CHAPTER 13

Internal Taxation in the EU's Internal Market: Is Article 110 TFEU All about Protectionism?

Ivan Sammut

Abstract

This paper looks at the evolution of Article 110 TFEU through the Court of Justice of the European Union's main cases. Such a phenomenon often occurs through the imposition of discriminatory taxation upon goods originating in another Member State with the intent and effect of promoting the locally produced good. Situations are reminiscent of the latter circumstances and can thus impede one of the four freedoms central to the proper functioning of the European Union, proving a hindrance to the free circulation of goods between the Member States. Thus, mechanisms preventing the application of such discriminatory measures through internal taxation are imperative. At face value, the wording of the article prevents discriminatory indirect taxation upon goods that are either similar or capable of competing. This said internal taxation may nonetheless be differential yet not discriminatory. The latter applies when there is an objectively justifiable reason for imposing a higher tax on goods originating in another Member State than that imposed upon the domestic product. Finally, the paper compares and contrasts jurisprudence to examine if an element of protectionism is needed for a national measure to be caught up by Article 110 TFEU.

1 Introduction – the Objectives of Article 110 TFEU

Over the past decades, one can appreciate that the underlying rationale of the Internal Market is to produce an economic union where goods move freely within the Union's borders. This involves eliminating all differences between individual economists capable of impairing the flow of factors, that is, preferences based on nationality, after becoming relevant. However, the objective of Article 110 TFEU is to prohibit discrimination based on nationality. It does not seem to aim at making taxation provisions identical, merely to cleanse them of discrimination. The consistent case law of the CJEU has noted that Member States can operate different systems of taxation to reflect different social and

 | DOI:10.1163/9789004712119_015

economic goals. However, such differential systems cannot infringe the principle of non-discrimination.

The Court appears to place little or no value on the similarity of national tax regimes. Not only is the goal of this harmonisation imperfectly recognised by the TFEU, but it is also a very contentious political issue. According to several case laws, the Court suggests that the primary function of Article 110 TFEU is to prevent discrimination and internal tax matters based on nationality. Regarding Article 110 TFEU (Ex Article 95 EEC pre 1999 and ex Article 90 EC pre 2009), the Court of Justice in the *Bobie* case said:[1]

> Article 95 seeks to ensure, by means of the prohibition which it lays down, that an importing Member State does not, by means of internal taxation of imported products and similar domestic products, give domestic traders preferential treatment as compared with their competitors from other Member States who sell similar products on the market of that State.

This statement has been followed in several other cases. Also, one may have to examine the difference between this provision's first and second paragraphs. The first reads that "no Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products". The second paragraph reads that "furthermore, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford protection to other products". The first difference between the two paragraphs is the use of 'similar' in the first paragraph and 'other products' in the second paragraph. The scope of Article 110 TFEU paragraph 1 differs from that of Article 110 paragraph 2 in that the former is more narrow. This brings the question: what does comparable mean? From the *Spirits* case decided in 1980,[2] the Court draws an indistinct line between 'similar products' under the first paragraph and 'other products' under the second.

2 The Context

Through protectionism, one can understand the difference between discrimination based on the product's nature and discrimination based on the product's nationality. Protectionism involves the latter and not the former.

1 Case 127/75.

2 See Case 168/78.

Article 110 TFEU does not stop Member States from taxing whisky more than wine or beer. That is within the discretion of the Member State. It, though, prevents Member States from offering an advantage to the local product over that of another Member State through taxation. A Member State may decide that whisky is a cause of alcoholism and beer is not, and vice versa. A Member State can decide to tax the protection of synthetic alcohol more than alcohol distilled from surplus food even though the products are chemically identical, and there is no obligation on the Member States to treat similar comparable products identically.

