OPINION OF ADVOCATE GENERAL

GEELHOED

delivered on 18 September 2003 (1)

Case C-308/01

GIL Insurance Ltd

UK Consumer Electronics Ltd

Consumer Electronics Insurance Co. Ltd

Direct Vision Rentals Ltd

Homecare Insurance Ltd

Pinnacle Insurance plc

v

Commissioners of Customs & Excise

(Reference for a preliminary ruling from the VAT and Duties Tribunal, London)

(Reference for a preliminary ruling – VAT and Duties Tribunal, London – Interpretation of Articles 27 and 33 of Directive 77/388/EEC – Interpretation of Article 87 EC – Introduction of tax on insurance contracts – Obligation to seek prior authorisation from the Council)

I ? Introduction

1. In the present case the VAT and Duties Tribunal has referred to the Court five questions for a preliminary ruling. The first two questions relate to Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment (hereinafter 'the Sixth Directive'). (2) More specifically they concern the interpretation of Articles 27 and 33 of that directive.

2. The last three questions are founded on the supposition that a selective higher tax which exclusively applies to certain precisely defined economic activities may lead to distortions in competition to which Articles 87 and 88 are applicable. More specifically, those questions concern the criterion in Article 87(1) EC concerning effect on trade between Member States (Questions 3 and 4) and the consequences of non-notification of the relevant measure introducing the tax (Question 5).

3. The context within which the last three questions were raised prompts a closer analysis of the scope of Articles 87 and 88 as *leges speciales* aimed at the prevention and elimination of

distortions in competition on the Community market in so far as they stem from State aid. For if the selective tax measures at issue in the main proceedings cannot be deemed to constitute State aid, the distortions to which they give rise may be eliminated only by application of the seldom applied Articles 96 and 97 EC which, in regard to Articles 87 and 88 EC, constitute the *lex generalis*.

4. This problem area, which was also highlighted by the Commission in its written observations, confers on this case greater legal importance than the questions raised would appear at first sight to suggest.

II – Legal framework

A – National law

5. Section 31 and Group 2 of Schedule 9 of the Value Added Tax Act 1994 provide that supplies of insurance and related services are exempt from value added tax ('VAT') in the United Kingdom in accordance with Article 13 of the Sixth Directive.

6. Under the Finance Act 1994, a tax on insurance premiums, the 'insurance premium tax' ('IPT'), was introduced in the United Kingdom on the receipt of insurance premiums by an insurer. The rate of the tax was originally fixed at 2.5%. By the Finance Act 1997 the standard rate was increased from 2.5% to 4% and a new higher rate of 17.5% was introduced.

7. The standard rate is the generally applicable rate. The higher rate, which at the time of introduction corresponded to the standard rate of VAT in the United Kingdom, applies only to insurance premiums relating to domestic appliances, motor cars and travel.

8. As far as travel is concerned, the higher rate applied only to travel insurance sold through travel agents; travel insurance sold directly by insurers was subject to the standard rate. In *R* v *Commissioners of Customs & Excise*, ex parte *Lunn Poly Limited and another* [1999] STC 350 the Court of Appeal of England and Wales held that the differential rates of tax in relation to travel insurance constituted a State aid within the meaning of Article 87(1) EC.

9. Faced with this decision confirming the Divisional Court's earlier decision to that effect, the Commissioners of Customs & Excise in a business brief published on 24 April 1998 announced that it would not be seeking recovery by means of the retroactive application of the higher rate of tax on travel insurance sold at the standard rate. As from 1 August 1998 all travel insurance has been subject to the higher rate.

10. As far as domestic appliances are concerned, the higher rate applies only where the insurer is connected with the supplier of the appliance, or where the insurance is arranged through the supplier, or where the supplier is paid a commission on the provision of insurance. Similar insurance sold through insurance brokers or directly by insurance companies is subject to the standard rate.

