2. As there are characteristics common to spirits of various types which are sufficiently marked for it to be said that they are at least partly or potentially in competition, taxation of them must not have the effect of protecting domestic products. For that purpose it is necessary to take into consideration the potential market of the products in question in the absence of protectionist measures and to ignore comparisons of consumption and import figures.

3. As the products concerned are either similar to or in competition with one another — which brings them within the scope of the second paragraph of Article 95 of the Treaty — a criterion for the charging of higher taxation, such as designation of origin or provenance, which by definition cannot ever be fulfilled by domestic products in the absence of rules protecting their designation of origin or provenance, cannot be considered to be compatible with the prohibition of discrimination laid down in that provision.

Such a system has the effect of excluding domestic products in advance from the heaviest taxation since they will never fulfil the conditions on which the higher rate is charged and it is entirely at the discretion of the national legislature, in choosing not to introduce a general system applicable to all spirits, to perpetuate that situation indefinitely regardless of similarities or differences in conditions of production, quality, price or competition between national products and those imported from other Member States.

4. Member States have the right to adopt, whilst observing the relevant directives, a higher rate of VAT on luxury products as opposed to domestic or imported products not having that quality, provided, however, that the criteria chosen to determine which category of products is to be more heavily taxed are not discriminatory as against imported products similar to or in competition with domestic products in the manner contemplated by the second paragraph of Article 95 of the Treaty.

In Case 319/81

COMMISSION OF THE EUROPEAN COMMUNITIES, represented by its Legal Adviser, Antonio Abate, acting as Agent, with an address for service in Luxembourg at the office of Oreste Montalto, a member of its Legal Department, Jean Monnet Building, Kirchberg,

applicant,

supported by

THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND, represented by J. D. Howes, of the Treasury Solicitor's Department, acting as Agent, with an address for service in Luxembourg at the British Embassy,

intervener,

v

ITALIAN REPUBLIC, in the person of its Agent, Arnaldo Squillante, represented by Marcello Conti, Avvocato dello Stato, with an address for service in Luxembourg at the Italian Embassy,

defendant,

APPLICATION for a declaration under the second paragraph of Article 169 of the EEC Treaty that the Italian Republic has failed to fulfil the obligations arising from Article 95 of the EEC Treaty as regards value-added tax (VAT) on spirits,

THE COURT

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

Advocate General: Sir Gordon Slynn
Registrar: P. Heim

gives the following

JUDGMENT

Facts and Issues

I — The facts

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

1. Background to the dispute

This action should be seen in the context of the attempt to find a judicial solution to the situations created in the various Member States by the rules on the taxation of alcoholic drinks which the Commission considers to be contrary to the provisions of Article 95 of the EEC Treaty. It follows the breakdown of negotiations between the Member States with a view to finding homogeneous, parallel and simultaneous solutions in such a way as to abolish all fiscal discrimination still affecting both fermented and distilled alcoholic drinks.

The negotiations continued for roughly two years, with no positive result. This outcome was finally acknowledged by the Council of Ministers of 21 October 1981 and led directly to the Commission's decision to bring the matter before the Court.

The Commission's action against the United Kingdom in Case 170/78 concerning excise duties on wine and beer may be seen in the same context.

2. *The Italian system of value-added tax*

Besides the *standard rate*, which is at present 15%, the Italian system of value-added tax (VAT) also provides for a reduced rate and two higher rates.

The reduced rate of 8% is applicable to transactions concerning a range of goods and services which basically fulfil essential needs.

There are also two *higher rates* on non-essential goods. The 20% rate is charged on a range of products which, though non-essential, are not judged by the Italian legislature to be particularly marked by their luxury or prestige. The 38% rate is charged on consumer goods which are more clearly luxurious or prestigious.

In this context Decree-Law No 58 of 4 March 1977, converted into Law No 183 of 9 May 1977, provides that all spirits are to be taxed at the higher rates. The 38% rate is charged on gin and spirits "with a designation of origin or provenance, regulated and protected by specific measures in the area of production", which are thus considered to be high-class or luxury goods. Other spirits are taxed at the 20% rate.

II — Written procedure

By application dated 22 December 1981, registered at the Court on the following day, the Commission brought the matter before the Court of Justice in accordance with the second paragraph of Article 169 of the EEC Treaty in view of the fact that the Italian Government had not complied with the reasoned opinion of 2 February 1979.

Upon hearing the report of the Judge-Rapporteur and the views of the Advocate General, the Court decided to open the oral procedure without any preparatory inquiry. It did, however, ask the parties to the proceedings, in a letter dated 20 October 1982, to answer a number of questions to clarify the situation and they did so within the time allowed.

III — Conclusions of the parties

1. The Commission claims that the Court should:

(a) declare that the Italian Republic by charging different rates of tax on spirits on the basis of the criterion of designation of origin or provenance, under Decree-Law No 58 of 4 March 1977 on value-added tax, has failed to fulfil its obligations under Article 95 of the EEC Treaty as far as products imported from other Member States are concerned;

(b) order the Italian Republic to pay the costs.

2. The Italian Republic contends that the Court should dismiss the Commission's application.

IV — Submissions and arguments of the parties

In its application the *Commission* contends that the Italian system in question is contrary to Community law and in particular to Article 95 of the EEC Treaty on the ground that the criterion of designation of origin or provenance concerns only imported spirits as domestically-produced spirit is not subject to any similar rules. The effect of the Italian system is to tax more heavily almost all spirits imported from other Member States (whisky, brandy, armagnac, rum and so forth) thereby producing a discriminatory or protectionist effect.