What a Member State cannot do is make choices based on the nationality of the product or the producer. If a Member State says all foreign cheese is to be taxed at 15% and the domestic equivalent at 5%, there is discrimination based on nationality. On the other hand, suppose a Member State requires all the wine with a designated appellation, whatever its origin, to be considered a luxury product and is taxed at 100%. In contrast, the undesignated wine is taxed at 5%, and the system does not appear discriminatory. However, if there is no system of appellation for wines produced in the importing Member State, then the clear rule is that there cannot be discrimination based on nationality. Member States can discriminate between products, but this discrimination cannot affect or be based on the product's nationality. Objective criteria must be used to differentiate products, and defining the product correctly is essential. The definition of a product has two competing aspects. If the product is narrowly defined, for example, only diesel cars instead of cars in general, it is relatively easy to claim discrimination. The product coverage of the discrimination is, by definition, narrow. This would mean the effect of the ruling striking down discriminatory legislation introduced.

On the other hand, an expansive definition of a product that is all cars rather than just diesel cars includes a wide product base, but discrimination across such a wide base is more difficult to prove. For example, the *Italian VAT diesel cars*[3] is a typical case where the Commission argued that the Court should consider discrimination only concerning diesel cars. The Court did not follow the suggestion, arguing that the relative products were cars in general, i.e. both petrol and diesel. At that time, electric cars were not on the market. The choice of product was crucial. Had the Court followed the Commission's suggestion, there would have been no Italian products suffering the highest tax rate. This would have raised the question of the protection of Italian products. As it happened, by choosing the category of cars, Italian petrol cars were taxed

3 See Case 200/85.

at a higher rate. Therefore, Italian products indeed suffered as a result of the tax criteria. One can conclude that the Court seems to have chosen the products with a view to the case's outcome. This might support an argument that the Court was looking to the intent underlying the Italian law and ignoring the effect of the law on the diesel car market.

So, does the Court first examine the intention behind the national legislation and then select the products? This is also another contentious argument to make. One could conclude that a possible way of explaining the Court's diverging behaviour concerning product organisation is that, in some cases, the Court seems to say that everything is comparable. In contrast, in other cases, it is also a very close and objective distinction which could have been previously disregarded. So, how could one conclude what the Court would decide when interpreting Article 110 TFEU?

First, the Court looks to the intent underlying the statute. If the law discriminates between domestic and foreign products, the Court will strike down the law since it intends to protect domestic production. On the other hand, if the statute is not formally discriminatory and pursues a policy that does not discriminate between products based on nationality, then it will be upheld. However, one has to consider the following considerations. Suppose the law is formally non-discriminatory but is intended to operate politically so that only domestic products qualify for prevention and treatment. In that case, the Court may strike it down since the notion presumed is to intend to protect domestic production. Secondly, suppose the law is formally non-discriminatory but operates so that a significant amount of the foreign product is denied the full preferential tax treatment. In that case, the Court may also strike down the national legislation since there is evidence of the protection of domestic production. For example, if only the domestic product is in the low-tax band, and only the following products are in the high-tax band, the presumption of protection is the strongest. If a mixture of foreign and domestic production is in the lower band, and only the following goods are in the high end, then the presumption of protection is stronger but not as strong as in the previous case. If only domestic production is in the low-tax strength and the mixture of foreign and domestic is in the high-tax band, then the presumption of protectionism is weak. Finally, where even a mixture of both domestic and foreign goods appear in both categories, then there is probably no presumption of any protectionism.

Regarding the connection with the intended effect, the Court will strike down the tax if the law has a protectionist purpose. On the other hand, if the effect is protectionist but the purpose is not met, the Court may still uphold the law. What does one mean by protectionist or discriminatory law? The

Court's classification as protectionism when the national law protects local goods seems appropriate when it aims to protect domestic products against competing imported products. However, it is not necessarily connected with the exclusive purpose in mind. Should the protectionist purpose, which is not the only purpose of the specific exploration, be considered by the Court as sufficient to render the law protectionist? Concerning the objective of non-discrimination pursued by the Court and the cases decided so far, protectionism does not have to be the law's main purpose. The Court strikes down the law as long as it is apparent that it has the purpose of protectionism, which is one of the motives for its enactment. This permits the Court to scrutinise and strike down a large number of revenue losses and to pursue non-discrimination in a very powerful way.

3 The Nationality Hypothesis through the CJEU's cases

A good way of examining the hypothesis that the Court of Justice strikes down any internal tax law that can be deemed protectionist is by comparing several similar cases and seeing each case's outcome.

