2. The first paragraph of Article 95 must be interpreted widely so as to cover all taxation procedures which conflict with the principle of the equality of treatment of domestic products and imported products; it is therefore necessary to interpret the concept of "similar products" with sufficient flexibility. It is necessary to consider as similar products which have similar characteristics and meet the same needs from the point of view of consumers. It is therefore necessary to determine the scope of the first paragraph of Article 95 on the basis not of the criterion of the strictly identical nature of the products but on that of their similar and comparable use.
3. The function of the second paragraph of Article 95 is to cover all forms of indirect tax protection in the case of products which, without being similar within the meaning of the first paragraph, are nevertheless in competition, even partial, indirect or potential, with certain products of the importing country. For the purposes of the application of that provision it is sufficient for the imported product to be in competition with the protected domestic production by reason of one or several economic uses to which it may be put, even though the condition of similarity for the purposes of the first paragraph of Article 95 is not fulfilled.

   Whilst the criterion indicated in the first paragraph of Article 95 consists in the comparison of tax burdens, whether in terms of the rate, the mode of assessment or other detailed rules for the application thereof, in view of the difficulty of making sufficiently precise comparisons between the products in question, the second paragraph of that article is based upon a more general criterion, in other words the protective nature of the system of internal taxation.
4. Whilst Community law, as it stands at present, does not prohibit certain tax exemptions or tax concessions, in particular so as to enable productions or undertakings to continue which would no longer be profitable without these special tax benefits because of the rise in production costs, the lawfulness of such practices is subject to the condition that the Member States using those powers extend the benefit thereof in a non-discriminatory and non-protective manner to imported products in the same situation.
5. The classifications in the Common Customs Tariff which were designed with the Community's foreign trade in mind, do not provide conclusive evidence as to whether different products in relation one to another are similar within the meaning of the first paragraph of Article 95 of the EEC Treaty, or in competition, even partial, indirect or potential, and so covered by the second paragraph of that article.

In Case 168/78

COMMISSION OF THE EUROPEAN COMMUNITIES, represented by its Legal Adviser, Jean-Claude Séché, acting as Agent, with an address for service in Luxembourg at the office of its Legal Adviser, Mario Cervino, Jean Monnet Building, Kirchberg,

applicant,

v

FRENCH REPUBLIC, represented by Noël Museux, Assistant Director at the Directorate for Legal Affairs at the Ministry of Foreign Affairs, acting as Agent, and Pierre Péré, Secretary for Foreign Affairs at the Directorate for Legal Affairs, acting as Assistant Agent, with an address for service in Luxembourg at the Embassy of France,

defendant,

APPLICATION for a declaration that, by applying a discriminatory tax system on spirits, the French Republic has failed to fulfil its obligations under Article 95 of the EEC Treaty,

THE COURT

composed of: H. Kutscher, President, A. O'Keeffe and A. Touffait (Presidents of Chambers), J. Mertens de Wilmars, P. Pescatore, Lord Mackenzie Stuart, G. Bosco, T. Koopmans and O. Due, Judges,

Advocate General: G. Reischl
Registrar: A. Van Houtte

gives the following

JUDGMENT

Facts and Issues

The facts, procedure, conclusions and submissions and arguments of the parties may be summarized as follows:

I — Summary of the facts

French production of spirits, in other words spirituous beverages obtained by distillation coming within tariff subheading 22.09 C of the Common Customs Tariff, is of the order of 1 230 000 hectolitres per annum.

That production is, according to the rules of the Service des Alcools [Spirits Department], divided into three categories:

(a) The first category includes spirits which are obtained from wine or fruit and have a controlled and regulated designation of origin; it contains well-known spirits such as cognac, armagnac and calvados. Cognac production is the largest; it increased from 1955 to 1975 from 100 000/125 000 hectolitres to 546 000 hectolitres per annum. Other spirits obtained from wine amount to almost 120 000 hectolitres and those obtained from fruit to 140 000 hectolitres.

(b) The second category includes spirits obtained from wine or fruit produced by small-holders by the distillation of their own production (known as "bouilleurs de cru" = home distillers). This production, which is of the order of 100 000 hectolitres per annum, is not subject to the rules governing registered designation of origin.

(c) The third category covers spirits obtained from cereals. Genevas constitute a limited production, subject to quota, of approximately 8 000 hectolitres per annum; the production of other spirits (whisky, gin and vodka) is negligible. The overseas departments have a rum production of the order of 312 000 hectolitres.

The French legislation (Articles 403 and 406 A of the Code Général des Impôts [General Tax Code] and the annual finance law) provides for the levying on the various spirits of a purchase tax and a manufacturing tax the rate of which was fixed for certain types of products as follows:

(in FF)

	Year	Spirits obtained from grain	Geneva	Spirits obtained from wine
Purchase tax (per hl of pure alcohol)	1975	3 060	3 060	3 060
	1976	3 490	3 490	3 490
	1977	3 880	3 880	3 880
	1978	3 880	3 880	3 880
	1979	4 270	4 270	4 270
Manufacturing tax (per hl of pure alcohol)	1975	1 530	515	—
	1976	1 745	585	—
	1977	1 920	645	—
	1978	1 920	645	—
	1979	2 110	710	—
Total duty	1975	4 590	3 575	3 060
	1976	5 235	4 075	3 490
	1977	5 800	4 525	3 880
	1978	5 800	4 525	3 880
	1979	6 380	4 980	4 270

According to the draft finance law for 1980, the total excise duty and manufacturing tax should be FF 7 655 in the case of spirits obtained from cereals, FF 5 975 in the case of geneva and FF 5 125 in the case of spirits obtained from wine.

On 14 July 1975, the Commission drew the attention of the Government of the French Republic to the fact that the tax system applicable to geneva, a beverage produced in France in appreciable quantities, discriminated against other spirits obtained from cereals, the bulk of which are imported, and that the tax system applicable to spirits obtained from cereals was protective in nature *vis-à-vis* other spirits, in particular those obtained from wine, the French production of which is large.