Whilst acknowledging that differential taxation may be imposed provided that the rule against discrimination between similar products is observed, the Commission maintains that domestic and imported spirits are similar or competing products or both within the meaning of Article 95 of the EEC Treaty and that under Italy's tax system a higher rate of tax is charged on imported spirits than on similar domestic products.

The Commission refers to the Opinion of Advocate General Sir Gordon Slynn in Case 244/80 (*Foglia* v *Novello* [1981] ECR 3045) in which French excise duty on liqueur wines was in question. The Italian and French systems resemble one another inasmuch as they both use the criterion of origin and provenance: the Italian in order to support domestic products where they do not satisfy that criterion and the French in order to support domestic products where they do satisfy it. Here again, the Commission claims, the effect is the same, but the national interests to be protected are opposite.

A further resemblance between the two systems in question may, in the Commission's view, also be seen in the geographical component of the criterion chosen. When products are taxed or exempted from tax on the basis of their origin or provenance, it is clearly impossible to apply the more advantageous tax treatment to imports of similar or competing products. The result of this is geographical protection of domestic products alone, which by being irreversible and inescapable, is contrary to the principle that taxation should not be discriminatory, as the Court has constantly stressed.

In its judgment of 30 October 1980 in Case 26/80 *(Schneider-Import GmbH & Co. KG* v *Hauptzollamt Mainz* [1980] ECR 3469 at p. 3486) the Court in fact held that the requirement of non-discrimination is fulfilled:

"... where the arrangements applicable to spirits imported from other Member

States may be considered as equivalent to the arrangements applicable to national production, so that imported products may in fact enjoy the same advantages as comparable national products".

In the Commission's view that is not and logically cannot be possible under the VAT system since the Italian legislature has made the application of the reduced rate of 20% subject to a condition which imported products can never satisfy. The condition is therefore, in the Commission's view, one which by definition prevents imported products from benefiting from the reduced rate in question and reserves it for domestic products alone.

That system of taxation is therefore discriminatory and as such falls foul of the prohibition laid down in Article 95 of the Treaty.

The *Italian Government* adduces in particular the following arguments:

At the present stage of its development Community law allows the national legislature to choose the most appropriate system for taxing consumption for achieving certain legitimate objectives of economic and social policy, applying general principles, on which moreover all modern tax systems are based, of contributive capacity and tax progressivity. Article 95 merely requires, in the Italian Government's view, that the tax system chosen should be applied without discrimination to both domestic products and those imported from other Member States. The concept of similarity cannot be general and abstract but must be considered in the light of the objectives of the particular national taxation system and by comparison with the kind of needs satisfied by the consumption of spirits. Neither the essential legality of the distinguishing criterion nor the appropriateness in substance of the factors chosen by the legislature to identify in practice luxury or prestige goods can therefore be denied. The matter is really one, the Italian Government states, of a choice which unquestionably comes within the discretion of the national legislature; this discretion is not liable to any review as long as there has been no proof of a clear and precise infringement of the principles enunciated in Article 95.

Secondly, there is no basis for claiming an infringement of Article 95 because the Italian legislature does not discriminate between domestic and imported products. The products concerned are taxed according to their quality and not according to their place of production. The classification thus adopted is therefore fully adapted to achieving the aim of the Italian legislature. The Commission's objections are accordingly unfounded.

In reply to the Commission's contention that the absence of domestically-produced spirits " with a designation of origin or provenance" which is "regulated and protected" results in discrimination, the Italian Government states that the criterion is an abstract one so that imported products which do not satisfy the necessary or sufficient conditions enabling them to be considered high-class goods may in fact enjoy the same advantages as comparable domestic products. Moreover, the fact that similar spirits might not be produced domestically cannot in any event be a sufficient ground for preventing the general criterion from being applied or therefore for treating consumption of the goods in question more favourably. The Italian Government here instances hand-made oriental carpets which are without question products of great value compared with their industrially-produced equivalents.

Similarly, the fact that Italy does not produce spirits of superior quality is not a sufficient ground for preventing the consumption of spirits in that category from being taxed in accordance with the general principles of the Italian system of VAT, the universality of which is enough to rule out any intention to discriminate.

Lastly, the Italian Government maintains that the higher rate is not calculated to curtail consumption. Since the products in question are luxury goods, demand for them tends to be characteristically stable. This is confirmed by statistics which as a matter of fact show that the consumption of some spirits (particularly whisky) has increased considerably in spite of the fact that the rate of VAT has been 35% and, since October 1982, 38%.

As far as gin in particular in concerned, the Commission does not appear to contest its tax system. The Italian Government also states that gin is outside the scope of the action since the tax applied is based solely on the objective characteristics of the product in conjunction with the raw material used and the method of manufacture. Moreover, gin is produced in abundance in Italy and the 38% rate is charged on both domestic and imported gin alike.

In its *reply* the Commission comments in particular on the previous decisions of the Court relevant to this case. It admits that the judgment given on 14 January 1981 in Case 46/80 (*SpA Vinal* v *SpA Orbat* [1981] ECR 77) represents a departure from all previous decisions of the Court on the application of Article 95 as for the first time the Court held that a tax system involving different rates of tax of which the highest is charged only on a product imported from other Member States and which as a result curbs imports of that product (synthetic alcohol) into Italy to the advantage of the similar domestic product (alcohol of agricultural origin) is compatible with Community law.