11. The reason given for the introduction of the higher rate was to preclude 'value-shifting'. The authorities were of the view that suppliers of domestic appliances might take advantage of the absence of VAT on supplies of insurance by manipulating the prices attributed to the appliances themselves and to the corresponding insurance.

B – Community law

12. Pursuant to Article 13(B) of the Sixth Directive,

'Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse:

(a) insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents;

...'

13. Article 27 of the Sixth Directive provides that the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance. Measures intended to simplify the procedure for charging the tax, except to a negligible extent, may not affect the amount of tax due at the final consumption stage.

14. Finally, Article 33(1) of the Sixth Directive provides that, without prejudice to other Community provisions, in particular those laid down in the Community provisions in force relating to the general arrangements for the holding, movement and monitoring of products subject to excise duty, the provisions of that Directive may not prevent a Member State from maintaining or introducing taxes on insurance contracts, taxes on betting and gambling, excise duties, stamp duties and, more generally, any taxes, duties or charges which cannot be characterised as turnover taxes, provided however that those taxes, duties or charges do not, in trade between Member States, give rise to formalities connected with the crossing of frontiers.

III – Facts and procedure

The dispute before the national court

15. The applicants in the main proceedings are all companies incorporated and trading in the United Kingdom which provide insurance or insurance-related services for domestic appliances. Some are insurance companies (Consumer Electronics Insurance Co. Ltd, which belongs to the Thorn group, Homecare Insurance Ltd and Pinnacle Insurance plc) while others are rental and retail companies acting as taxable insurance intermediaries (GIL Insurance Ltd, UK Consumer Electronics Ltd and Direct Vision Rentals Ltd, which belong to the Granada group).

16. The respondents in the main proceedings are the Commissioners of Customs & Excise who are responsible for the administration, collection and repayment of insurance premium tax ('IPT') and VAT in the United Kingdom.

17. The applicants paid the higher rate of IPT in relation to insurance sold in connection with the sale or rental of domestic appliances. Following the judgment of the Court of Appeal in *Lunn Poly*, referred to in point 8 above, they claimed from the respondents repayment of the amounts paid by them. Those claims were rejected and they appealed to the VAT and Duties Tribunal, London.

18. Before that tribunal, the applicants maintained that they were entitled to reimbursement of the amounts paid by way of higher-rate IPT, claiming that:

– the higher rate was a special measure which derogated from the provisions of the Sixth Directive and therefore required prior authorisation under Article 27, which authorisation had not been sought or obtained;

– the higher rate could be characterised as a turnover tax of a type not permitted by Article 33 of the Sixth Directive; and

– the differential between the standard rate and the higher rate constituted State aid under Article 87 EC, of which the European Commission had not been informed as required by Article 88(3) EC.

19. The Commissioners of Customs & Excise disputed those assertions in the main proceedings. They accepted that an authorisation for a derogation under Article 27 of the Sixth Directive had not been sought or obtained and that the European Commission had not been informed under Article 88(3) EC of the plan to introduce the higher rate of insurance premium tax. They accepted that, if there were a breach of the Sixth Directive, then the applicants were entitled to repayment of the whole of the tax they had paid but they argued that, if the differential between the standard rate and the higher rate of IPT were an illegal State aid, then repayment of the differential was not the appropriate remedy.

20. Consequently, the VAT and Duties Tribunal referred five questions to the Court for a preliminary ruling.

Questions referred

‘1. Is Article 27 of the Sixth ... Directive ... to be interpreted so that the prior authorisation of the Council was required before the introduction of a higher rate of tax on insurance premiums, which tax was designed to nullify the exemption for insurance services in Article 13 of the Directive; which was at a rate identical to the standard rate of value added tax; which was administered in the same way as value added tax; which was intended with value added tax to form part of an inseparable whole; and where there was no tax evasion or tax avoidance?