In its reply of 25 February 1975, the French Government contested that the products in question could be considered similar or interchangeable; it claimed that the differences in taxation complained of could not therefore come within either the first paragraph or the second paragraph of Article 95.

Taking the view that the French Republic was, by applying taxation the effect of which was to afford protection to national production, failing to fulfil its obligations under Article 95 of the EEC Treaty, the Commission, by letter of 16 March 1976, initiated against the French Republic the procedure laid down in Article 169.

The French Government, in its observations of 31 May 1976, maintained its viewpoint that it was impossible to complain that the French Republic had been in breach of the Treaty. Consequently, on 22 December 1976 the Commission delivered to the French Republic the reasoned opinion provided for in the first paragraph of Article 169 of the Treaty. The French Republic was requested therein to adopt within 45 days the necessary measures to put an end to the failure to fulfil its obligations under Article 95 complained of.

The French Government merely acknowledged receipt of the Commission's reasoned opinion on 10 January 1977.

II — Written procedure

By application lodged on 7 August 1978, the Commission, pursuant to the second paragraph of Article 169 of the EEC Treaty, brought before the Court of Justice the alleged failure of the French Republic to fulfil, as regards the taxation of spirits, its obligations under Article 95 of the EEC Treaty.

The written procedure followed the normal course; the Government of the French Republic did not lodge a rejoinder.

The Court, after hearing the report of the Judge-Rapporteur and the views of the Advocate General, decided to open the oral procedure without any preparatory inquiry. It requested the Commission and the French Republic however to reply in writing to certain questions; that request was complied with within the prescribed periods after those periods had been extended.

III — Conclusions of the parties

The *Commission* claims that the Court should:

— Declare that, by applying a discriminatory tax system on spirits, the French Republic has failed to fulfil its obligations under Article 95 of the EEC Treaty;

— Order the French Republic to pay the costs.

The *Government of the French Republic* contends that the Court should:

— Dismiss the application lodged by the Commission;

— Order the Commission to pay the costs.

IV — Submissions and arguments of the parties put forward during the oral procedure

The *Commission* takes the view that the French tax system has the effect of imposing on spirits a burden in inverse proportion to the volume of domestic production so as to afford protection to French-produced spirits in relation to those from Member States.

The interpretation of Article 95 of the EEC Treaty

(a) The function of Article 95 is to eliminate, after the abolition of customs duties and charges having equivalent effect, the last trade barriers, not only those against identical imported products in relation to domestic products but also those against products which are similar to or in competition with those domestic products. Article 95 should operate on the basis of objective criteria which are extraneous to all considerations of economic or social policy. The prohibition on tax discrimination does not allow of any exception. Article 95 is an additional rule of the customs union and leaves no scope for conditional application or application subordinate to criteria for interpretation formulated outside the Community rules. Its aim is to guarantee the transparency of the common market and to protect the principle of the neutrality of taxation at Community level. The tax sovereignty of the Member States has been considerably limited in the interests of intra-Community trade; those limitations relate in particular to the freedom for the national legislature to have recourse to a tax device in order to pursue extra-fiscal objectives. A national tax system should not have secondary effects on the economic activities of traders in the other Member States which are contrary to the attainment of the common market. National legislation must be adapted to the Community rules, in particular as regards the taxation of alcoholic beverages.

(b) It follows from the case-law of the Court that for the purpose of defining the concept of "similar products" it is appropriate to compare the taxation on products which, at the same stage of production or marketing, have similar characteristics and meet the same needs from the point of view of consumers; the fact that a domestic product and an imported product are or are not classified under the same heading of the Common Customs Tariff constitutes in this respect an important criterion.

The Court has shown its preference for criteria which are more certain and easier to apply and are based on formal factors as against other criteria of a material nature which are based in particular on the nature and quality of the products, the raw materials used and the manufacturing processes.

Similarity must be appraised from the point of view of consumers and their needs; the concept of similarity contained in Article 95 is specifically subject to tax requirements, disregarding the physical or chemical properties of the products in question.

The concept of similarity cannot be national in dimension: a single, uniform

definition for all the Member States is necessary rather than nine divergent and contradictory definitions.

(c) The second paragraph of Article 95 extends the prohibition on tax discrimination to competing imported products which may be substituted for domestic products. This provision confirms that barriers to trade expressed by tax measures which are of such a nature as to afford direct or indirect protection to domestic production from competition by imported products are incompatible with the Treaty. It follows from the case-law of the Court that Article 95 is intended to eliminate all discrimination between imported and domestic products which are in whatever manner in legitimate confrontation within the common market.

(d) It is not appropriate to use the device of harmonization for the purpose of eliminating trade barriers of a tax nature: it is incorrect to make the prohibition on tax discrimination which flows from Article 95, a provision which has direct effect, subject to the adoption of "implementing" rules forming the subject-matter of harmonization directives within Article 99 of the Treaty.

The relationship between the various spirits

(a) The similarity between the spirits, in the absence of Community rules and definition, cannot be appraised according to the rules of the country concerned. The concept of "similar domestic products" requires a uniform interpretation for all the Member States.

(b) The classification of the products under the same tariff heading in the Common Customs Tariff constitutes an important criterion; the Common customs Tariff classifies all spirituous beverages under the same tariff heading, 22.09 C.

In view of the fact that the rates of duty are fixed on the basis of subdistinctions, it is necessary to take into consideration the fact that the tax relationship between tariff subheadings and sub-items is based on special considerations dependent upon the commercial policy of the Community or on its tariff policy and that the existence of such subdistinctions does not prevent the spirituous beverages thus classified being found to be similar.

The classification into tariff headings and subheadings is, of course, merely indicative as regards the appraisal of similarity; nevertheless, the classification of "spirituous beverages" in subheading C of tariff heading 22.09 is an indication of their similarity which the other factors on the file only confirm.

