JUDGMENT OF THE COURT (Fifth Chamber)
15 March 2001 *

In Case C-265/99,

Commission of the European Communities, represented by E. Traversa and H. Michard, acting as Agents, with an address for service in Luxembourg,

applicant,

v

French Republic, represented by K. Rispal-Bellanger and S. Seam, acting as Agents, with an address for service in Luxembourg,

defendant,

APPLICATION for a declaration that:

— by retaining and applying rules providing for the application of a formula for calculating the engine rating for administrative purposes which is unfavour-

* Language of the case: French.

able to vehicles fitted with a six-speed manual gearbox or five-speed automatic transmission, which has discriminatory or protectionist effects in the case of vehicles manufactured in other Member States compared with similar or competing domestic vehicles, and

— by retaining provisions limiting the K factor for the purposes of calculating the engine rating for tax purposes of vehicles approved on an individual basis between 1 January 1978 and 12 January 1988 and which are regarded as equivalent to type-approved vehicles having an actual power output in excess of 100 kW,

the French Republic has failed to fulfil its obligations under Article 95 of the EC Treaty (now, after amendment, Article 90 EC),

THE COURT (Fifth Chamber),

composed of: A. La Pergola, President of the Chamber, M. Wathelet (Rapporteur), D.A.O. Edward, P. Jann and L. Sevón, Judges,

Advocate General: S. Alber,
Registrar: L. Hewlett, Administrator,

having regard to the Report for the Hearing,

after hearing oral argument from the parties at the hearing on 14 September 2000,

after hearing the Opinion of the Advocate General at the sitting on 26 October 2000,

gives the following

Judgment

1 By application lodged at the Court Registry on 16 July 1999, the Commission of the European Communities brought an action under Article 226 EC for a declaration that:

— by retaining and applying rules providing for the application of a formula for calculating the engine rating for administrative purposes which is unfavourable to vehicles fitted with a six-speed manual gearbox or five-speed automatic transmission, which has discriminatory or protectionist effects in the case of vehicles manufactured in other Member States compared with similar or competing domestic vehicles, and

— by retaining provisions limiting the K factor for the purposes of calculating the engine rating for tax purposes of vehicles approved on an individual basis between 1 January 1978 and 12 January 1988 and which are regarded as equivalent to type-approved vehicles having an actual power output in excess of 100 kW,

the French Republic has failed to fulfil its obligations under Article 95 of the EC Treaty (now, after amendment, Article 90 EC).

2 At the hearing, the Commission withdrew the second complaint.

The national legal context

3 The French system for the taxation of private cars is based on the calculation of their engine rating for administrative purposes, which determines the basis of assessment of the tax.

4 At the material time, namely, during the period prior to 1 July 1998, there were in that system of taxation two principal and distinct methods of calculating the engine rating for administrative purposes of private cars.

5 Those two methods of calculation were laid down respectively by the Circular of 28 December 1956 (*Journal Officiel de la République Française* of 22 January 1957, p. 910, hereinafter 'the 1956 Circular') and Circular No 77-191 of 23 December 1977 (*Journal Officiel de la République Française* of 8 February 1978, p. 1052, hereinafter 'the 1977 Circular'), which has been amended a number of times. Those circulars were given force of law, with retroactive effect, by Article 35 of Law No 93-859 of 22 June 1993, the Finance (Amendment) Law for 1993 (*Journal Officiel de la République Française* of 23 June 1993, p. 8815).

6 The formula for calculating the engine rating for administrative purposes under the 1956 Circular is based solely on a vehicle's cylinder capacity.

7 Finding that reference exclusively to the cylinder capacity had had the effect of encouraging maximisation of the power output obtained from small engines, with results which might prove unfavourable as regards noise and the limitation

of fuel consumption, the French authorities adopted the 1977 Circular in order to adjust the formula laid down in the 1956 Circular so as to obtain an engine rating for administrative purposes which was more closely related to a vehicle's actual capacity for fuel consumption and which would encourage efforts to reduce that consumption.