2. Is Article 33 of the Sixth ... Directive ... to be interpreted so as to prevent a Member State from introducing a tax on insurance premiums which is calculated by reference to the services supplied; which is proportional to the price of the services supplied; which is charged at the final stage of sale to the consumer; which is passed on to the final consumer in a manner characteristic of value added tax so that the burden of tax rests on the final consumer; which applies to the whole territory of the United Kingdom; but which does not apply generally to all transactions relating to goods and services?

3. Is Article 87(1) EC to be interpreted so that an aid is to be held to affect trade between Member States only if it has, or is capable of having, an appreciable effect on trade between Member States? If so, what are the criteria for determining whether or not a measure has such an effect?

4. Is Article 87(1) EC to be interpreted so that an aid is to be held to affect trade between Member States if as a result of that aid (1) traders in one Member State reduce the volumes of the goods they import from other Member States; or (2) a trader who rents domestic appliances to customers in one Member State has a number of its rental contracts discontinued and disposes of those appliances in another Member State; or (3) insurance companies in one Member State, which provide insurance connected with the sales of domestic appliances, are placed at a competitive disadvantage with companies which sell direct insurance some of which are subsidiaries of companies in other Member States?

5. If, in the light of the answers to Questions 3 and 4, the higher rate of insurance premium tax constitutes a State aid within the meaning of Article 87(1) EC, is Article 88 EC to be interpreted so

that, where the Commission is not informed of any plans to grant such aid, the legislative measures introducing the aid should be disapplied and any tax paid under those measures should be repaid?'

Procedure before the Court

21. Those questions were submitted in an order of 24 July 2001, which was received at the Court Registry on 6 August 2001. Written observations were submitted by the applicants in the main proceedings, the United Kingdom Government and the Commission. At the hearing on 19 June 2002 they further elucidated their views. At that hearing the Netherlands Government also put forward its views.

IV – The first and second questions referred for a preliminary ruling

22. The first two questions were raised in connection with the introduction of ITP. That tax was introduced in 1994, at the original rate of 2.5%. In 1997 that rate was increased to 4%. In 1999 it was again increased to 5%. In 1997 a higher rate of ITP was also introduced. That rate, 17.5%, has since remained unchanged. The higher rate was introduced in order to combat 'value-shifting', a form of tax avoidance.

23. Before going into the questions I will give a brief account of the background against which they are raised.

24. In regard to relatively expensive household appliances, such as audiovisual systems, washing machines and such like, consumers have the choice of rental or purchase. In the United Kingdom many consumers initially preferred the rental option. In the course of time that has changed to a preference in favour of the purchase of appliances. (3) This change in preference is linked with increasing prosperity and the improved quality of products. Developments on the market for television sets are an illustration of that. When at the beginning of the 1960s they came onto the United Kingdom market in large quantities, they were expensive in relation to disposable income, technically unreliable and required regular repairs. That was why consumers clearly opted for rental. Subsequently, television sets became relatively less expensive and their technical reliability improved drastically. As a result and owing to the development of consumer credit as a sales promotion technique, consumers progressively opted for the purchase of television sets. The same pattern of consumer behaviour became evident in the case of other household appliances.

25. The initially rental-dominated market had certain specific characteristics. The rental agreements normally contained an obligation on the customer to maintain the equipment and a corresponding obligation on the rental company to service it. Both those aspects were reflected in the rental price. These arrangements were advantageous to the supplier inasmuch as the equipment remained in a good state of repair during the rental period, thus enabling it to be rented out again after expiry of the rental agreement. The advantage for the consumer was that his enjoyment of the equipment rented was assured.

26. Subsequently, suppliers introduced analogous arrangements in connection with the sale of household appliances by offering service contracts. These gave customers a certain security in regard to use of the equipment. Those contracts which were ancillary to the sales and purchase agreements provided that suppliers were liable to remedy any defects in the appliance sold on payment by the customer of a fixed or annual amount.