However, the conditions which the Court laid down in that judgment are not all fulfilled by the system now in question.

In particular, the argument as to the equivalent economic effect of the VAT on the same domestic products is not accepted by the Court. That argument seems to have still less relevance in this case when it is considered that in no instance has the application of the higher rate had the effect of discouraging the same kind of spirits from being produced in Italy. The discriminatory aspect of the VAT is therefore quite apparent: the highest rate is invariably borne by almost all imported spirits (whisky and brandy) and no others.

The Commission stresses that economically the difference between the special revenue system (at issue in *Vinal*) and the VAT system is even more striking. In the first case, the fact that no synthetic alcohol is produced in Italy is due to a calculation of production costs and the taxes which any such production would have to bear. In the second case, the fact that no "quality" spirits are produced domestically is entirely the result of the fact that there is no *ad hoc* legislation which, by protecting such drinks, would allow them to "exist" and be available on the market.

The Commission contends that in such a situation it is futile to claim that the VAT system is arranged in such a way that the "extension" of the second highest rate of 20% to imported spirits not meeting the criteria of regulated designation of origin or provenance "is fully guaranteed". When the structure of the markets in question is considered it is quite obvious that the 20% rate benefits the totality of domestically-produced spirits, imports of similar products from other Member States being of marginal importance.

As to the criteria used to distinguish between the products chargeable to the tax, namely the quality and luxuriousness of the products, the Commission contends that the parameters of commonly accepted opinion or of popular and luxury goods taken by the Italian Government to justify such classifications are also entirely irrelevant.

The Commission points out that, owing to the effect of four entirely distinct tax systems, spirits imported from other Member States have always been taxed much more heavily in Italy than Italian spirits. In spite of that, retail sale prices of Italian and foreign spirits have always been much the same and comparable in all respects. Hence the tax-paying capacity of the various consumers of spirits must be the same.

It also seems contradictory to have recourse to the criterion of popular consumer goods and "elitist consumer goods" when the Italian Government agrees that in every case the drinks concerned are meant to satisfy non-essential needs. On this point the Commission refers to the established case-law of the Court according to which for the purposes of the application of Article 95 the capacity of products to satisfy the same consumer needs must be taken into account.

Having said that, the Commission points out that the parameters in question are clearly subjective criteria. They express the choices open to the legislature which the defendant wrongly considers to be a matter of discretion and "not liable to any review", to such an extent that no check is made as to whether the requirement that the taxation in question should be neutral is observed.

Moreover the Commission takes the view that the Italian Government's attempt to assimilate the VAT system applied to goods to a system of direct taxation on the tax-paying capacity of those liable does not deserve consideration. The criteria chosen by the Italian legislature still remain subjective. As such they are contrary to the requirement laid down by the Court in several of its judgments according to which any differentiation between products for tax purposes must be based on objective criteria precisely in order to avoid arbitrary taxation such as that based on the geographical location of production (as with Scotch whisky, for example).

The Commission then goes on to examine whether the objective of fiscal policy underlying the Italian legislature is legitimate.

The Commission remarks that the general reference to fiscal objectives appears irrelevant for various reasons. By definition objectives of fiscal policy are appropriate to any taxation system. Such objectives are irrelevant where any given system does not comply with the conditions laid down in Article 95. The Court has never claimed jurisdiction in relation to objectives of fiscal policy *per se*. In this regard Article 95 imposes quite precise limits on the sovereignty of Member States in fiscal matters.

The Commission confines itself to observing that the judgment of 27 February 1980 in Case 169/78 *(Commission* v *Italy* [1980] ECR 385) does not allow the VAT system in question to be endorsed.

Moreover, the system presents an unquestionably aggravating feature, namely that it is invariably charged on almost all imported spirits (whisky and brandy) and no others. Viewed from that angle the system of tax banderoles at issue in Case 169/78 might be viewed in a much better light since it was applied to spirits on the basis of the raw material used, irrespective of their place of origin or provenance. Cognac and French marc de Bourgogne were taxed at exactly the same rate as brandy and Italian-made grappa.

In conclusion the Commission stresses that the case should be decided by the application of the criteria of interpretation developed by the Court in its judgments on tax arrangements applied to spirits and in particular that given in Case 169/68. It argues that the quite unique nature of the spirits market precludes any possible extension to this case of the criteria for assessment developed by the Court in Case 46/80 *Vinal* in connection with the market in denatured ethyl alcohol, although the Commission believes that the system now in question does not satisfy the conditions set out by the Court in that judgment either.

However, whilst acknowledging the difficulties of interpretation, to which the *Vinal* judgment may give rise, the Commission considers it desirable that the Court should respond by supplementing the text with an interpretation capable of dispelling continuing doubts and uncertainties.

In its *rejoinder* the Italian Government refutes the Commission's arguments, especially as far as the case-law of the Court is concerned.