(c) Spirits, whether obtained from cereals or wine and fruit, have, according to the Explanatory Notes to the Brussels Nomenclature, from the point of view of consumption, similar characteristics and meet the same needs of consumers. Those needs may obviously be determined and influenced by various factors: habits, individual preferences, local or national traditions, social, seasonal and climatic conditions, or even fashion; nevertheless, on the market spirits appear, as far as consumers are concerned, to be products which are no longer complementary but parallel, in other words similar products within the meaning of the first paragraph of Article 95.

(d) Since the difference between the three categories of spirits provided for under the French legislation is solely a question of flavour, there is no need to take into consideration consumer habits alleged by the French Government, even less so since consumer habits may very well be a result of the price of the beverage, that is indirectly of the taxation imposed on it.

(e) The taste, flavour and smell of spirits is of an infinite variety; therefore they are not identical. Whether manufactured from wine, fruit or cereals, they have, however, a common property which indicates their similarity: they all possess flavouring substances or distinctive properties of taste which enable a number of specific needs of consumers to be met.

(f) The various spirits, whatever the raw materials from which they are produced, may be used in very different ways. It follows from this variety of uses that several spirits always correspond to each of them; there is no case in which only one of them, manufactured from a specific wine, fruit or cereal, cannot be replaced by one or several others which are not necessarily in one or other of the categories laid down by the French legislation. Spirits, however, all meet comparable needs in their diversity.

(g) An examination on the basis of the first paragraph of Article 95 must be made taking into account not the raw materials used but the similarity of the products obtained at the end of the manufacturing process.

(h) Spirits, in their diversity, have the same uses; assuming that they are not similar they are at least substitute products and in competition with one another within the second paragraph of Article 95.

The infringement of the first paragraph of Article 95

The manufacturing tax and the purchase tax laid down by the French tax system are higher on spirits obtained from cereals, the production of which is negligible in France, and appreciably lower (approximately 30%) in the case of spirits obtained from wine or fruit which are produced in large quantities in France.

A markedly higher tax burden is therefore imposed on imported spirits; as they are products similar to domestic products, there is an infringement of the paragraph of Article 95.

The infringement of the second paragraph of Article 95

(a) Even accepting that the similar nature of the products in question may be contested, the French rules in any case constitute an infringement of the second paragraph of Article 95: the taxation on spirits obtained from cereals and geneva constitutes taxation of such a nature as to afford indirect protection to spirits obtained from wine.

(b) The incidence of the tax on whisky and cognac must be calculated on the retail selling prices excluding tax and not including tax for reasons both of tax practice and of transparency. In terms of competition the prices including tax are already distorted by the existence of the discriminatory tax.

The selling prices indicated by the French Government do not correspond

to the average retail prices charged in France for the products concerned.

The extent of the discrimination must not be assessed by taking into consideration the difference between the incidence of the tax on whisky and that on cognac but having regard to the relationship between those two incidences.

(c) The figures relating to the consumption of whisky and cognac in France are not such as to justify the difference in taxation on those spirits but rather to explain the reasons prompting the French Government to have no intention to bring it to an end.

The *Government of the French Republic* considers that the tax system on spirits in France is not contrary either to the first or to the second paragraph of Article 95 of the EEC Treaty.

The alleged infringement of the first paragraph of Article 95

(a) The existence of a tax system distinguishing between several categories of products cannot, quite clearly, have by itself the effect of bringing that system within the first paragraph of Article 95: the implementation of that provision implies the application of criteria by which the existence or lack of similarity may be recognized.

(b) In this respect, it is necessary to state generally that there is no definition of the concept of similarity of products in the EEC Treaty.

In the absence of harmonization at the Community level, the national authorities have the power to lay down a tax classification; it is necessary in this case to check whether the effects of that classification are compatible with Article 95.

(c) An analysis of the concept of similarity should begin with an examination of the case-law of the Court of Justice; it follows from that case-law, on the one hand, that although formal factors constitute, at the most, an "important criterion" for the purpose of assessing the relationship of similarity, they are not themselves determining for the purpose of proving such similarity, and, on the other, it is necessary ultimately to examine whether, from the point of view of consumers, the products in question have similar properties and meet the same needs.

(d) As these are formal criteria and, more particularly, customs tariff headings laid down by the Common Customs Tariff, it is necessary to bear in mind that although tariff heading 22.09 C gathers together all "spirituous beverages", on the other hand, the rates of duty are fixed on the basis of the subheadings; over and above the method of classification, the customs reality is therefore that fixed by the tariff subheadings. The Court moreover, establishes the classification of products as to which there is uncertainty on the basis of that customs reality. The existence of those distinctions between categories of beverage within the same tariff heading shows that even according to formal criteria the products in question cannot be considered as similar products.

The Brussels Nomenclature may, according to the consistent case-law of the Court of Justice, constitute a criterion for interpretation; however, it cannot alter the fact that under the Common Customs Tariff "for legal purposes, classification shall be determined according to the terms of the headings and any relative Section or Chapter Notes".

Thus the customs classification laid down by the Common Customs Tariff confirms that spirits are not similar products.

(e) Moreover, the various categories of spirits do not have similar properties and do not meet the same needs from the point of view of consumers.

— The various products are distinguished by important differences in their chemical composition. Distillation enables "non-alcoholic" constituents to be extracted, of which there may be more than 275; the "flavour" of the distillate emerges from the combination of those constituents, in other words, organoleptic qualities which combine taste, flavour and smell. This difference in chemical composition can only create special organoleptic properties which are noticed by consumers. The Court itself considered that those characteristics validly enabled the products to be distinguished from one another.

— From the point of view of the needs of consumers, spirits are neither competing nor substitute products on the market, taking into account consumer habits. The organoleptic qualities of the various categories of spirits are obviously noticed by consumers; the methods of consumption of those products are also different (the distinction between digestives and aperitifs, neat consumption or consumption with the addition of water or soda). As far as consumers are concerned, the various products are obviously not consumed indiscriminately; they correspond to quite specific and distinct uses.