27. The supply of services under such service contracts was subject to VAT at the standard rate of 17.5%. The fact that insurance services were exempt from VAT under Article 13B(a) of the Sixth Directive prompted a number of large suppliers to offer those service contracts in the form of

an insurance contract; the introduction in 1994 of the much lower IPT did not deter them from doing so. In that connection they established their own insurance companies or acted as intermediaries for insurance companies and received commission on each insurance contract taken out.

28. The applicants in the main proceedings also began to offer service contracts in the form of insurance contracts. Thus, Granada, one of the larger suppliers of household appliances in the United Kingdom, established the GIL undertaking in order to be able through it to offer insurance contracts to its rental customers and purchasers. In the case of rentals it was even a requirement that such a contract be taken out. If defects occurred in the appliance of the insured person, GIL could ask Granada's service department to carry out the necessary repairs. The latter provided the necessary labour and spare parts.

29. In 1994 the majority, that is to say 85 to 90%, of insurance contracts against mechanical defects in household appliances were sold through the intermediary of the supplier of the appliance (connected insurance). Only a small proportion of insurance contracts was sold by insurers directly to the consumer.

30. It was apparent from a report from the same year that the sale of those extended warranties (service and insurance contracts) involved an annual amount of GBP 400 million the greater part of which was accounted for by insurance costs.

31. The Commissioners of Customs & Excise recognised that this form of tax avoidance occasioned a loss of VAT revenue. That prompted the United Kingdom legislature to introduce a higher rate of IPT at 17.5% applicable to what is known as connected insurance contracts, that is to say where there is in some way a fixed relationship between the insurer and the supplier of the appliance concerned.

32. The introduction of that higher rate had a significant effect on the market behaviour of the parties concerned. Most suppliers reverted to offering normal service contracts for the appliance supplied by them. Where insurance contracts were still taken out, direct insurance accounted for an appreciably greater market share. Insurers tied to suppliers terminated those settled relationships. The applicants in the main proceedings were also compelled to adjust their market behaviour accordingly.

Parties' observations

33. The observations of the parties to the main proceedings, on the one hand, and the United Kingdom Government and the Commission, on the other, focus on two aspects: first, the nature of (higher-rate) IPT as indirect taxation and secondly the consequences flowing therefrom for the interpretation and application of Articles 27 and 33 of the Sixth Directive.

34. The view of the applicants in the main proceedings may be summarised as follows:

– the first two questions concern only higher-rate and not standard-rate IPT. Higher-rate IPT was introduced on insurance arrangements directly connected with taxable supplies of goods. The purpose of that rate was to combat VAT avoidance. Since that was not the purpose of the introduction of the standard rate, those questions do not concern that rate;

– since higher-rate IPT on service contracts in connection with the supply of household appliances forms an inseparable part of VAT and because both taxes are mutually interchangeable higher-rate IPT must be deemed to be a turnover tax prohibited under Article 33 of the Sixth Directive;

– in the specific context in which it is applied, higher-rate IPT displays all the essential characteristics of VAT: the tax is proportional to the price of goods and services and is ultimately borne by the end-user. The characteristic that VAT is charged at each stage of the production and distribution process and subject to deduction of input tax is less relevant in this connection since in the present case the chain, apart from reinsurance contracts, only has one link, namely the transaction between the insurer and the insured. It is true that VAT is generally applicable to transactions concerning goods and services and higher-rate IPT applies only to certain economic transactions but the complementarity between VAT and higher-rate IPT results in a general tax applicable to all transactions concerning household appliances to which VAT is also applicable;

– the purpose of Article 33 is to preclude the introduction of charges and taxes which by imposing a charge on the movement of goods and services in a manner comparable to a turnover tax jeopardise the functioning of the common VAT system. The negation of the effect of Article 13B(a) of the Sixth Directive, which exempts insurance services from VAT, is sufficient to demonstrate that the proper functioning of the common VAT system is being undermined;

– for the introduction of higher-rate IPT, a measure intended to combat VAT avoidance, the Sixth Directive makes provision in Article 27 for an authorisation procedure. Since the United Kingdom Government did not seek or obtain such authorisation, the introduction of higher-rate IPT runs counter to Article 27 of the Sixth Directive.