3.1 *Danish Fruit*[4] *v John Walker*[5]

In Denmark, the production of grapes and grape wine is practically impossible. There is, however, a substantial production of fruit wine, mostly from apples. Danish legislation taxed grape wine of the table type at a rate of DKR 10.725 per litre and grape wine of the liquor type at DKR 19.93 per litre. Fruit wine of the table type was taxed at DKR 6.92, and fruit wine of the liquor type at DKR 11.02 per litre. The total consumption of grape wine of both types was much greater than the total consumption of food wine of both types; however, the consumption of food wine of the liquor type was almost all produced in Denmark, while consumption of the grape wine of the liquor type has decreased in absolute numbers. The European Commission brought an action against Denmark, arguing that the tax was discriminatory. Grape and fruit wine should be considered similar by the legislator and taxed similarly, even if the two are not similar. The Commission argued that the two types of wine were at least in competition and that the tax system afforded indirect protection to domestic production.

4 Case 106/84.

5 Case 243/84.

Denmark denied the similarity of the competitive relationship between the two products. It also argued that the text did not have a protective effect. It represented the same percentage of the price even though there was a surcharge on wine if the base taken for composing was the volume of the alcoholic strength. Finally, Denmark argued that the purpose of the legislation was to guarantee food growers working in different climatic conditions sufficient income to support farmers growing local production. Under Danish law, imported fruit wine benefits from the favourable arrangement without considering production conditions. The Advocate General started by pointing out that the differential taxation of similar products could be justified when it pursued social and economic policy objectives compatible with the requirement of the Treaty; however, in the specific case, the purpose specified system, that is, the favourable treatment of certain agricultural products against certain other agricultural products was not compatible with the Treaty and the CAP. The tax system protected food producers in Denmark from imports from food producers. The Advocate General accepted in principle the Danish argument that if the tax is measured based on the price, the tax burden on the two products was the same; however, he then argued that notwithstanding similarity, fruit and grape wines of the table type were not similar.

The Court did not completely follow the AG's suggestion. In a rather short judgement, it was first noticed that the grape wine consumed in Denmark was completely imported while fruit wine of the liquor type was essentially domestic. Two-thirds of the fruit wine of the table type was domestically produced. It then pointed out that fruit wine of the table type has traditionally represented an essential market for domestic producers. It stated that to determine whether two products are similar, it is necessary to consider the objective characteristics of both categories of beverages, including their origin, method of manufacture, and other organoleptic properties. Then, they have to verify whether they meet the same consumer needs, keeping in mind that the test should not be assessed based on current consumer habits but rather take into account the prospective developments of these habits.

In the comparative case, a Danish court made a preliminary reference to the CJEU concerning the system of taxation and spirits in Denmark, particularly the Johnnie Walker case. In Denmark, spirits were taxed at a specific rate per litre of pure alcohol and an *ad valorem* duty. As one has already observed, the fruit wine of the liquor type was taxed according to different criteria, leading to an inferior global burden. Fruit wine of the liquor type is not considered spirit if the final alcoholic strength is less than 20%, even if ethyl alcohol was added to reach the desired strength. Walker, who exported whiskey to Denmark, argued that the taxation system was discriminatory. It favoured fruit liquors whose

production was domestic and spirits imported from other Member States. A bottle of fruit wine was only taxed at about 25% of the final price, while John Walker incurred a tax of 70%. There was no substantial difference between the two in terms of alcoholic strength. The production system was also similar because, in both cases, ethyl alcohol was added.

In line with the Advocate General's opinion, the Court denied that fruit wine and whiskey could be considered similar products. The Court pointed out that the physical characteristics and consumer needs should be given equal weight. The Court then stressed that the organoleptic qualities system of production, including fermentation and distillation, and consumers' habits regarding alcohol level led to the conclusion that the two products were fundamentally different. The Court turned to the second paragraph of Article 110 and pointed out that about 72% of the domestic production of alcoholic beverages was in the same tax bracket as whiskey; hence, there was no protectionism in this case, and the tax regime was upheld.