(f) If the various categories of spirits cannot be substituted for one another there can be no similarity between the products.

In these circumstances, the complaint that the first paragraph of Article 95 has been infringed as regards the taxation on spirits in France is without foundation.

The alleged infringement of the second paragraph of Article 95

(a) It follows from the case-law of the Court that the second paragraph of Article 95 prohibits the protective effects of internal taxation either as regards a competing product or an activity linked to the manufacture of the product. In this case only the alleged protection of domestic products against competing imported products is at issue.

(b) The French system of taxation on spirits does not come within the second paragraph of Article 95, principally because there is no competition between the categories of products which it establishes and, in the alternative, because the relative level of taxation between those categories of products is not of such a nature as to afford protection to one of them.

(c) The categories of spirits are not competing products: the different uses for which the products are intended and the result of the fact that they are not interchangeable from the point of view of consumers is that on the market consumption cannot be transferred from one category of spirits to another.

A shift in consumption determined by the relative level of prices can only occur within the same homogeneous category corresponding to identical consumer habits but certainly not from one category to another.

(d) The various levels of taxation between the products are not of such a nature as to afford protection to certain of them to the disadvantage of others.

A comparative table of the proportion of indirect taxes (specific taxes and value-added tax applicable) in the retail selling price of the main beverages in question shows that the proportion of indirect

taxation in spirits obtained from wine is 6% less than that imposed on whisky. This difference in taxation is relatively small in the absolute; it is minimal, if not non-existent, if the actual relationship between those products is taken into consideration. The taxation on spirits in the French system does not therefore have the protective effect complained of and is shown, in fact, to be practically neutral.

Moreover, this system in no way discriminates against products from other countries of the Community.

(e) The alleged protective effect of the French system of taxation on spirits is also refuted by examining the trend in the volume of consumption of imported products; thus from 1963 to 1977 the consumption of cognac increased by less than 35% and that of whisky ten times more.

(f) The tax system on spirits in France therefore has no effect contrary to the second paragraph of Article 95.

V — Replies to questions put by the Court

In its written replies to the questions put by the Court, the *Commission* emphasized in particular, as regards the work in progress at the Community level with regard to the production of spirits and the harmonization of tax systems, that there is no relationship of cause and effect between, on the one hand, the fact that the proposal for a directive on the harmonization of excise duty on spirits and the proposal for a regulation on the organization of the market in agricultural alcohol were adopted in due time and, on the other, the fact that the prohibition on tax discrimination laid down in Article 95 of the Treaty has not been complied with. The latter provision can from now on be fully effective; there is no justification for making the abolition of tax barriers subject to the adoption by the Council of the directive or regulation in question.

The proposal for a directive on the harmonization of excise duty on spirits (Journal Officiel 1972, C 43, p. 25) is based on the principle of the similarity between all spirits and on the need to make the products subject to a tax system with a single rate per hectolitre of pure alcohol. The proposal for a regulation on the common organization of the market in ethyl alcohol of agricultural origin and additional provisions (Journal Officiel 1972, C 43, p. 3 and Official Journal 1976, C 309, p. 2) provides for measures concerning the production of alcohol and intervention systems (price compensation, withdrawal from the market and sale to reserved sectors), measures relating to alcoholic beverages (grant of aid and the imposition of equalization charges), measures of commercial policy and general provisions. Spirits obtained by distilling wine are only referred to partially by that proposal, the intervention measures which are appropriate and necessary for the purpose of maintaining the price of those products being expressly governed by the Community rules on wine (Council Regulation No 337/79 of 5 February 1979 on the common organization of the market in wine, Official Journal 1979 No L 54, p. 1). The Community already has appropriate economic means for settling the most important problem, that

of the compensation for the difference between the production costs of brandy and spirits obtained by distilling wine on the one hand and products based on other agricultural raw materials, in particular cereals, on the other. These mechanisms can only operate correctly if they act on a market which is neutral from a tax point of view. The delay which has been noted in the progress of the Council's work on the proposals put forward by the Commission is largely due to the existence on the internal level of discriminatory national tax measures ensuring national products additional protection which is in no way justified against competing products from other Member States.

Taxation which is levied on domestic products and similar and/or competing imported products within the meaning of Article 95 not only at the same rate but according to the same structure, on the one hand, and internal taxation which, whilst constituting different treatment from a tax point of view as regards the rates and the structure of the tax, so as to benefit specific types of domestic products, is imposed on imported products without discrimination, in other words which extends to imported products the more favourable treatment for tax purposes reserved to certain similar and/or competing domestic products within the meaning of Article 95, on the other, is compatible with Article 95. The essential factor is that the principle of the neutrality of taxation in intra-Community trade should be observed unconditionally. These statements are in accordance with the case-law of the Court, in particular in the judgment of 10 October 1978 in Case 148/77 (*Hansen* [1978] ECR 1978).

The *French Government* for its part recalled that in France a distinction has traditionally been made between on the one hand spirits obtained from cereals which are intended for consumption in the form of aperitifs and on the other wine-based spirits which are consumed as digestives. This distinction prompted the French Government to provide from an early date for different taxation on those different products, which has become established.

VI — Oral procedure

The *Commission*, represented by Jean-Claude Séché, assisted by Mr Maurel, an expert and Principal Administrator in the Wine, Spirits and Derived Products Directorate of the Directorate General for Agriculture, and the *Government of the French Republic*, represented by Noël Museux, assisted by Mr Corrèze, an expert and Assistant Director at the Central Office of the Ministry for the Budget, Directorate General for Taxes, delivered oral argument and replied to the questions put by the Court at the hearing on 9 October 1979.

The Advocate General delivered his opinion at the sitting on 28 November 1979.

Decision

1 By application of 7 August 1978 the Commission brought under Article 169 of the EEC Treaty an action for a declaration that, by applying discriminatory taxation on certain spirits, the French Republic has failed to fulfil its obligations under Article 95.