It contends first of all that it is not correct that the judgment of 14 January 1981 in Case 140/79 *(Chemial Farmaceutici SpA* v *DAF SpA* [1981] ECR 1) and in Case 46/80, cited above, broke new ground as against all previous case-law on Article 95. Quite the contrary, they too fall squarely into that consistent line of decisions. The Italian Government also believes that the Court confirmed the principles of its established case-law in its judgment of 27 May 1981 in Joined Cases 142 and 143/80 *(Amministrazione delle Finanze dello Stato* v *Essevi and Salengo* [1981] ECR 1413).

It argues that a tax system whereby categories of products differing from one another according to objective and neutral criteria are treated differently is not contrary to Article 95. Article 95 is indisputably infringed, however, if the various categories of products subject to different tax treatment are singled out more or less explicitly, according to whether they originate at home or abroad. The mere fact that only the imported product is in practice taxed more heavily is not sufficient *per se* to infer that there is unlawful discrimination. To arrive at that conclusion it is necessary to look more closely and in each particular case at the criteria by which the tax system under consideration is structured as well as at the relationship between that system and trends in domestic production.

The Italian Government maintains that the judgments in *Chemial* and *Vinal* made case-law clearer on this point in the sense that the discrimination prohibited by Article 95 must be real.

The Italian Government dwells at length on the non-discriminatory and neutral character of the system in issue as regards the question whether the products taxed are domestic products or come from other Member States and points out the system's objective characteristics.

In particular, the object of the system is not to discourage consumption of the goods taxed but to ensure that they are taxed fairly and in accordance with the more general aims of fiscal policy. This case cannot, the Italian Government thinks, be considered to be on all fours with Cases 140/79 and 46/80, cited above.

The fact that there are no rules in Italy governing designation of origin or provenance cannot be conclusive evidence of the discriminatory nature of the Italian system. To demonstrate that, the Italian Government points out that both Italian-made gin and imported gin are taxed at the same rate of 38%.

Secondly, ordinary spirits and those with a designation of origin are quite distinct and non-interchangeable products aimed at quite different markets.

The simply fact is that Italy does not produce high-quality spirits (just as it does not make Persian carpets or produce Russian caviar). But that is absolutely no reason for exempting high-quality spirits (or Persian carpets or caviar) from the taxation to which all luxury products are subject.

On the question of distinguishing criteria the Italian Government also contends that spirits which fulfil the criteria of both a designation of origin and special rules are precisely those which are generally regarded by all consumers as being particularly prestigious. These are not therefore arbitrary and "subjective" judgments, as market analyses show.

The Italian legislature was therefore quite entitled to classify as luxury goods only spirits subject to rules and having a designation of origin.

Nor can it be said that there is anything "contradictory" in distinguishing between two categories of product both of which nevertheless come within the category of goods intended for non-essential consumption.

As to the Commission's refusal to recognize the legitimacy of the objectives of fiscal policy, the Italian Government observes that the criterion of tax-paying capacity holds good for direct, as well as for indirect, taxation. All modern tax systems are based on the idea that all taxes, both direct and indirect, shall be progressive. In particular, schemes for the taxation of consumer goods are always based on the distinction drawn between essential goods, those consumed every day, and luxury goods, the very purpose of that distinction being to tax the greater contributive capacity unquestionably evident in the case of luxury goods.

Secondly, the Italian Government replies to the Commission's argument that the Italian system of VAT on spirits cannot be lawful as it is not designed to implement objectives of economic or industrial policy of the kind taken into consideration by the Court in its judgments in *Chemial* and *Vinal*. That objection appears, the Government thinks, to be based on a misapprehension. The condition that tax systems charging different rates of tax on similar products should be introduced in pursuance of lawful objectives cannot be taken to mean that there should in each case be a non-fiscal aim (of economic or industrial policy) and that that aim should in substance be capable of being judged positively. What is really required, it is suggested, is that the tax system in question should not pursue aims contrary not only to Article 95 but also to other rules or principles of Community law or exigencies of a policy adopted in a Community context. Besides that purely negative requirement, there is no other requirement to be fulfilled in order that a system of differential taxation may be lawful, provided, of course, that it complies with the fundamental condition that the distinction drawn between the various categories of product taxed at different rates should be based on objective, neutral and non-discriminatory criteria which are fully satisfied in this case.

The *United Kingdom*, which has intervened in support of the applicant, submits the following arguments:

The concept of similarity must be identical for the whole Community and must be decided according to objective criteria, based on the purposes which the product serves for consumers. The United Kingdom contends that the two categories of product, those which have a designation of origin and those which do not, are in competition and thus fall within the provisions of Article 95 (2).

The distinction on which the different rates of VAT are based does not correspond, the United Kingdom states, to any distinction in quality or objective criterion. It is based entirely upon a difference in the policies of the legislatures in the territories in which the spirits are produced. The tax distinction thus established favours all spirits produced in Italy since the Italian legislature has ensured that no domestically-produced spirit can ever be subject to the higher rate. This case is therefore clearly distinguishable from *Vinal*.

Conversely, since imports into Italy of spirits without a designation of origin from other Member States are of marginal importance, the distinction substantially corresponds to a distinction between spirits produced domestically and those which are imported.

Even if the Italian criterion of tax-paying capacity were accepted, the United Kingdom contends in this regard that a system of taxation which encourages and entrenches existing consumer habits and thus discourages any potential development of the market is not to be justified on the basis of any such statistical conception of consumer tastes. To tax a commodity on the basis that it is "high-class or prestigious" is calculated to perpetuate the very distinction on which it is based. There is no evidence in the United Kingdom's view to suggest that whisky would not be consumed throughout a wide range of social and economic groups in Italy were it not subject to this double discrimination.

