OPINION OF ADVOCATE GENERAL SIR GORDON SLYNN DELIVERED ON 25 JANUARY 1983

My Lords,

This is an application by the Commission, under Article 169 of the EEC Treaty, for a declaration that the Italian Republic has failed to fulfil its obligations under Article 95 of the EEC Treaty which provides that the Member States shall not "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" and that they shall not "impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products."

In Italy value-added tax (VAT) is applied at different rates: a standard rate, a reduced rate and two higher rates which, at the time the action began, were of 18% and 35%, but which on 1 October 1982 were increased to 20% and 38% respectively (Decree-Law No 697 of 1 October 1982, GURI No 273 at p. 7166).

A decree-law of 4 March 1977 (No 58, GURI No 70 of 14 March 1977), later converted into Law No 183 of 9 May 1977 (GURI No 129 of 13 May 1977) provided that gin and all spirits should be taxed at the higher rates. Gin and those spirits covered by a designation of origin or provenance, regulated or protected by specific measures applied in the area of production, are taxed at what is now the 38% rate; all other spirits are taxed at what is now the 20% rate. It is this distinction which has brought about the present application by the Commission.

It is not disputed that all spirits produced in Italy other than gin are taxed at 20%, because there is no system of designations of origin or provenance regulated or protected in the manner specified which relates to spirits made in Italy. Gin is the only spirit made in Italy which is taxed at 38%, the rate which is also applied to imported gin. The Commission and the Italian Government seem to be agreed that about 4 000 hectolitres of gin (pure alcohol) are produced and consumed in Italy each year, although precise figures may not be available. On any view it represents a very small proportion of the total Italian production of spirits, including gin. An average figure put forward for the years 1975-81 is 1.22%, and assuming that none of the gin is exported, it would seem clearly to be less than 1.5% of the yearly consumption in Italy of Italian spirits, including gin.

On the other side, most imported spirits (including gin) are taxed at 38% though rum and vodka are, and some other spirits may be, taxed at 20%. According to the Italian Government these account

for about 2-3 000 hectolitres of the total amount of spirits (including gin) imported each year from the other Member States. On the basis of the statistics produced by the Italian Government, the lowest annual level reached by imports in the period 1975-1981 was 194 099 hectolitres in 1975 when imported spirits taxed at the 18% rate did not exceed 1.55% of the total amount of imported spirits (including gin). In other years, when total imports were higher, the percentage taxed at 18% was even lower.

In the light of this state of affairs (whereby all but a minute percentage (1.5% or less) of Italian-made spirits including gin attract only a 20% tax, and all but a minute percentage (1.5% or less) of imported spirits attract a 38% tax) the Commission contends that the Italian legislation is both discriminatory and protective. Since all gin, whatever the Member State in which it is manufactured, is taxed at 38%, the scope of the complaint before the Court is, as I understand it, limited to the other spirits involved.

The figures produced by the parties show that, whilst the price of good quality imported French brandy is higher than that of Italian-made grappa, the retail price of imported whisky (after deduction of VAT and State tax of about LIT 500) is in some cases less, in other cases not markedly different from the retail price of some Italian-made grappa (after deduction of VAT, the State tax not being charged). The price differential really emerges when 38% is added to one; 20% to the other.

As a matter of first impression this substantially higher tax on imported spirits would seem to be "of such a nature as to afford indirect protection to other products", namely locally-made spirits, within the meaning of the second paragraph of Article 95. Whether they are consumed before, during, after or without a meal they are in a broad sense in competition with each other.

For the purpose of deciding whether the legislation is of "such a nature as to afford indirect protection", the Court has already made it clear that detailed statistics do not have to be investigated (Case 170/78 *Commission* v *United Kingdom* [1980] ECR 417). The effect of the protection may be so apparent that it can be assumed without detailed proof. *Prima facie*, but subject to the arguments of the Italian Government, that seems to be the position here.

Unless this *prima facie* view is shown to be wrong, and although it seems to be accepted that some of the imported spirits are "similar" to some domestic products (so long as the distinction betweeen cereal-based and wine-based spirits is observed) it is accordingly not necessary to consider whether or not there is a violation of the first paragraph of Article 95. (See, for example, Cases 168/78 *Commission* v *France*, 169/78 *Commission* v *Italy* and 171/78 *Commission* v *Denmark* [1980] ECR 347, 385 and 447 respectively.)

Against this *prima facie* view a number of arguments have been put forward by the Italian Government.