35. The views of the United Kingdom Government and the Commission coincide, save in certain particular respects:

– IPT, at both the standard and higher rate, cannot be deemed to be a turnover tax in breach of Article 33 of the Sixth Directive;

– IPT does not display certain essential characteristics, as laid down in the Court’s case-law. It is not of general application to transactions concerning goods and services, nor is it charged at every stage of the production and distribution procedure. It applies only to insurance contracts and is charged only once;

– Article 33 of the Sixth Directive expressly confers on the Member States the competence to introduce or apply taxes on insurance contracts provided that they are not in the nature of a turnover tax, as they are not in the present case;

– if IPT is not a turnover tax the imposition thereof is not in breach of the exemption from VAT for insurance services under Article 13B of the Sixth Directive. Therefore, no prior authorisation under Article 27(1) of the Sixth Directive is required. For that provision is applicable solely to the charge to VAT;

– the argument of the applicants in the main proceedings that the first question solely concerns higher-rate IPT is untenable. It cannot be maintained that one rate of a tax is contrary to the Sixth Directive but not another.

Assessment

36. Like the United Kingdom Government and the Commission I choose to answer the second

question first. The reply thereto has consequences for the reply to the first question.

Article 33 of the Sixth Directive: the legal nature of IPT

37. At the outset I would point out that I cannot share the applicants' view that the questions solely concern higher-rate IPT.

38. Although it is in itself correct that the questions in the main proceedings are primarily raised in connection with the higher rate and although the United Kingdom Government and the applicants are agreed that the higher rate was specifically intended to combat tax avoidance in respect of VAT in connection with service contracts in the form of insurance contracts ancillary to the rental and purchase of household appliances, the present case concerns a type of tax with two rates. It follows that in examining IPT against Article 33 of the Sixth Directive that tax must be considered as a whole in regard to all its characteristics. In that connection only two outcomes are possible: either IPT is a disguised VAT measure and therefore in breach of the Sixth Directive or it does not have the characteristics of VAT and is therefore permitted. Both outcomes apply to standard and higher-rate IPT.

39. The question whether IPT must be deemed to be a turnover tax must be answered in light of the purpose of Article 33 of the Sixth Directive.

40. In that connection the Court has on several occasions held that that article seeks to prevent the functioning of the common system of VAT from being compromised by fiscal measures imposed on the movement of goods and services in a manner comparable to VAT. (4) That will be the case where such fiscal measures have the essential characteristics of VAT. (5) Thus, Article 33 expressly permits the Member States to introduce freely determined fiscal measures ? including taxes on insurance contracts which are expressly mentioned in that article ? as long as those taxes do not have the essential characteristics of VAT. (6)

41. The typical characteristics of VAT may be summarised as follows: a tax which is of general application to goods and services and is charged at every stage of the production and distribution process and is strictly proportional to the price of the goods and services concerned and is calculated on the added value subject to deduction of input tax charged at the preceding stages.

42. In the case of IPT it is established that it is proportional to the price of the services concerned and is ultimately borne by the consumer. However, it is not generally applicable to transactions concerning goods and services; it is applicable only to a specific service, namely the supply of insurance services. Arguments adduced as to the applicability of that tax to the whole territory of the United Kingdom or as to the economic significance of the insurance sector do not alter the conclusion that IPT is not a general tax on consumption. On that ground alone it may be stated that IPT is not a turnover tax within the meaning of Article 33 of the Sixth Directive.

43. IPT also lacks certain other characteristics typical of the VAT system. Thus IPT is not charged, as is the case with VAT, at each stage of the production and distribution process and is not charged on the added value. It is charged once only on the insurance premium on conclusion of the insurance contract. Nor, in logic, can there be any right to deduction of input tax.