In answer to the Italian Government's contention that imports of gin and Scotch whisky increased during the five years following the introduction of VAT in Italy the United Kingdom states that the increase might have been substantially higher but for the discriminatory rates of taxation. Indeed, between 1979 and 1980, although the value of exports of Scotch whisky to Italy rose by 2%, the quantity, measured by volume, fell by 6%.

The United Kingdom therefore submits that the Italian system at least affords indirect protection from competition from such spirits.

V — Answers to the questions raised

1. The first question reads as follows:

"Which Italian spirits are taxed at the 18% rate and which at the 35% rate?"

The *Italian Government* replies that at the moment no spirits, apart from gin, are made in Italy, which meet the conditions for the application of the 38% rate. All other Italian-made spirits are taxed at the 20% rate. However, like imported gin, all Italian-produced gin is taxed at the 38% rate (from 1 October 1982 the 18% rate was increased to 20% and the 35% rate to 38%).

The *Commission* agrees with that reply and observes that those figures confirm the discriminatory character of the system in question. In short, the highest rate of 38% is charged on virtually all spirits imported from other Member States.

The *United Kingdom* submits that the spirits taxed at 20% are grappa, wine-brandy, and rum. Gin in the only spirit produced in Italy which is taxed at 38%.

2. The second question is as follows:

"Which spirits imported from other Member States are taxed at the 18% and 35% rates? What was the quantity of those products imported from 1977 to 1981 compared with the previous period?"

The *Commission* produces tables showing that of the total volume of imports in 1981 (106 162 hectolitres of spirit at 100% volume), 98.67% of the spirits from the United Kingdom and France were taxed at the 35% rate (now 38%) whilst the lower rate of 18% (now 20%) was charged on the remaining 1.33%.

In particular, imports into Italy of spirits taxed at the 35% and 18% rates of VAT are as follows:

(a) *VAT at 35%*

	Hectolitres of alcohol at 100% volume
Gin	2 220
Scotch and Irish whisky	96 657
French wine brandies and marc (cognac, armagnac, marc de Bourgogne, etc.)	5 716
French fruit spirits (calvados, mirabelle, etc.)	154
	104 747

(b) *VAT at 18%*

	Hectolitres of alcohol at 100% volume
Rum, vodka and other spirits	1 415

The *Italian Government* states that it is not possible to provide an exhaustive list of all the spirits produced in the Member States fulfilling the two conditions, namely that they should have a designation of origin and be specifically regulated and protected in the territory in which they are produced as regards methods of manufacture and so forth.

As regards the composition of imports into Italy, the most widely consumed products taxed at 38% appear to be Scotch whisky, cognac and gin. Irish whiskey, armagnac and French regulated marc, such as marc de Bourgogne and marc de Champagne, should also be mentioned.

As an appendix to its replies the Italian Government sets out the statistics on imports from Community countries during 1975 to 1981 whilst emphasizing that it is not possible to provide precise figures on the composition of imports of spirits subject to the 20% rate.

The *United Kingdom* restricts its observations to spirits imported into Italy from the United Kingdom comprising, in the main, Scotch whisky, Irish whiskey, gin and rum. According to the figures furnished by the United Kingdom, in the years 1969 to 1974 inclusive imports of Scotch whisky increased by 199%, from 38 330 hectolitres to 114 480 hectolitres, whilst in the years 1975 to 1980 inclusive they increased by 66% from 72 520 hectolitres to 120 700 hectolitres. In the case of gin the increase was 70% in the period 1969 to 1974, from 1 822 hectolitres to 3 099 hectolitres, whilst in the period 1977 to 1980 the increase was 36%, from 2 647 hectolitres to 3 380 hectolitres. Full figures are attached to its replies.

3. The third question which the Court put to the parties was whether they thought "that domestically-produced spirits and imported spirits have similar properties and whether or not they meet the same needs".

The *Commission* explains that "spirits" are defined as distilled spirituous beverages having the characteristics described in the Explanatory Note to the Nomenclature of the Customs Cooperation Council. As such they necessarily have similar properties and meet the same consumer needs. For those reasons the Court has constantly held that all spirits are similar or in competition within the meaning of Article 95 of the Treaty.

The *Italian Government* believes that not all spirits may be considered to be identical or similar products. It believes in particular that a clear distinction must be drawn between wine-based spirits and cereal-based spirits. They have different organoleptic properties and in the consumer's view meet different needs.

On the other hand the Italian Government does not think that different properties may be attributed to domestic and imported products falling into the same category of spirits and it cannot be contended that they meet different needs.

As regards the difference in this case between the two rates of VAT, it is in fact based on the fulfilment or non-fulfilment of two precise conditions (a product must have a designation of origin and be governed by specific production standards) which are likely to make spirits which fulfil them products of superior quality.

The Italian Government admits that the fact that one kind of product has characteristics of a particularly high quality is not sufficient by itself to make it radically different from other similar products.

The United Kingdom believes that the Court has already found in Case 169/78 *Commission* v *Italy* and Case 216/81 *Compagnia Generale Interscambi* that cereal-based spirits, which comprise a large part of the products imported from the United Kingdom, and wine-based spirits, which comprise a high proportion of the domestically-produced product, satisfy the same or similar consumer needs.