It is argued first that what matters is whether the system in fact operates to restrict imports and that here the system has not in fact restricted imports because there has continued to be an increase in the level of whisky imports, even though overall consumption of spirits has declined or remained stationary, and even though local consumption of Italian-made spirits has declined and exports increased. Quite apart from the fact that this argument ignores the effect of the system on other imported spirits, it has already been rejected by the Court as an approach on several occasions. In the first place, Article 95 is infringed if the nature or inherent characteristics of a tax mechanism are such that they are likely to produce a protective effect *(Commission* v *United Kingdom* at paragraph 10 of the judgment). In the second place the fact that the market share of whisky has increased despite its disadvantageous tax treatment does not prove that there is no protective effect (see, for example, *Commission* v *France* at paragraph 41 of the judgment).

In any event, in this case the figures produced by the United Kingdom (which have not effectively been challenged) appear to show that since the period 1968-74 the percentage increase has fallen and during the years 1979 and 1980, even if the value of imports increased marginally, the quantity imported fell. At a time of rising prices the quantity imported is likely to give a more meaningful guide than the value of the imports. Accordingly I do not consider that this argument has been made out either in principle or in fact.

It is also argued that some domestic production (i.e. gin) is taxed at the 38% rate, so that this tax is not discriminatory or protective. This does not seem to me to affect the position since the quantities involved are even less than the "minimal" or "insignificant" quantities referred to by the Court in *Commission* v *Italy* and Case 26/80 *Schneider Import* v *HZA Mainz* [1980] ECR 3469. Moreover, in *Commission* v *Denmark* the Court found that the tax system in question was protective, even though some 16.33% of the domestic production consumed in Denmark did not benefit from more favourable treatment. In that case the tax system largely benefited a "typical domestic product" (aquavit) and disfavoured all but 2.49% of imports; in the present case the protective characteristics of the system are, if anything, clearer.

A more fundamental answer to the claim put forward by the Italian Government is based on cases in which the Court has held that the Member States are free to adopt tax systems which differentiate between certain products as long as they are not discriminative or protective. In the contention of the Italian Government, the principle adopted by the Court is to be found in paragraph 21 of the judgment in Cases 142 and 143/80 *Amministrazione delle Finanze* v *Essevi and Salengo* [1981] ECR 1413: "... in its present stage of development Community law does not restrict the freedom of each Member State to lay down tax arrangements which differentiate between certain products on the basis of objective criteria, such as the nature of the raw materials used or the

production processes employed. Such differentiation is compatible with Community law if it pursue objectives of economic policy which are themselves compatible with the requirements of the Treaty and its secondary legislation and if the detailed rules are such as to avoid any form of discrimination, direct or indirect, in regard to imports from other Member States or any form of protection of competing domestic products" (see also Case 127/75 *Bobie Getränkevertrieb* v *HZA Aachen Nord* [1976] ECR 1079 at paragraph 9 of the judgment, Case 148/77 *Hansen* v *HZA Flensburg* [1978] ECR 1787 at paragraphs 16 to 17, Case 21/79 *Commission* v *Italy* [1980] ECR 1 at paragraphs 14 to 15, Case 68/79 *Just* v *Ministry for Fiscal Affairs* [1980] ECR 501 at paragraph 12, the *Schneider* case, *supra*, at paragraph 9, Case 140/79 *Chemial Farmaceutici SpA* v *DAF SpA* [1981] ECR 1 at paragraph 14 and Case 46/80 *SpA Vinal* v *SpA Orbat* [1981] ECR 77 at paragraph 13).

The theme of these cases is that Article 95 "guarantees the complete neutrality of internal taxation as regards competition between domestic products and imported products" (Case 216/891 *COGIS* v *Amministrazione delle Finanze* [1982] ECR 2701 at paragraph 6 of the judgment) but does not otherwise prohibit differential tax arrangements. Such arrangements may be based on legitimate industrial or economic policy so long as they apply equally to imported and domestic goods.

In the present case, two aspects of fiscal policy are relied upon and are said to be well-established, within the discretion of the taxing authorities and in no way in conflict with principles of Community law. Firstly, it is said that the intention is to tax consumption according to the needs which are satisfied. The VAT system therefore distinguishes between essential and non-essential goods. The latter are in turn subdivided into (a) goods which are non-essential and (b) goods which, apart from being non-essential, are also luxury or prestige goods. Public opinion or taste, it is said, attaches importance to a designation of origin or provenance and this is taken to be the criterion for distinguishing between luxury spirits and others.