2 At the same time, the Commission submitted to the Court of Justice applications against the Kingdom of Denmark and the Italian Republic relating to problems of the same nature. The applications contain, in all three instances, certain general considerations from which it follows that those applications form part of a general action aiming to ensure that the Member States concerned comply with the obligations imposed on them by the Treaty in this respect. It therefore seems appropriate to clarify first of all certain questions of principle common to the three cases as regards the interpretation of Article 95 in the light of the special features of the market in spirits.

The interpretation of Article 95

3 Under the first paragraph of Article 95 "No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products". The second paragraph of that article adds as follows: "Furthermore, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products".

4 The above-mentioned provisions supplement, within the system of the Treaty, the provisions on the abolition of customs duties and charges having equivalent effect. Their aim is to ensure free movement of goods between the Member States in normal conditions of competition by the elimination of all forms of protection which result from the application of internal taxation which discriminates against products from other Member States. As the Commission has correctly stated, Article 95 must guarantee the complete neutrality of internal taxation as regards competition between domestic products and imported products.

5 The first paragraph of Article 95, which is based on a comparison of the tax burdens imposed on domestic products and on imported products which may be classified as "similar", is the basic rule in this respect. This provision, as the Court has had occasion to emphasize in its judgment of 10 October 1978 in Case 148/77, *H. Hansen jun. & O. C. Balle GmbH & Co.* v *Hauptzollamt Flensburg* [1978] ECR 1787, must be interpreted widely so as to cover all taxation procedures which conflict with the principle of the equality of treatment of domestic products and imported products; it is therefore necessary to interpret the concept of "similar products" with sufficient flexibility. The Court specified in the judgment of 17 February 1976 in the *REWE* case (Case 45/75 [1976] ECR 181) that it is necessary to consider as similar products which "have similar characteristics and meet the same needs

from the point of view of consumers". It is therefore necessary to determine the scope of the first paragraph of Article 95 on the basis not of the criterion of the strictly indentical nature of the products but on that of their similar and comparable use.

6 The function of the second paragraph of Article 95 is to cover, in addition, all forms of indirect tax protection in the case of products which, without being similar within the meaning of the first paragraph, are nevertheless in competition, even partial, indirect or potential, with certain products of the importing country. The Court has already emphasized certain aspects of that provision in its judgment of 4 April 1978 in Case 27/77, *Firma Fink-Frucht GmbH* v *Hauptzollamt München-Landsbergerstrasse* [1978] ECR 223, in which it stated that for the purposes of the application of the first paragraph of Article 95 it is sufficient for the imported product to be in competition with the protected domestic production by reason of one or several economic uses to which it may be put, even though the condition of similarity for the purposes of the first paragraph of Article 95 is not fulfilled.

7 Whilst the criterion indicated in the first paragraph of Article 95 consists in the comparison of tax burdens, whether in terms of the rate, the mode of assessment or other detailed rules for the application thereof, in view of the difficulty of making sufficiently precise comparisons between the products in question, the second paragraph of that article is based upon a more general criterion, in other words the protective nature of the system of internal taxation.

8 The application in this instance of the criterion of similarity, which determines the scope of the prohibition laid down in the first paragraph of Article 95, has given rise to differences of opinion between the parties. According to the Commission, all spirits, whatever the raw materials used for their manufacture, have similar properties and in essence meet the same needs of consumers. Therefore, whatever the specific characteristics of the various products coming within that category and whatever the consumer habits in the various regions of the Community, spirits as finished products represent, from the point of view of consumers, a single general market. It is necessary to observe that this concept is expressed in the proposals submitted by the Commission to the Council for the establishment of a common organization of the market in alcohol, based on the application of a single rate of tax for all the products in question on the basis of their pure alcohol content.

9 This concept is contested by the governments of the three defendant Member States. In their opinion, it is possible to distinguish in the case of spirits various categories of product which differ either in terms of the raw materials used or of their typical characteristics or of the consumer habits observed in the various Member States.

10 In this connexion, the Commission points out however that the appraisal of the characteristics of the various alcoholic beverages, in the same way as consumer habits, is variable in time and space and that such factors cannot provide valid criteria as regards the Community taken as a whole. It draws attention moreover to the danger of hardening such habits by means of tax classifications made by the Member States.

11 These arguments prompt the following reply from the Court. The application of the provisions of Article 95 to specific national situations forming the subject-matter of the applications submitted by the Commission must be examined in the context of the general state of the market in alcoholic beverages within the Community. In this respect it is necessary to take into account three lines of thought:

(a) it is impossible, first of all, to disregard the fact that all the products in question, whatever their specific characteristics in other respects, have common generic features. All are the outcome of the distillation procedure; all contain, as a principal characteristic ingredient, alcohol suitable for human consumption at a relatively high degree of concentration. It follows that within the largest group of alcoholic beverages spirits form an identifiable whole united by common characteristics;

(b) in spite of those common characteristics, it is possible to distinguish within that whole products which have their own more or less pronounced characteristics. Those characteristics spring either from the raw materials used (in this connexion it is possible to distinguish in particular spirits distilled from wine, fruit, cereals and sugar-cane), or from manufacturing processes or, again, from the flavourings added. Typical varieties of spirits may in fact be defined by these particular characteristics, so much so that some of them are even protected by registered designations of origin;

(c) at the same time, it is impossible to disregard the fact that there are, in the case of spirits, in addition to well-defined products which are put to relatively specific uses, other products with less distinct characteristics and wider uses. There are, on the one hand, numerous products derived from what are known as "neutral" spirits, in other words spirits of all origins including molasses alcohol and potato alcohol; these products

owe their individuality only to flavouring additives with a more or less pronounced taste. On the other hand, it is necessary to draw attention to the fact that in the case of spirits there are products which may be consumed in very different forms, either neat or diluted or, again, in the form of mixtures. These products may therefore be in competition with a range of varying size of other alcoholic products of more limited use. A characteristic of the three cases brought before this Court is however the fact that in each there are, in addition to well-defined spirits, one or several products with a broad range of uses.