4. In the fourth question the parties are asked to:

"Produce, by common agreement if possible, a table of average retail prices showing the prices without VAT of a selection of spirits which they consider to be representative of Italian-made spirits and spirits imported from the other Member States in question."

By common agreement the parties (the *Commission* and the *Italian Government)* have drawn up a list (attached to the replies) of average retail prices (with and without VAT) of a selection of products representative of the Italian market.

The United Kingdom, however, regrets that it has not been possible to achieve common agreement on the figures requested. It has however produced a table showing certain information.

5. By its fifth question the Court asks what effect the rules in question have had on imports since their introduction.

The *Commission* considers that the effects of the VAT system introduced in Italy in 1977 cannot be assessed appropriately and objectively.

In the first place the system in question was introduced on to a market — that in spirits — already made artificial by the other taxes on alcohol which are also discriminatory. Furthermore, during the period prior to the introduction of the changes made by Decree-Law No 58 of 4 March 1977 (the subject of this action) spirits imported from other Member States also bore VAT and to a considerably greater extent.

Secondly, the Commission feels that the actual impact of discriminatory taxes on similar or competing products imported from other Member States need not be taken into account. In previous judgments the Court itself has rejected all arguments seeking to make the application of Article 95 dependent on import trends or the results of any market research or statistical evidence that a particular tax system has a protective effect. Otherwise the prohibition of tax discrimination would be inoperative.

Having said that, and accepting that statistical considerations cannot be relevant for the purposes of Article 95, the Commission does not deny that, despite the charging of at least four discriminatory taxes on alcohol, including VAT, imports into Italy of Scotch and Irish whisky increased in the period 1977 to 1981. The increase in imports of those products is even more evident if the figures for 1971 and 1981 are compared.

Still, it is undeniable too that in the period 1975 to 1981 Italian production of spirits remained at the same levels whilst exports of Italian spirits increased considerably, from 13 600 hectolitres of alcohol at 100% volume in 1975 to 76 270 hectolitres of alcohol at 100% volume in 1981.

The *Italian Government* considers that the figures set out in the appendix clearly show that the tax system in issue has had no restrictive effect on imports.

It considers in particular the case of whisky which from the comparison of imports in the two years prior to the adoption of the measure in question (1975 and 1976) with those of the last two years (1980 and 1981) shows that there was an increase of 21.88%. It emphasizes, however, that while consumption of the imported product increased so markedly, consumption in general declined or remained stationary.

On the other hand, according to the *United Kingdom*, the import figures illustrate the reduced rate of increase in the quantities of Scotch whisky and gin imported into Italy since the introduction of the relevant decree-law in 1974. The United Kingdom submits that this effect may well be exacerbated by the bigger difference in the rates of VAT applicable since July 1982.

6. The sixth question is as follows:

"The parties are requested to produce a table comparing production and consumption levels in Italy of gin and Italian spirits."

On the consumption of Italian gin the *Commission* provides the following table drawn up by common agreement between the parties in question:

Consumption of Italian-made spirits (including gin) in hectolitres of alcohol (at 100% vol.)

	1975	1976	1977	1978	1979	1980	1981
Total consumption (domestic and exported)	336 633	400 441	339 478	348 082	369 384	351 743	343 248
Domestic consumption	323 033	368 644	322 325	336 130	357 580	325 053	266 978

The Commission does not provide any production figures because there are no relevant statistics.

In the absence of specific statistics the Commission assumes that annual consumption must be roughly 4 000 hectolitres, which is negligible.

The *Italian Government* maintains that production and consumption of Italian gin are not shown by the official statistics. From estimates based on information collected from producers it believes that it is able to judge consumption of Italian-made gin in Italy to be about 4 000 anhydrous hectolitres (equal to 10 000 hydrated hectolitres), that figure having remained virtually static during the last few years.

In the annex to its reply it gives the complete figures for the consumption of Italian-made spirits. Figures on quantities in stock are not given.

The *United Kingdom* was not able to obtain sufficiently apposite or accurate figures for a proper comparison to be drawn.

VI — Oral procedure

At the hearing on 14 December 1982 oral argument was presented by the following: Antonino Abate, for the Commission; R. J. A. Carnwath, for the United Kingdom of Great Britain and Northern Ireland; and Marcello Conti for the Italian Republic.

The Advocate General delivered his Opinion at the sitting on 25 January 1983.

Decision

1 By application lodged at the Court Registry on 23 December 1981 the Commission of the European Communities brought an action before the Court under Article 169 of the EEC Treaty for a declaration that by applying to spirits in the case of value-added tax (VAT) a system of

differential taxation on the basis of designation of origin or provenance, the Italian Republic has failed to fulfil its obligations under Article 95 of the EEC Treaty.

2 Apart from the standard rate of tax the Italian system of VAT provides for a reduced rate and two higher rates. The first higher rate, which was 18% when the action was brought, was increased to 20 % by Decree-Law No 697 of 1 October 1982 (Gazzetta Ufficiale della Repubblica Italiana No 273 of 4 October 1982). It is charged on a range of products which the Italian legislature judges to be non-essential goods. The other higher rate, which is applied to products which the national legislature considers to be items of luxury or prestige, was 35% when the action was brought and increased to 38% by Decree-Law No 697 of 1 October 1982.

