ECR 2671, paragraphs 13 and 14; Case C-200/90 *Dansk Denkavit and Poulsen Trading* [1992] ECR I-2217, paragraph 10; Case C-28/96 *Fricarnes* [1997] ECR I-4939, paragraph 36; and Case C-308/01 *GIL Insurance* [2004] ECR I-4777

<sup>4</sup> See the Opinion of Advocate-General Jacobs at paragraph 24 and the judgment of the Court at paragraph 26, and the cases cited there.

<sup>5</sup> Advocate-General Jacobs cites the example of Case C-437/97 *EKW* [2000] ECR I-1157 at paragraph 20. The approach to "temporal limitation" has its roots in the powers of the Community Courts in relation to Community legislation. In Article 230 actions for annulment, under Article 231 EC, the Community Courts may, in an

- those concerned have acted in good faith; and
- there is a risk of serious difficulties if the ruling is given full retrospective effect.

Advocate-General Jacobs considered that both these criteria were met.<sup>6</sup>

However, he raised the possibility that the temporal effect of the judgment should not be limited to relations established after the date of judgment, but rather to relations established after some future point in time, in order to give the Italian government time to legislate to solve the problem. He argued that simply applying the temporal limitation from the date of judgment would not solve the Italian regions' difficulties, since "large numbers" of Italian traders were already seeking reimbursement of IRAP paid, with the result that there would be serious disruption of the regions' finances until such time as new legislation was introduced.

Subsequently, the ECJ decided, in the light of the issues raised in the Opinion, to reopen the oral procedure. As a result 15 Member State submitted observations to the Court, and a second Opinion was delivered by Advocate-General Stix-Hackl on 14 March 2006.

### ***The Opinion of Advocate-General Stix-Hackl***

Advocate-General Stix-Hackl agreed that IRAP should be prohibited by Article 33 of the Sixth Directive, for broadly identical reasons to those put forward by Advocate-General Jacobs. She also proceeded to analyse the temporal limitation rule at considerable length, drawing heavily from the Opinion of Advocate-General Tizzano in Case C-292/04 *Wienand Meilicke v Finanzamt Bonn-Innenstadt*, which had been delivered in the intervening period. On that basis, she drew a distinction between two matters:

- the temporal limitation, which in the past had been applied to claims based on legal relations established prior to the date of judgment;
- the possibility of an exception to that limitation for claims in relation to legal relations entered into prior to judgment if the claim itself had been brought prior to the date of judgment.

She also pointed out that the dates chosen for the application of both the limitation and the exception need not be the date of judgment. She proposed that the Court should limit the effect of its judgment so that it only applied to legal relations entered into after the end of the Italian tax year following judgment, in order to give time for legislation. She also proposed that an exception to that limitation should apply to claims which were brought prior to 17 March 2005, the date on which Advocate-General Jacobs delivered his opinion.

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appropriate case, limiting the retrospective effect of the invalidity by declaring certain of the past effects of the legislation "definitive". (See for example, Case 34/86 *Council v Parliament* [1986] ECR 2155 at paragraph 48 and Case C-445/00 *Austria v Council* [2003] ECR 8549 at paragraphs 103-106.) The Community Courts have also applied a similar approach by analogy when considering the validity of Community acts under the preliminary reference procedure, even though no such power is expressly provided for under the Article 234 procedure (See for example Case 4/79 *Providence Agricole de la Champagne* [1980] ECR 2823 at paragraphs 42 to 46; Case 109/79 *Maiseries de Beauce* [1980] ECR 2883, paragraphs 42 to 46; Case 145/79 *Roquette Frères* [1980] ECR 2917, paragraphs 50 to 52.)

<sup>6</sup> In relation to good faith, he noted that the DG responsible for customs and indirect taxation had written to the Italian government stating that IRAP did not appear to be incompatible with the Sixth Directive. IN relation to serious economic difficulties, he noted that approximately €120 billion had been raised through the tax and that it was the main source of funding for the Italian regions.

### **The judgment of the Court**

As stated above, in its judgment the ECJ restricted itself to considering the first of the issues with which the Advocate-Generals grappled. It concluded that “a tax with the characteristics of IRAP differs from VAT in such a way that it cannot be characterised as a turnover tax within the meaning of Article 33(1) of the Sixth Directive”.<sup>7</sup>

The Court concluded that IRAP was dissimilar to VAT in respect of two of the four essential characteristics of VAT of those characteristics. First, it concluded that IRAP was not proportional to the price of goods or services supplied because IRAP is charged on the net value of the production of an undertaking in a given period rather than on individual transactions, and includes elements such as variation in stocks, amortisation and depreciation, which have no direct connection with the supply of goods or services.<sup>8</sup>

Secondly, the ECJ concluded that IRAP was not intended to be passed on to the final consumer in a way that is characteristic of VAT. It stated that “a tax levied on production in such a way that it is not certain that it will be borne, like a tax on consumption such as VAT, by the final consumer, is likely to fall outside the scope of Article 33”.<sup>9</sup> The Court laid stress on two factors: first, that the taxable person cannot know how much tax was included in the purchase price; and secondly, that if a taxable person raised the price of its goods in order to pass the burden of the tax onto the consumer, by raising the price the amount of IRAP payable would also rise.

Since the result of the case was that IRAP was not prohibited by Community law, the Court therefore did not proceed to consider the possibility of limiting the temporal effect of its judgment.

### **Conclusions**

On the substance of the case, it is apparent that the ECJ took a restrictive approach to the scope of Article 33 of the Sixth Directive. It rejected the approach taken by Advocate-General Jacobs, who laid greater stress on the practical effects of the tax. That approach is perhaps surprising. IRAP appears, in terms of its practical effects, to be a turnover tax. Even if the tax applies to increases in the value of stocks, those stocks will eventually be used to make supplies. As Advocate-General Jacobs pointed out if Member States may introduce what is essentially a tax on added value, but escape the prohibition in Article 33 by ensuring that technical features of VAT are not reproduced, that prohibition will be rendered ineffective.

Most interestingly for tax lawyers outside of Italy, the ECJ's judgment in *Banca Popolare* does not end the question of whether the ECJ can and will adopt a more flexible approach to the temporal limitation of its judgments. Member states will frequently have an interest in limiting the scope of application of judgments of the ECJ, and can be expected to push for a more flexible approach.

Only two days after the ECJ delivered judgment in *Banca Popolare*, Advocate-General Stix-Hackl delivered her Opinion in *Meilicke*, a case which raises the issue of temporal limitation in a direct tax context.<sup>10</sup> The Court's order reopening the oral procedure in that case may indicate a greater willingness to grapple with these issues in its forthcoming judgment in that case.

*Tim Ward appeared for the United Kingdom government in both Banca Popolare di Cremona and Meilicke.*

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<sup>7</sup> See judgment of the Court at paragraph 38

<sup>8</sup> See judgment of the Court, paragraph 30

<sup>9</sup> See judgment of the Court, paragraph 31

<sup>10</sup> Case C-292/04 *Wienand Meilicke and Others v Finanzamt Bonn-Innenstadt*