12 Two conclusions follow from this analysis of the market in spirits. First, there is, in the case of spirits considered as a whole, an indeterminate number of beverages which must be classified as "similar products" within the meaning of the first paragraph of Article 95, although it may be difficult to decide this in specific cases, in view of the nature of the factors implied by distinguishing criteria such as flavour and consumer habits. Secondly, even in cases in which it is impossible to recognize a sufficient degree of similarity between the products concerned, there are nevertheless, in the case of all spirits, common characteristics which are sufficiently pronounced to accept that in all cases there is at least partial or potential competition. It follows that the application of the second paragraph of Article 95 may come into consideration in cases in which the relationship of similarity between the specific varieties of spirits remains doubtful or contested.

13 It appears from the foregoing that Article 95, taken as a whole, may apply without distinction to all the products concerned. It is sufficient therefore to examine whether the application of a given national tax system is discriminatory or, as the case may be, protective, in other words whether there is a difference in the rate or the detailed rules for levying the tax and whether that difference is likely to favour a given domestic production. It will be necessary to examine within this framework the economic relationships between the products concerned and the characteristics of the tax systems which form the subject-matter of the disputes in the case of each of the applications lodged by the Commission.

14 In the various procedures, the parties have relied, with regard to the distinction between several categories of alcoholic product, upon certain statements made by the Court of Justice in the judgment in the *Hansen & Balle* case, *supra*, which was delivered at a time when these applications were pending. Reference has been made more particularly to a passage in that judgment which states as follows: "At the present stage of its development and in the absence of any unification or harmonization of the relevant

provisions, Community law does not prohibit Member States from granting tax advantages, in the form of exemption from or reduction of duties, to certain types of spirits or to certain classes of producers. Indeed, tax advantages of this kind may serve legitimate economic or social purposes, such as the use of certain raw materials by the distilling industry, the continued production of particular spirits of high quality, or the continuance of certain classes of undertakings such as agricultural distilleries".

15 Since certain of the defendant Governments have relied upon these statements in order to justify their tax system, the Court has asked the Commission questions as to the compatibility with Community law of the differences in the rates of tax applied to various categories of alcoholic beverages and as to its intentions in that respect within the context of the harmonization of tax legislation. The Commission, after re-stating its view that all spirits are similar and its intention to propose the introduction, at least in principle, of a single rate of tax in future Community regulations, draws attention to the fact that the problems linked to the use of certain raw materials, continued high-quality production and the economic structure of manufacturing undertakings to which the Court referred in the above-mentioned judgment may be resolved by means of aid to producers or systems of compensation between producers, taking into account the difference in the cost of the raw materials used. It draws attention to the fact that this objective has already been attained within the context of the common organization of the market in wine as regards spirits obtained by distilling wine. According to the Commission, such mechanisms might safeguard the marketing chances of certain products which are handicapped by production costs, without its being necessary to have recourse for this purpose to the procedure of variation in the rates of tax.

16 In view of these observations, the Court points out that although it acknowledged in the judgment in the *Hansen & Balle* case, taking into account the state of development of Community law, that certain tax exemptions or tax concessions are lawful, this is on condition that the Member States using those powers extend the benefit thereof without discrimination to imported products in the same conditions. It is necessary to emphasize that it was acknowledged that those practices were lawful in particular so as to enable productions or undertakings to continue which would no longer be profitable without these special tax benefits because of the rise in production costs. On the other hand, the considerations expressed in that judgment cannot be understood as legitimating tax differences which are discriminatory or protective.

The subject-matter and the background of the dispute in question

17 The terms in which the Commission brought its action against the French Republic call for certain preliminary observations concerning the subject-matter of the dispute. Whereas, according to the conclusions contained in the application, the Commission asks the Court for a declaration that the French Republic has failed to fulfil its obligations under Article 95 of the EEC Treaty "by applying a discriminatory tax system on spirits", it appears from the wording itself of the application and from subsequent developments in the case that the application in fact concerns only certain elements of the French legislation thereon, in other words the discriminatory taxation imposed on geneva and other alcoholic beverages resulting from the distillation of cereals on the one hand and on spirits obtained from wine and fruit on the other. More specifically, the Commission refers above all to the difference in the taxation on two typical and well-known products, whisky and cognac.

18 The French Government contested this way of putting the problem when, they claim, the categories of taxation adopted by the Commission do not correspond either to the terminology of the French legislation or to French tax practice.

19 This preliminary objection raised by the French Government is justified. It is necessary therefore to recall the wording of the provisions at issue in the Commission's application, in other words Articles 403 and 406 of the Code Général des Impôts [General Taxation Code], so as to ascertain the subject-matter of the dispute in terms adapted to the state of French legislation. This legislation is subject to annual amendments through successive finance legislation, so that it is quoted hereinafter in the state in which it was at the date of the hearing by the Court.

20 Under Article 403 of the Code Général des Impots, all spirits are subject to a "purchase tax" the rate of which is fixed per hectolitre of pure alcohol. The amounts are fixed by the same article, first of all for certain named products (none of which is at issue in this procedure) then for "all other products". The rate fixed for this general category is FF 4 270 per hectolitre.

21 According to Article 406 of the same Code, certain alcoholic products are subject in addition to a "manufacturing tax", the rate of which is fixed at the following amounts per hectolitre of pure alcohol:

— FF 2 110 "for alcoholic beverages resulting from the distillation of cereals and spirits sold under the same name as those beverages, except genevas"; and

— FF 710 "for all other alcohol-based beverages which are capable of being consumed as aperitifs and for wine-based aperitifs, vermouth, liqueur wines and wines treated as such which do not benefit from a registered designation of origin, and natural sweet wines subject to the tax system applicable to spirits and genevas".

22 It follows from the foregoing that although all spirits including spirits obtained from wine and fruit are subject uniformly to the same "purchase tax", geneva and other spirits obtained from cereals are in addition subject to the "manufacturing tax".