3 By Decree-Law No 58 of 4 March 1977 (Gazzetta Ufficiale della Repubblica Italiana No 70 of 14 March 1977), converted into Law No 183 of 9 May 1977 (Gazzetta Ufficiale No 129 of 13 May 1977) and amended by Decree-Law No 697 of 1 October 1982 (Gazzetta Ufficiale No 273 of 4 October 1982), all spirits are taxed at the higher rates. However, a distinction is made between them inasmuch as gin and spirits having a designation of origin or provenance regulated or protected by specific measures in the territory in which they are produced are taxed at the rate of 35%, now 38%, whereas other spirits are taxed at the rate of 18%, now 20%.

4 As there are no rules in Italy protecting designations of origin or provenance as far as domestically-produced spirits (essentially those called "grappa") are concerned, the Commission took the view that, by the indirect means of the criterion referred to above, that system introduced a sub-category of tax causing almost all spirits imported from other Member States to be taxed more heavily than similar or competing domestic products.

5 Considering that the system was therefore contrary to Article 95 of the EEC Treaty it instituted proceedings under Article 169 of the Treaty and on 2 February 1979 issued a reasoned opinion relating to the higher taxation of both gin and spirits having a designation of origin or provenance and produced in other Member States. The opinion states that by maintaining that system of taxation in force, the Italian Republic has failed to fulfil its obligations under Article 95 of the Treaty and requests it to adopt the measures necessary to bring the alleged failure to an end.

6 As the Italian Republic failed to comply with that request the Commission brought this action.

7 The Commission, which is supported in its submissions by the United Kingdom, contends in substance that the effect of the system of differential taxation is to tax almost all spirits imported from other Member States more heavily than almost all Italian-made spirits and thus to protect domestic production. Whilst it admits that Member States may adopt different rates of taxation even for similar or competing products, provided that the conditions laid down by the Court in its judgment of 14 January 1981 in Case 46/80 *(SpA Vinal* v *SpA Orbat* [1981] ECR 77) are observed, the Commission considers that the criteria selected by the Italian Government do not meet those conditions. It contends that the criterion relating to regulated designation of origin or provenance has the effect of preventing by definition almost all imported spirits from being taxed at the less high rate whilst it affords that advantage to almost all Italian production whereas the fact that the designation of origin or provenance of spirits is protected by other Member States does not make them sufficiently different from Italian-made spirits to warrant different treatment. To support that contention the Commission points out that the prices before tax of certain imported spirits and certain Italian products are comparable. Such a comparison contradicts the Italian Government's statement that the products subject to the highest rate are consumed by customers who prefer luxury or prestige products and who have greater tax-paying capacity.

8 Throughout the administrative stage of these proceedings and before the Court the Government of the Italian Republic has continued to deny that it has failed to fulfil its obligations as alleged. It observes first of all that in a consistent line of decisions the Court has held that even in the case of identical products Member States are not prohibited from introducing systems of differential taxation based on objective criteria such as conditions of production or the raw materials used (judgments of 22 June 1976 in Case 127/75 *Bobie* [1976] ECR 1079; of 10 October 1978 in Case 148/77 *Hansen* [1978] ECR 1787; of 30 October 1980 in Case 26/80 *Schneider* [1980] ECR 3469; of 14 January 1981 in Cases 140/79 *Chemial* and 46/80 *Vinal* [1981] ECR 1 and 77; and of 27 May 1981 in Joined Cases 142 and 143/80 *Essevi and Salengo* [1981] ECR 1413). It stresses in particular that in the judgments of 14 January 1981 in the *Chemial* and *Vinal* cases the Court held that the application of a system of differential taxation cannot be considered to constitute indirect protection of domestic products within the meaning of the second paragraph of Article 95 merely because the more heavily taxed product happens to be a product imported entirely from other Member States.

9 According to the Italian Government, the higher taxation of gin and of spirits having a designation of origin or provenance, regulated or protected by specific measures in the territory in which they are produced, meets objective criteria. The highest rate of VAT charged on such spirits reflects the legitimate concern, appropriate to any system of VAT, to charge different rates of tax on essential or at any rate necessary consumer goods, non-essential goods and, lastly, luxury or prestige goods.

10 Spirits protected by a designation of origin or provenance belong, it is claimed, precisely by reason of that characteristic to the last category of goods which for that reason are particularly sought out by the more highly privileged social groups. Their higher taxation is therefore meant "simply to tax more heavily, for reasons of distributive justice, a luxury commodity the consumption of which is in itself an indication of greater contributive capacity". The system of taxation in question thereby meets the requirements of objectivity and neutrality which are necessary for justifying, with regard to Article 95, differential taxation of similar or competing products.

11 As a point of fact the Italian Government further observes that domestically-produced gin, the volume of which is higher than that of imported products, is taxed at the highest rate for the same reasons. It also maintains that the higher taxation of spirits with a regulated designation of origin or provenance has not had the effect, prohibited by the second paragraph of Article 95, of protecting other products. The figures produced on both sides show in fact that total imports into Italy from other Member States, especially the United Kingdom and France, of both gin and spirits having a designation of origin or provenance increased considerably between 1971 and 1981.

12 Before the various points of view put forward in this dispute are examined it should be mentioned that these proceedings, as is shown by the terms of the application and as was confirmed by the Commission at the hearing, do not concern the taxation of gin but only the taxation of spirits having a designation of origin or provenance, regulated or protected by specific measures in the territory in which they are produced.