8 The 1977 Circular thus introduced, with effect from 1 January 1978, a second formula for calculating a motor vehicle's engine rating for administrative purposes, incorporating a number of parameters in addition to cylinder capacity, such as petrol consumption, tyre circumference and the various reduction ratios of four- and five-speed manual gearboxes and three-speed automatic transmissions. The formula was amended by various circulars.

9 In particular, the Circular of 15 April 1983 (*Journal Officiel de la République Française* of 5 May 1983, supplementary issue, p. 4279) adjusted the rating formula under the 1977 Circular to take account of developments in automatic transmissions, including certain technological concepts which did not exist to any significant extent in industry in 1977. The developments in question related to four-speed automatic transmissions.

10 No further amendments were made to the rating formula under the 1977 Circular in order to take subsequent technological innovations specifically into account.

11 In the *Tarantik* case (Case C-421/97 *Tarantik* v *Direction des services fiscaux de Seine-et-Marne* [1999] ECR I-3633, paragraph 8), where the legal context was the same as here, the Commission maintained, without being contradicted, that application of the formula in the 1977 Circular generally resulted in an engine rating for tax purposes which was lower by some 2 HP than that arrived at by application of the formula in the 1956 Circular. That difference has an effect on

the amount of the differential tax and on insurance premiums, since the latter are calculated on the basis of a vehicle's engine rating for administrative purposes.

12 One of the criteria for determining which rules apply is the method by which the vehicle was approved.

13 Thus, in principle, the 1977 Circular applies to private cars type-approved on or after 1 January 1978 and, pursuant to Circular No 87-56 of 24 June 1987, to private cars granted individual approval on or after 24 June 1987 and conforming to an approved type or considered to be equivalent, as regards the engine rating for administrative purposes, to an approved type whose engine rating for administrative purposes has been calculated in accordance with the 1977 Circular.

14 The 1956 Circular, on the other hand, applies to all motor vehicles approved prior to 1 January 1978, whether they were granted type or individual approval. With effect from 1 January 1978, it continued to apply to vehicles granted individual approval until 23 June 1987. With effect from 24 June 1987, it applied only to vehicles granted individual approval which were considered not to conform to an approved type (see *Tarantik*, cited above, paragraph 10).

15 The great majority of vehicles approved in France during the period material to the present proceedings were subject to the provisions of the 1977 Circular, the 1956 Circular having residual application.

16 Since 1 July 1998, a new method of calculating a vehicle's engine rating for administrative purposes, which is not challenged by the Commission in the present proceedings, has been added to the existing methods. This third formula, which was introduced by Article 62 of the Loi de finances (Finance Law) of

2 July 1998 (*Journal Officiel de la République Française* of 3 July 1998, p. 10138), applies to vehicles put on the road in France for the first time on or after 1 July 1998 and to vehicles registered there after being put on the road for the first time on or after the same date in another Member State or in a third country belonging to the European Economic Area.

17 The provisions of Article 35 of the Finance (Amendment) Law for 1993, which had given force of law to the 1956 and 1977 Circulars, were not repealed by the Loi de finances of 2 July 1998, but now apply only to vehicles already put on the road and registered in France before 1 July 1998.

The pre-litigation procedure

18 According to the Commission, vehicles imported from other Member States, which incorporate certain innovative technologies, and in particular five-speed automatic transmissions and six-speed manual gearboxes, are subject in France to a much higher rate of annual vehicle excise duty than similar national models on account of a minor difference in the design of the gearbox. That overtaxation results from systematic application of the formula laid down in the 1956 Circular for calculating the engine rating for administrative purposes. The Commission observes that those innovative technologies were not taken into account in the 1977 Circular even though they represented a refinement of known techniques which were being applied industrially. It also points out that, since the engine ratings for administrative purposes of motor vehicles are used, *inter alia*, to determine the level of premiums for certain insurance policies, the owners of such vehicles have to pay an insurance surcharge in addition to the fiscal charge itself.

19 By letters of 25 May 1993 and 19 September 1994, the Commission informed the French authorities that that situation was contrary to Article 95 of the Treaty.

20 The French authorities replied by letters of 6 August 1993 and 13 March 1995.

21 In their letter of 6 August 1993, the French authorities acknowledged that vehicles fitted with a manual gearbox with six or more speeds and those fitted with an automatic transmission with five or more speeds were subject to the provisions of the 1956 Circular, as were all vehicles which used technologies not known and industrially applied in 1977.