3.2 *Italian Sparkling Wines and Italian Marsala*[6] *vs French Sweet Wines*[7]

Marsala wine represented a large percentage of Italian wine production. According to the European Commission, it represented 90% of the total. The Italian system applied a manufacturing tax on domestic alcohol. In the *Marsala* case, the European Commission argued that the system protected the Marsala against similar competing liqueur wines imported from other Member States. Italy imposed this to help Marsala, an economically depressed region, improve economically. Italy argued that Marsala required a separate system of protection, which differentiated from any other one. In his opinion, the AG observed that the legislation was intended to encourage and protect the Marsala wine producers and that the criteria chosen by the legislator were non-objective. As a result, imported liquors were disadvantaged, with a substantial part of the domestic production taxed at a lower rate. The Court of Justice agreed with the opinion of the Advocate General. In the first place, it pointed out that only wines were similar products, which is the meaning of the first paragraph of Article 110 TFEU. It then turned to justifications brought by Italy. The Court argued that Italian law was designed in a way that would never consent to any foreign products to qualify for the designation of Marsala and, therefore, enjoy the reduced tax rate. The Italian text legislation was, therefore, clearly discriminatory.

6 Case 277/83.

7 Case 196/85.

Set against this background is a case dealing with the taxation of French national sweet wines. French legislation accorded favourable treatment to national sweet wines as against other sweets and liquor wines; initially, the treatment was accorded only to national sweet wines produced in France. After a formal opinion by the Commission, France extensively treated a national sweet wine produced in specific regions of the EU. The legislation stipulated conditions for foreign wine to meet before qualifying for treatment. After the Commission notified France, France complied again with some of the recommendations provided by the Commission's opinion; however, the Commission still proceeded to take action before the Court, arguing that further conditions in the legislation put foreign wine at a disadvantage. In particular, the Commission challenged that the product should come from a region where the production was traditional and customary.

The second challenge was requiring wines to be subjected to control guarantees equivalent to those required for national sweet wines. France justified the legislation by arguing that the production was carried out in regions with peculiar weather conditions where other agricultural products could not be produced, and the economy was largely dependent on that production. Both historical and technical significance justified the traditional requirement. Moreover, the legislation did not discriminate against other European products. For example, wine from other Member States' regions that could qualify for the objective criteria could also qualify under French law. Hence, the benefits were not exclusively to domestically produced French wine.

The Court of Justice upheld the French legislation. Regarding the traditional customer requirement, the Court argued that the policy pursued by France was consistent with EU law, and two points are particularly important. First is the analysis by the Court that accepted the suggestion coming from the Advocate General and did not discuss whether or not the French requirement was justified by compelling reasons as long as it was not formally or practically discriminatory. Then, the Court rejected the second objection and argued that a Member State was free to require the legislation of other Member States, which permits verifying the compliance of a particular imported product with the requirements set out by the national legislation. The requirement was, therefore, not unnecessarily restrictive.

Hence, one can compare the French and Italian cases here. In the *Marsala* case, Italian law was discriminatory without objective grounds from a national perspective. Italian law wanted to protect Italian products as opposed to imported products. On the other hand, the French case did not seek to protect the domestic product but rather the disadvantaged product. This meant that French and imported disadvantaged products could enjoy the protection of

French tax law. Hence, in the first case, there was an element of national protectionism; in the second French case, there was no national protectionism. Hence, similar cases concluded differently by the CJEU further prove that the CJEU, in interpreting Article 110 TFEU, looks at an element of protectionism as a major basis in determining whether Article 110 TFEU is infringed.

3.3 *Belgian Beer*[8] *and Wine v British Beer and Wine*[9]

These two cases are very similar to each other. Both deal with the drinking habits of beer instead of wine in their respective countries. The UK and Belgium have temperate climates and produce more beer than wine. Both countries also have populations that enjoy drinking. There was a higher tax on imported wine than locally produced beer in the UK and Belgium. In the UK, it was clear that consumers would purchase the cheapest alcoholic drink. If the tax is at a lower rate, this means that in the UK, consumers will end up purchasing more domestically produced beer as opposed to imported wine. In fact, during the five years of its membership, the UK had a transitory period within which it was allowed to offer favourable treatment. However, when the UK continued offering favourable treatment to locally produced beer instead of imported wine, the Court found that this breached Article 110 TFEU.