13 As far as those spirits are concerned, the Government of the Italian Republic rightly recalls that in a consistent line of decisions the Court has held that "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 differentiation is compatible with Community law if it pursues 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" (judgment of 27 May 1981 in Joined Cases 142 and 143/80 *Amministrazione delle Finanze dello Stato* v *Essevi and Salengo* [1981] ECR 1413 at p. 1434).

14 Nor can it be denied that in the sphere of harmonized systems of value-added tax Member States have the right to tax some consumer goods, particularly those regarded as luxury products, more heavily. However, the freedom which must therefore be left to Member States in the field of domestic taxation cannot justify any departure from the fundamental

principle of non-discrimination in taxation matters laid down in Article 95 but must be exercised within the confines of that provision and observe the prohibitions contained therein.

15 An examination of the system of taxation in question leads to the conclusion that it does not meet those requirements.

16 As the Court had repeatedly held *inter alia* in its judgments of 27 February 1980 in Cases 160/79 *Commission* v *France*, 169/78 *Commission* v *Italy* and 171/78 *Commission* v *Denmark* ([1980] ECR 347, 385 and 447), amongst all spirits there is an indeterminate number of beverages which must be regarded as similar products within the meaning of the first paragraph of Article 95 and even where is it impossible to perceive a sufficient degree of similarity between the products concerned, there are nevertheless characteristics common to all those spirits which are sufficiently marked for it to be said that they are at least partly or potentially in competition. That is sufficient for it to be concluded that taxation of them must not have the effect of protecting domestic products. For that purpose it is necessary to take into consideration the potential market of the products in question in the absence of protectionist measures and to ignore comparisons of consumption and import figures.

17 As the products concerned are either similar to or in competition with one another — which brings them within the scope of the second paragraph of Article 95 — a criterion for the charging of higher taxation, such as designation of origin or provenance which by definition cannot ever be fulfilled by domestic products similar to or in competition with products imported from other Member States as described above, cannot be considered to be compatible with the prohibition of discrimination laid down in that provision. Such a system has the effect of excluding domestic products in advance from the heaviest taxation since they will never fulfil the conditions on which the higher rate is charged and it is entirely at the discretion of the national legislature, in choosing not to introduce a general system applicable to all spirits, to perpetuate that situation indefinitely regardless of similarities or differences in conditions of production, quality, price or competition between national products and those imported from other Member States.

18 That discriminatory and in any event protective character in regard to domestic production is amply demonstrated by the fact shown by the statistical information provided by the defendant that in the period 1975 to 1981 at least 98.5% of imported spirits were taxed at the highest rate of 35% (in the estimate of the Italian Government, only 2 000 to 3 000 hectolitres of spirits taxed at the rate of 18% were imported by Italy as against total annual imports varying between 194 099 and 284 087 hectolitres) whilst in the same period more than 98.5% of Italian-made spirits were taxed advantageously at 18% (the annual consumption of Italian gin subject to the rate of 35% has been estimated to be approximately 4 000 hectolitres whereas total consumption of domestically-produced spirits varied between 266 978 and 368 644 hectolitres per year).

19 Furthermore, it must not be overlooked that, although some designations of origin or provenance may be such as to give the products profiting from them a reputation for quality, such designations do not thereby generally and automatically confer on the spirits to which they apply the character of consumer goods of luxury or prestige. That is particularly true when they do not have that character in the Member State in which they originate.

20 If, however, the Italian legislature's presumption that because a product has a designation of origin or provenance it must be one of luxury or prestige were ever to correspond in any given Member State to previous habits of consumption (which it has not been possible to demonstrate), it must be remembered that the purpose of creating a common market in which goods move freely in undistorted conditions of competition in accordance with Articles 2 and 3 of the Treaty is to eliminate such entrenchment of habits of consumption by ensuring that all consumers have as far as possible equal access to all Community products.

21 Finally, it must be emphasized that the considerations set out above by no means fetter the ability of Member States to adopt, whilst observing the relevant directives, a higher rate of VAT on luxury products as opposed to domestic or imported products not having that quality, provided, however, that the criteria chosen to determine which category of products is to be more heavily taxed are not discriminatory as against imported products similar to or in competition with domestic products in the manner contemplated by the second paragraph of Article 95.

22 It follows from the foregoing considerations that by applying a differential system of taxation to spirits on the basis of the ciriterion of designation of origin or provenance, in pursuance of Decree-Law No 58 of 4 March 1977 on value-added tax, the Italian Republic has failed to fulfil its obligations under Article 95 of the EEC Treaty as far as products imported from other Member States are concerned.

On those grounds,

THE COURT

hereby:

1. **Declares that by applying a differential system of taxation to spirits on the basis of the criterion of designation of origin or provenance, in pursuance of Decree-Law No 58 of 4 March 1977 on value-added tax, the Italian Republic has failed to fulfil its obligations under Article 95 of the EEC Treaty as far as products imported from other Member States are concerned;**

2. **Orders the defendant to pay the costs.**

Mertens de Wilmars Pescatore O'Keeffe Everling

Mackenzie Stuart Bosco Koopmans Due Bahlmann

Delivered in open court in Luxembourg on 15 March 1983.

P. Heim
Registrar

J. Mertens de Wilmars
President