22 In their letter of 13 March 1995, the French authorities conceded that the application of different rating formulae depending on whether a vehicle was fitted with any of those novel gearboxes might, in some circumstances, result in engine ratings for administrative purposes which differed from those of models considered similar.

23 According to the same letter, a first detailed comparative study carried out on the basis of models sold on the French market in 1993 showed that:

— in comparison with similar models fitted with five-speed manual gearboxes, models fitted with six-speed manual gearboxes may have engine ratings for administrative purposes which are 2 to 3 HP higher;

— in comparison with similar models fitted with a four-speed automatic transmission, models fitted with a five-speed automatic transmission may have engine ratings for administrative purposes which are the same, 1 HP higher or 4 to 7 HP lower, and

— for many vehicles, it was not possible to make a comparison since there were no technically similar models fitted with conventional gearboxes on the market.

24 A letter of formal notice was served on the French Republic by the Commission on 12 February 1997. The French authorities did not reply.

25 On 22 December 1997 the Commission sent the French Republic a reasoned opinion, calling on France to adopt the measures necessary to render its legislation determining vehicle engine ratings for administrative purposes compatible with Article 95 of the Treaty within two months of the date of notification of the opinion.

26 By letter of 2 March 1998, the French authorities replied to the Commission, essentially confirming their position.

The action and the forms of order sought therein

27 The Commission continued to maintain that there was an infringement of Article 95 of the Treaty, and therefore brought the present action. It claims that the Court should:

— declare that, by retaining and applying rules providing for the application of a formula for calculating the engine rating for administrative purposes which is unfavourable to vehicles fitted with a six-speed manual gearbox or five-speed automatic transmission, which has discriminatory or protectionist effects in the case of vehicles manufactured in other Member States compared

with similar or competing domestic vehicles, the French Republic has failed to fulfil its obligations under Article 95 of the EC Treaty;

— order the French Republic to pay the costs.

The forms of order sought by the French Government

28 At the hearing, the French Government contended that the Court should:

— dismiss the Commission's application;

— order the Commission to pay the costs.

Substance

Positions of the parties

29 The Commission's single claim challenges the application of the method of calculating the engine rating for administrative purposes under the 1956 Circular

to vehicles fitted with a six-speed manual gearbox or five-speed automatic transmission. Such vehicles, or at least the majority of them, are imported from other Member States, whereas vehicles of French manufacture, which, whilst not incorporating those transmission technologies, are nevertheless similar in the eyes of the consumer, are subject to the provisions of the 1977 Circular, which were generally applicable to private cars produced domestically.

30 That leads, as a general rule, to a higher rate of taxation being applied to vehicles incorporating an innovative technology and is likely to dissuade potential purchasers from buying such vehicles in favour of similar or competing vehicles produced in France, the engine ratings of which are calculated in a more favourable manner. The French system of taxation is therefore incompatible with Article 95 of the Treaty, inasmuch as it is not free in all cases from discriminatory or protectionist effects for vehicles produced in other Member States compared with similar or competing national vehicles.

31 According to the Commission, in the correspondence exchanged during the pre-litigation procedure the French authorities (a) acknowledged the unfavourable impact of the formula chosen to determine the engine rating for administrative purposes of vehicles imported from other Member States and incorporating certain innovative technologies and (b) admitted the fact that the application of that formula resulted in an increase in the fiscal charge by comparison with similar vehicles manufactured in France, whilst at the same time denying that overtaxation took place in all cases.

32 The Commission points out that the 1977 Circular was intended to introduce a new method of calculating a vehicle's engine rating for administrative purposes taking into account parameters such as the pursuit of better performance in terms of fuel consumption and the level of pollutant emissions. The formula for calculating a vehicle's engine rating for administrative purposes was adjusted only once, in 1983, in order to take account of technological developments connected with the production of vehicles fitted with a four-speed automatic transmission.