Secondly, it is said that the objective is to tax at a higher rate persons with a contributive capacity, the richer members of society. Accordingly, those products are taxed at the higher rate of 38% which are bought as luxury goods by the more affluent members of the community.

There is nothing in the Treaty or in secondary legislation which prevents *per se* the taxation of persons according to their "contributive capacity" and the Commission has not, in terms, challenged the use of variable VAT rates to achieve this purpose. Similarly, the taxation of consumption according to whether it is essential, non-essential or luxury does not, in itself, infringe Article 95. But even if both of these aims are within the discretion of the national taxing authority, it is clear that the rules adopted to give effect to them must not

at the same time conflict with the provisions of Article 95. They are not in themselves an answer to a claim that there has been discrimination or protection contrary to that article.

In any event, in the present case the argument put forward that, according to public opinion, spirits, having a certificate of origin or provenance with regulated methods of production have most value, are the most sophisticated and are the most appropriate for consumption by the privileged, who should be taxed most, does not seem to me to have been made out. It is said that, on the basis of an independent survey, at present the wealthier buy imported cognac and whisky rather than the poorer. If the price, because of tax levels, is higher than the price of locally-made liqueurs, that is not surprising and does nothing to prove that the goods themselves are of a higher quality or are made to satisfy a more sophisticated or cosmopolitan taste. It only proves that those who want to pay less will buy local goods with lower tax levels. If the starting price is almost the same and tax levels were the same, the price on the shelf would be the same. Then there would be the possibility of real competition and buying patterns might change. If the starting price of whisky is lower than that of some grappa, and the tax level is the same, there is nothing to indicate that only the rich would buy the cheaper product, the poorer the more expensive one, once the products had become familiar. If there is a higher tax on the already higher-taxed product, there may be a perpetuation of purchasing patterns, but that is perfectly capable of amounting to discrimination against imports or to protection of domestic production.

Moreover, a certificate of origin does not necessarily spell out superior quality; it may do no more than protect local industry or a regional name. The present system further ignores the difference in quality between various imported brands of cognac and whisky, and taxes them all at the same level; it treats all gin as being luxury or prestige without any real explanation being given as to why this is superior to good Italian grappa: it treats vodka, in some countries clearly regarded as being a prestige spirit, as being neither prestige nor luxury, without in my opinion any valid justification being put forward. It makes the assertion that there is no Italian spirit of superior quality, as to which, perhaps fortunately, the Court is not required to make a finding of fact but which seems unduly self-denigrating.

Accordingly, it seems to me that if the real intention is to tax those who can best afford to pay, the tax should be geared to the price of the product before tax. If good grappa and good whisky cost the same without tax, the only way to tax those who can afford to pay is to tax both at the same level. At present the heavier burden is placed on those with a higher contributive capacity who buy imported spirits, but not those who buy spirits produced in Italy.

Further, if the real intention is to tax goods of superior quality, it is not

achieved consistently or without discrimination or protection; if the real intention is to tax goods with a certificate of origin there is discrimination or protection because in Italy no such certificate of origin or provenance is required or exists, so that domestic goods can never fall into the higher bracket. It seems to me impossible to accept the assertion that no Italian spirits can merit such a system of certificates or of regulation.

Accordingly, I am not satisfied that the conditions relied upon by the Italian Government to justify the discretion it claims are made out even if it is right to look at the position in only one Member State. I have doubts as to whether this is the right approach since if local tastes, opinions or prejudices are to determine tax levels, protectionism can easily be justified. It seems to me that whether a drink is a luxury or a prestige drink ought to be seen on a national basis.

At the end of the day, it seems to me that even accepting that the aims of setting a variable tax according to the luxuriousness of the product, and of taxing those best able to pay, are permissible aims, they must be achieved by means which do not discriminate between imports from Member States and domestic products, and which do not impose taxes on imports from Member States of such a nature as to afford indirect protection to other products.

In my opinion the present system quite clearly does protect the local products by the taxes imposed on goods imported from other Member States. The real basis for this tax differential seems to me to have been shown to be the place of origin; the Italian product is favoured at the expense of the imported product. The differential is not shown to be based on acceptable objective criteria.

In these circumstances, it follows that Decree-Law No 58 of 4 March 1977, as converted into Law No 183 of 9 May 1977, does not apply indifferently as between domestic and imported spirits and that it does, therefore, infringe Article 95 of the Treaty.

For these reasons, it is my opinion that the declaration sought by the Commission should be granted and that the Italian Republic should be ordered to pay the costs.