44. The applicants in the main proceedings have sought to suggest that IPT must nonetheless be deemed to be a turnover tax akin to VAT because, if that tax were applicable to insurance services, it could only be applied at a single stage, namely on conclusion of the insurance contract. That argument fails because it confuses the legal characteristics of VAT, which provides for a tax on the added value at each stage of the production chain, with the characteristics of a specific chain which in the present case has only one link. In my view the Commission is right to point out

that the applicants' viewpoint would entail that all taxes on insurance services which are charged at a single stage only should be deemed to be turnover taxes.

45. Because IPT as a system does not have the characteristics of a turnover tax, this tax on insurance contracts, which as such is expressly permitted by Article 33 of the Sixth Directive, does not generally compromise the application of the VAT system. Therefore, Article 33 does not preclude the application of IPT.

Applicability of Article 27 of the Sixth Directive

46. By its first question the referring court seeks to ascertain whether prior to the introduction of higher-rate IPT the procedure under Article 27 ought to have been followed.

47. Article 27 provides for the possibility that Member States, after approval by the Council, may introduce special measures for derogation from the provisions of the Sixth Directive, in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance. The applicants maintain that higher-rate IPT is such a measure derogating from the Directive, in particular Article 13B thereof, because it has the effect of negating the exemption from VAT under that article for insurance contracts for certain supplies of insurance services, namely those to which higher-rate IPT applies.

48. It follows from the reply to the second question that I do not share this view of the matter. If IPT (or the higher rate thereof) is not a turnover tax, the charge to that tax is not in breach of the VAT exemption for insurance services. In that case it cannot be regarded as a derogating measure.

49. For the sake of completeness I would point out that although insurance services are exempt from VAT they are not immune from other indirect taxes. It is open to the Member States to introduce their own indirect taxes on insurance contracts. As stated in connection with the previous question, that is expressly stated in Article 33 of the Sixth Directive. They are not allowed to do so only in the case of a turnover tax. Since they have competence to tax insurance contracts they are also free to determine a differentiated rate of such tax, so long of course as that does not conflict with the EC Treaty provisions on freedom of movement or would result in the grant of prohibited aid. That is not altered by the fact that the higher rate of IPT is the same as the VAT rate. In other words I see no reason why the United Kingdom should not be able to introduce a differentiation in order to eliminate a distortion occurring on its domestic market.

50. The applicants have further pointed to the judgments in *Belgium I* (7) and *Belgium II*. (8) The facts underlying those cases however differ from the present case. In the former case Belgium based itself for the purposes of the charge to VAT on the list price of new cars in place of the price actually agreed. The Court held that to be contrary to the Sixth Directive. The Belgian legislature subsequently brought its legislation into line but at the same time enacted a supplementary measure with a view to adjusting the scheme of the tax in such a way that nothing would change. Both were implemented by operating a certain method of computation. In the explanatory memorandum to the measure it was stated in so many words that it was a corrective measure as a result of the Court's judgment and that there was a clear connection between the charge to VAT and the levying of the registration tax. The Court went on to hold in the judgment in *Belgium II* that the registration tax and the charge to VAT were closely interconnected. In the present case IPT as a scheme of taxation is entirely separate from VAT. That is not altered by the fact that the higher rate was introduced in order to combat a specific form of VAT avoidance.

V – Questions concerning State aid

Preliminary observations

51. In their written observations both the United Kingdom Government and the Commission submitted that they doubted whether the facts underlying the main proceedings constitute a case of State aid within the meaning of Article 87(1) EC.

52. A closer study of the order for reference and more specifically the arguments inferred by the referring tribunal from the judgment of the Court of Appeal in *R* v *Commissioners of Customs & Excise* ex parte *Lunn Poly Limited and another*, cited at point 8 hereof, persuades me that the doubts surrounding that issue merit further attention.

53. If it should transpire that the relevant facts warrant the conclusion that there is no State aid the questions raised in the present case acquire a certain hypothetical character. In that connection the question again arises as to whether they are on that ground admissible.