23 It therefore seems that the Commission's application concerns only three types of product which, albeit both important and representative, far from exhaust the whole range of alcohol products referred to by the tax code. In particular, as the French Government pointed out, the application covers neither "anise spirits", the treatment for tax purposes of which is equivalent to that of alcoholic beverages resulting from the distillation of cereals, nor the category of "aperitif" which is subject to the same system as genevas.

24 Although it may have seemed more appropriate to examine the system of taxation on alcoholic beverages in France as a whole, in particular so as to be able to appraise from a general point of view the question of the similarity of the various products, it is however impossible to contest the objectivity of the Commission's presentation of the facts of the case as regards the treatment for tax purposes applied to the three categories of products which it chose to adopt, in other words spirits obtained from cereals, geneva and spirits obtained from wine and fruit.

25 It follows from this that all the alcoholic beverages referred to by the Commission are uniformly subject to the same purchase tax but that genevas and other alcoholic beverages resulting from the distillation of cereals are subject in addition to a manufacturing tax which is not applicable to spirits derived from wine and fruit. It is also not contested that there is no significant production of geneva and other spirits obtained from cereals in France. The Commission considers, in these circumstances, that the tax system is contrary to the provisions of Article 95 in that it gives a tax advantage to certain spirits produced in France whereas similar or competing products imported from other Member States are subject to an additional tax.

26 The French Government puts forward two lines of argument for the purpose of defending the tax system complained of:

— First, it contests that the products referred to in the application are similar within the meaning of the first paragraph of Article 95;

— Moreover, it contests that there is between those products sufficiently marked competition to justify the application of the second paragraph of Article 95.

27 In the opinion of the French Government, the classifications laid down by French legislation and tax practice are therefore justified from the point of view of the Treaty and the fixing of different rates of tax for the various categories cannot be criticized from the point of view of the requirements flowing from Article 95.

The application of the contested tax system

28 In accordance with the viewpoint recalled above, the Commission considers that all the spirits in question are "similar" products within the meaning of the first paragraph of Article 95. The detailed rules on taxation applied under the French tax legislation are therefore incompatible with the prohibition against discrimination laid down in the first paragraph of Article 95. The Commission considers that the customs classification of the products in question, which are all grouped under "spirituous beverages" in tariff sub-heading 22.09 C of the Common Customs Tariff and covered in a common definition by the relevant Explanatory Note to the Brussels Nomenclature, supports its argument. That note in fact describes as "spirits" products obtained "by distilling wine, cider or other fermented beverages or fermented grain or other vegetable products". The Commission recalls moreover the terms in which the Court of Justice defined the concept of similarity in its judgment in the above-mentioned *REWE* case.

29 From the point of view of the second paragraph of Article 95, the Commission observes that the French tax system is adjusted so as to place at a disadvantage spirits obtained from cereals which are almost exclusively imported from other Member States, whereas domestic production of those products is insignificant. On the other hand, the main domestic product, in other words spirits obtained from wine and fruit, are favoured in that they are not subject to the payment of the "manufacturing tax". It thus seems that this tax system, even if it were necessary to state that spirits obtained from wine and fruit on the one hand and spirits obtained from cereals on the other are not similar, is of such a nature as to afford an indirect competitive advantage to national production.

30 The French Government, for its part, states that in the absence of a definition of the concept of similarity in the Treaty and pending harmonization at the Community level, the national authorities have the power to make a tax classification subject, of course, to compliance with the obligations flowing from Article 95. It considers that the effects of the classification made by the French tax legislation are compatible with those requirements.

31 As regards the indications which may be deduced from the Common Customs Tariff, the French Government draws attention to the fact that tariff heading 22.09 C in its turn contains subdivisions the effect of which is to treat differently products such as gin and whisky on the one hand and "other" spirituous beverages, including spirits obtained from wine and fruit, on the other. The classification laid down by the Common Customs Tariff therefore rather supports the opinion that spirits are not all similar products.

32 As regards the criteria which may be used for the classification of the products, the French Government considers that it is the "flavour" of the distillate, in other words, a number of organoleptic properties combining taste, aroma and smell, which, from the point of view of satisfying the needs of the consumer, forms the basis of the classification of products which are neither similar nor even interchangeable or competing within Article 95. The relevance of that criterion has been expressly acknowledged, it claims, in the judgment of 29 May 1974 in Case 185/73, *Hauptzollamt Bielefeld* v *Offene Handelsgesellschaft in Firma H. C. König* [1974] ECR 607, in which in order to distinguish between tariff subheading 22.09 A (ethyl alcohol) and tariff subheading 22.09 C V (other spirituous beverages), the Court referred to the presence in spirituous beverages "of flavouring substances or distinctive properties of taste".

33 More particularly, the defendant Government states that the French tax legislation is based on the distinction between "digestives" on the one hand, in other words beverages consumed at the end of the meal including in particular spirits obtained from the distillation of wine and fruit, such as cognac, armagnac and calvados, and "aperitifs" on the other, which are beverages drunk before meals including above all grain-based spirits, most frequently consumed diluted with water, such as whisky, gin and aniseed spirits. As regards the latter category of beverages, the French Government points out that although this is a typically French product it is subject to the "manufacturing tax" in the same way as spirits obtained from cereals so that it is impossible to speak in this respect of discriminatory treatment. In the same context, the French Government draws attention in addition to the fact that, from the tax point of view also registered designations of origin, of

which the Commission took no account at all in lodging its application, form an identifying criterion.

34 As regards the application of the second paragraph of Article 95, the French Government claims that there is no competition between the products coming within both tax categories laid down by the French legislation so that there cannot be a shift in consumption from one category of spirits to another as the result of a difference in taxation. True competition exists between whisky and aniseed spirits which in fact come within the same tax category. The system contested by the Commission has, moreover, had no protective effect as shown, according to the French Government, by the comparative statistics on the consumption of cognac and whisky in France from which it is clear that although the consumption of cognac increased only moderately in the period from 1963 to 1977 (from 33 361 hectolitres to 44 745 hectolitres), the consumption of whisky increased spectacularly during the same period (from 34 104 hectolitres to 117 379 hectolitres).