The Commission complains that the French authorities did not amend the 1977 Circular so as to take into account subsequent technological developments and to include within its scope vehicles fitted with technologies, such as the six-speed manual gearbox or five-speed automatic transmission, which would serve the purposes of that circular, in particular as regards fuel consumption. It follows that the rating formula laid down in the 1956 Circular is applied systematically to all new production vehicles incorporating a technical innovation, without taking account of the characteristics and objective performance data of those vehicles.

33 According to the Commission, the argument put forward by the French authorities, that they were unable, due to administrative difficulties, to amend the rating formula between 1983 and 1998 in order to take account of technical developments which had occurred, cannot be accepted. The Court has consistently held that a Member State may not rely on difficulties which it experiences in taking the measures necessary to adapt legislation in order to justify a failure to fulfil its obligations under Community law.

34 The Commission concludes by asserting that it is for the French Government to adduce proof that the system of taxation in question does not in any circumstances discriminate against imported vehicles, which that Government has been unable to do in this case.

35 The French Government contends that the Commission has not demonstrated that the application of the 1956 Circular to vehicles incorporating an innovative technology was contrary to Article 95 of the Treaty.

36 It acknowledges that the vehicles incorporating an innovative technology which are the subject-matter of the present proceedings have their engine rated for administrative purposes according to a formula laid down in the 1956 Circular. It

also acknowledges that the application, in order to determine the engine ratings for administrative purposes of such vehicles, of that formula may result in a heavier tax burden than that resulting from the application of the formula laid down in the 1977 Circular, but emphasises that that penalty effect is not systematic.

37 Relying on Case 45/75 *Rewe-Zentrale* v *Hauptzollamt Landau* [1976] ECR 181, paragraph 15, the French Government argues that it is not sufficient, in order to establish an infringement of the first paragraph of Article 95 of the Treaty, to demonstrate, as the Commission does, that application of the 1956 Circular to vehicles incorporating an innovative technology leads, if only in certain cases, to higher taxation of imported products. The application of that case-law is subject to the condition that the taxation of the imported product and that of the similar domestic product are calculated on the basis of different criteria, which is not the case here.

38 The French Government maintains in this regard that the criterion used to determine whether a vehicle is to be taxed on the basis of the 1956 or the 1977 Circular is the presence of innovative technologies, namely, a six-speed manual gearbox or five-speed automatic transmission, and not whether the vehicle is imported or manufactured in France. It states that vehicles incorporating an innovative technology, most of which are, admittedly, imported, include certain vehicles of French manufacture. For example, two versions of the Peugeot 306 and two versions of the Hommel 'Berlinette' and one version of the Hommel 'Barquette' are fitted with six-speed manual gearboxes.

39 The French Government further maintains that, even if vehicles incorporating an innovative technology were all imported, the system of taxation could not be regarded as discriminatory for the sole reason that only imported products, coming *inter alia* from the other Member States, would be more heavily taxed. It would also be necessary, for there to be an infringement of the first paragraph of

Article 95 of the Treaty, for the Commission to adduce proof that application of the formula in the 1956 Circular to vehicles incorporating an innovative technology has the effect of dissuading consumers from purchasing imported vehicles and encouraging them to choose similar vehicles produced in France. However, according to the French Government, economic and social realities suggest that consumers dissuaded from purchasing a model incorporating an innovative technology would transfer their choice to other vehicles of the same make, that is, to vehicles which were mostly imported, and not necessarily to nationally produced vehicles. A protectionist effect in favour of national production has therefore not been demonstrated.

Findings of the Court

40 It is settled case-law that a system of taxation may be considered compatible with Article 95 of the Treaty only if it is such as to exclude any possibility of imported products being taxed more heavily than similar domestic products (Case C-228/98 *Dounias* [2000] ECR I-577, paragraph 41, and the case-law cited therein).

41 For the purpose of examining the compatibility of the system of taxation called in question by the Commission with Article 95 of the Treaty, it is necessary, first, to specify to what extent vehicles produced in France can be regarded as similar to imported vehicles incorporating an innovative technology.

42 In order to determine whether products are similar within the terms of the prohibition laid down in the first paragraph of Article 95, it is necessary to consider whether they have similar characteristics and meet the same needs from the point of view of consumers (Case 106/84 *Commission* v *Denmark* [1986] ECR 833, paragraph 15).