In Belgium, where wine is not produced, but there is substantial beer production, wine was still subjected to a higher rate than beer. The Commission brought an action against Belgium, arguing that the tax was discriminatory because, as determined by the Court in the UK case, there was a competitive relationship between Beer and wine. The Commission took the view that once a competitive relationship has been shown, any difference in the rate of tax applied to the same taxable base is contrary to Article 110 TFUE. Belgium argued that, on the contrary, under the second paragraph of Article 110 TFUE, it is necessary to ascertain whether the difference in tax burdens will likely affect consumers' choices. In this case, the difference in VAT rates was small and could not influence the consumer's choice. In all the other cases, verifying the competitive relationship and actual protective effect is necessary. The Advocate General then addressed the question based on the decision of the Court, and the British case took the view that the most intense competitive relationship existed between the most commonly consumed and substantially cheaper wine and beer, which represented the wider market sector.

In this area, the Advocate General compared tax burden and used it to assess the incidence of the price index. He concluded that no protective effect was

8 Case 356/85.

9 Case 170/78.

shown since the difference in price between wine and beer was such that the difference in tax rate was not enough to distort competition. He pointed out that this conclusion was confirmed by the fact that the consumption of wine in Belgium had increased while beer consumption decreased. In its examination of the tax system, the Court of Justice agreed with the conclusions of the Advocate General. Unlike the UK case, in the Belgium case, the difference in taxation between wine and beer was less marked, and the consumer behaviour in Belgium was much less price sensitive than in the UK. Consumers behaved differently in the different countries, so the effect of protectionism in Belgium was much less evident than in the UK.

In other words, the Belgian case was concluded differently from the British one, even though the facts were similar. The difference between the two seems to revolve around the tax system in the UK case. The UK did not deny that the system was originally designed to have a protective effect but tried to argue that there was no possibility of comparing the products. In the Belgian case, the VAT system was a general taxation system applicable to thousands of products. Coincidentally, it appeared to discriminate between foreign and domestic products somewhere over its application range. Certainly, such an effect was unintentional.

4 Conclusion

While the cases analysed above go back to the early years of the Internal Market, and they may be considered old cases, they are still highly relevant today. One would expect these judgments to remain important well into the next decade and beyond. These cases are only samples. One can also mention, for example, the Italian *diesel car* cases mentioned earlier in this paper and the *Humblot* judgment[10] regarding car registration taxes, among others. The Court of Justice has mainly taken a protectionist approach in the sense that the Member States retain full freedom to impose any indirect tax they deem fit as long as the implementation of this tax is not done in such a way as to afford protection to domestically produced goods over goods imported from other Member States. Hence, one can conclude that Article 110 TFEU does present a strong element of protectionism in its implementation and ensures that Member States do not discriminate based on nationality when implementing rules and taxation. Unlike customs duties between Member States, which are

10 Case 112/84.

completely prohibited with no exceptions, internal taxation is allowed as long as it is not discriminatory. Thus, one can conclude that protectionism plays a very important role in the implementation, interpretation and application of Article 110 TFEU.

Bibliography

Bustin G., "Fiscal Measures Affecting International Trade"; from Demaret (ed) *Aides et Mesures de Sauvegarde en Droit International Economique,* Fondation pour l'étude du droit et des usages du commerce international Liege, 1980 239–265.

Danusson et al. "Does the European Court of Justice look for protectionist Motive under Article 95?"; 17 *Legal Issues of Eur. Integration* 67 (1990).

Easson A. "Fiscal Discrimination: New Perspectives on Article 95 of the EEC Treaty", *Common Market Law Review*, 18 (1981) 521.

Evans A. "A Textbook on EU law", Chapter 4 "Internal Taxation", Hart, Oxford, 1998.

Grabritz E. et al. "Scope for Action by the EC Member States for the Improvement of Environmental Protection under EEC Law: The Example of Environmental Taxes and Subsidies" *CMLR* 26. 427–447.

Green N. et al., *"The Foundations of the Single Market"* – Chapter 4 "Internal Taxation", OUP, Oxford, 1991.