35 The arguments based by the parties on the wording of tariff subheading 22.09 C cannot, in this case, provide a conclusive indication. It is true that this subheading covers all spirits in the same general category under the name of "spirituous beverages". In its turn, it contains several subdivisions (rum, gin, whisky and vodka), followed by a residual category covering the "other" spirituous beverages. These subdivisions, which were designed with Community foreign trade in mind, cannot however constitute an appropriate classification from the point of view of the application to the present case of Article 95 of the Treaty, especially since the French Code Général des Impôts is based on a system of classification which is entirely different from that of the Common Customs Tariff. Nor, finally, can an argument be based on the judgment of the Court in the *Hauptzollamt Bielefeld* v *Offene Handelsgesellschaft in Firma H. C. König* case since that case involved making a general distinction between spirits, grouped together in tariff subheading 22.09 C, and pure ethyl alcohol, which comes within tariff subheading 22.09 A. This judgment therefore provides no indications as to the scope of any classifications within spirits as a whole.

36 Nor does the Court think it is possible to adopt as a relevant classification the distinction advocated by the French Government between "aperitifs" and "digestives". It is necessary to point out that even Article 406 of the Code Général des Impôts does not classify spirits obtained from the distillation of cereals as "aperitifs" but merely places these two types of beverages side by side in the group of products subject to the same manufacturing tax. In fact, the distinction between aperitifs and digestives does not take into account many circumstances in which the products in question may be consumed

before, during or after meals or even completely unrelated to such meals; it seems, moreover, that, according to consumer preferences the same beverage may be used indiscriminately as an "aperitif" or "digestive". Therefore it is impossible to recognize, for the purposes of the application of Article 95 of the Treaty, the objective value of the distinction upon which French tax practice is based.

37 The same observation applies to the criterion for distinction based on the flavour of the various spirits for the purpose of determining the properties of the products in question with regard to the application of tax legislation. There is no question of denying the reality of and the shades of difference in the flavour of the various alcoholic products; it is necessary however to bear in mind that this criterion is too variable in time and space to supply by itself a sufficiently sound basis for distinction for the definiton of categories which may be recognized throughout the Community. The same applies to consumer habits which also differ from region to region and even according to social environment, so that they cannot supply appropriate differentiating criteria for the purpose of Article 95.

38 Classifications based on the flavour of the products and consumer habits are all the more difficult to lay down since the products in question, such as whisky and genevas, may be consumed in very varied circumstances, either neat or diluted or in the form of mixtures. Owing in particular to this flexibility of use, those drinks may be considered as similar to a particularly large number of other alcoholic beverages or as in at least partial competition which those beverages.

39 After considering all these factors the Court deems it unnecessary for the purposes of solving this dispute to give a ruling on the question whether or not the spirituous beverages concerned are wholly or partly similar products within the meaning of the first paragraph of Article 95 when it is impossible reasonably to contest that without exception they are in at least partial competition with the domestic products to which the application refers and that it is impossible to deny the protective nature of the French tax system within the second paragraph of Article 95.

40 In fact, as indicated above, spirits obtained from cereals, including genevas, have, as products obtained from distillation, sufficient characteristics in common with other spirits to constitute at least in certain circumstances an

alternative choice for consumers. Because of their characteristics, spirits obtained from cereals and genevas may be consumed in very varied circumstances and at the same time compete with beverages described as "aperitifs" and "digestives" according to French tax practice whilst, moreover, serving purposes which do not come within either of those two categories.

41 As the competitive and substitution relationships between the beverages in question are such, the protective nature of the tax system criticized by the Commission is clear. A characteristic of that system is in fact that an essential part of domestic production, in other words spirits obtained from wine and fruit, come within the most favourable tax category whereas at least two types of product, almost all of which are imported from other Member States, are subject to higher taxation under the "manufacturing tax". The fact that another domestic product, aniseed spirits, is similary placed at a disadvantage does not rule out the protective nature of the system as regards the treatment for tax purposes of spirits obtained from wine and fruit or the existence of at least partial competition between those spirits and the imported products in question. As for the fact that the market share of whisky has increased in spite of the tax disadvantage which it suffers, this fact does not prove that there is no protective effect.

42 It is necessary to state in conclusion from the foregoing that the tax system applied in the French Republic under the provisions of the Code Général des Impôts is incompatible with the requirements laid down in Article 95 of the Treaty as regards taxation on the one hand on genevas and other alcoholic beverages obtained from the distillation of cereals and, on the other, on spirits obtained from wine and fruit.

Costs

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

44 As the defendant has failed in its submissions, it must be ordered to pay the costs.

On those grounds,

THE COURT

hereby:

1. **Declares that, by the application of discriminatory taxation on spirits as regards, first, geneva and other alcoholic beverages obtained from the distillation of cereals and, secondly, spirits obtained from wine and fruit, under Articles 403 and 406 of the Code Général des Impôts, the French Republic has failed, as regards products imported from other Member States, to fulfil its obligations under Article 95 of the EEC Treaty;**

2. **Orders the French Republic to pay the costs.**

Kutscher O'Keeffe Touffait Mertens de Wilmars Pescatore

Mackenzie Stuart Bosco Koopmans Due

Delivered in open court in Luxembourg on 27 February 1980.

A. Van Houtte
Registrar

H. Kutscher
President

OPINION OF MR ADVOCATE GENERAL REISCHL DELIVERED ON 28 NOVEMBER 1979 [1]

Mr President,
Members of the Court,

The procedure for a declaration that a Member State has failed to fulfil its obligations under the Treaty which must be dealt with today must be considered in connexion with a number of other applications which the Commission has brought against several Member States (Cases 169/78 to 171/78 and 55/79). In these applications it complains that those Member States have infringed Article 95 of the EEC Treaty by giving preferential

1 — Translated from the German.