43 Furthermore, in paragraph 28 of the judgment in *Tarantik*, cited above, the Court held, first, that products such as cars are similar for the purposes of the first paragraph of Article 95 of the Treaty if their characteristics and the needs which they serve place them in a competitive relationship and, second, that the degree of competition between two models depends on the extent to which they meet various requirements regarding price, size, comfort, performance, fuel consumption, durability, reliability and other matters.

44 Since the tests of similarity developed by the case-law do not relate exclusively to the technical equipment of vehicles, other characteristics may also be taken into consideration. It is thus clear that vehicles of different makes, whether or not they are fitted with a six-speed manual gearbox or five-speed automatic transmission, may, in the eyes of consumers, constitute similar vehicles for the purposes of the first paragraph of Article 95 of the Treaty, as interpreted in the *Tarantik* case, cited above.

45 The concept of similar national vehicles cannot therefore be restricted solely to French-produced vehicles which are equipped with one of the innovative technologies referred to by the Commission in the present proceedings. For similar reasons, the argument put forward by the French Government that a consumer dissuaded from purchasing a vehicle incorporating an innovative technology by the prospect of heavier taxation would choose a vehicle of the same make cannot be accepted.

46 Second, it must be established whether imported vehicles incorporating an innovative technology are taxed more heavily than similar national vehicles.

47 It has not been disputed that imported vehicles represent the majority of the vehicles incorporating an innovative technology which are the subject-matter of these proceedings. Thus, the figures provided by the French Government in reply to the Court's written questions show, first, that all vehicles fitted with a five-speed automatic transmission and, second, that most, if not virtually all, vehicles fitted with a six-speed manual gearbox are imported vehicles to which the 1956 Circular applies.

48 It has also become clear that, in most cases, application of the formula under the 1956 Circular in order to determine the engine rating for administrative purposes of a vehicle penalises the owners of the vehicles concerned in that it leads to higher taxation than would result from application of the rating formula under the 1977 Circular. The French Government has not denied, in any case, that application of the 1956 Circular may have unfavourable effects in terms of taxation for the owners of vehicles.

49 It has been held on several occasions that the first paragraph of Article 95 of the Treaty is infringed where the taxation on the imported product and that on the similar national product are calculated in a different manner on the basis of different criteria which lead, if only in certain cases, to higher taxation being imposed on the imported product (Case C-375/95 *Commission* v *Greece* [1997] ECR I-5981, paragraph 20, and the case-law cited therein).

50 It is therefore clear that the French system of taxation, inasmuch as it provides for application of the 1956 Circular in order to determine the engine rating for administrative purposes of vehicles incorporating an innovative technology, most of which are imported, is not such as to exclude any possibility of imported products being taxed more heavily than domestic vehicles which may be regarded as similar.

51 It must therefore be held that, by retaining and applying rules providing for the application of a formula for calculating the engine rating for administrative purposes which is unfavourable to vehicles fitted with a six-speed manual gearbox or five-speed automatic transmission, which has discriminatory or protectionist effects in the case of vehicles manufactured in other Member States compared with similar or competing domestic vehicles, the French Republic has failed to fulfil its obligations under the first paragraph of Article 95 of the EC Treaty.

Costs

52 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Commission has applied for costs and the French Republic has been unsuccessful, the latter must be ordered to pay the costs.

On those grounds,

THE COURT (Fifth Chamber)

hereby:

1. **Declares that by retaining and applying rules providing for the application of a formula for calculating the engine rating for administrative purposes which**

is unfavourable to vehicles fitted with a six-speed manual gearbox or five-speed automatic transmission, which has discriminatory or protectionist effects in the case of vehicles manufactured in other Member States compared with similar or competing domestic vehicles, the French Republic has failed to fulfil its obligations under the first paragraph of Article 95 of the EC Treaty (now, after amendment, the first paragraph of Article 90 EC);

2. Orders the French Republic to pay the costs.

La Pergola Wathelet Edward

Jann Sevón

Delivered in open court in Luxembourg on 15 March 2001.

R. Grass

Registrar

A. La Pergola

President of the Fifth Chamber