54. In what follows I shall first examine *in abstracto* the interrelationship between Articles 96 and 97 EC, on the one hand, and Articles 87 and 88 EC, on the other. All those provisions share the common aim of seeking to eliminate distortions which may occur on the common market. I am prompted to do so by certain views stated by the Commission prior to its observations concerning the fifth question.

55. According to the Commission there are two types of aid:

– The classic type of aid granting a specific benefit or a specific fiscal derogation. The classic remedy provided for in terms of ‘eliminating the exceptional benefit’ is for the Member State concerned to recover the amount of aid granted, together with interest, from the person concerned. An alternative, though not available for budgetary reasons, is to generalise the aid;

– The second type of aid is where an exceptional fiscal burden is imposed on a part of a sector. In that case the aid is eliminated by eliminating the exceptional fiscal burden. In that connection the course of action decided upon could be to pay back to the undertaking concerned the specific charge paid in order in that way to restore competition with undertakings which were not subject to it. That is the solution proposed by the applicants. However, an alternative remedy would be to generalise the specific charge and thus recover the aid from all concerned.

56. The Commission adds that in regard to the second type of aid there are two options. Either the Court can for all cases in principle deny the availability of the last-mentioned solution. This approach is to be found in the *Banks* (9) judgment. It is also possible to leave open the possibility of such a solution, an approach which stems logically from the first part of the *Ferring* (10) judgment.

57. As I explain below the Commission is too ready to assume, in my view, that the cases which it describes as the second type of aid always constitute State aid within the meaning of Article 87 EC. On that view Article 87 EC would acquire a broader material scope than is warranted by the scheme of the Treaty.

Concerning distortions

58. In the negotiations which preceded the coming into existence of the EEC Treaty the economic concept of ‘distortion’ played a much discussed role. An echo of that is to be found in the Spaak report an excerpt from which the Commission appended to its written observations.

59. Substantively, discussion concerning the concept of distortion centred on the potential

effects of the creation of a common market on the national economies and national economic policy.

60. With the disappearance of internal economic borders Member States would also forfeit a part of their machinery with which they were hitherto able to redress imbalances in cross-border economic relations.

61. Such imbalances could occur at various levels as between the different economies. At macro level *global* distortions manifest themselves for example in excessively high labour costs and price levels which are discernible in a deficit on current account in terms of the balance of payments. Where the opposite occurs there is an appreciable current account surplus with an overstrained labour market and the threat of price inflation.

62. In order to redress such global distortions in a common market the Member States must in principle have recourse to their macroeconomic policy instruments and, until the creation of EMU, monetary policy instruments. The Community competences in regard thereto were mainly of a lightly coordinating nature. They were to be found in Articles 103 to 109 of the EEC Treaty. They have now been largely replaced, as regards (financial) economic policy, by Articles 99 and 104 EC and, for uniform monetary policy within EMU, by Articles 105 to 111 EC.

63. The disappearance of the economic internal borders also resulted in the occurrence of imbalances at intermediate or sectoral levels. They are mostly traceable to disparities in (systems of) legislation. Thus, a fiscal system which in country A weighs relatively heavily on the factor of employment and in country B weighs heavily on the capital factor can have a serious effect on competitive conditions within the common market. Such *generic* distortions, which may in principle result from *all* public interventions which affect the market behaviour of undertakings, may in the long run seriously disrupt the allocation processes on the common market (functioning of the common market). With a view thereto Article 100 of the original EEC Treaty provided for the possibility of harmonisation of legislation. It is not only use of the harmonisation instrument that has led within the common market to an unmistakable convergence in socioeconomic, economic and fiscal legislation. That has also stemmed from independent initiatives by national legislatures. That spontaneous convergence has primarily occurred in the sphere of direct taxation where it has been difficult for the Community to activate its competence.

64. Finally, between and within national economies imbalances may also occur in parts of sectors: these are referred to as *specific* distortions. They stem from *specific* interventions by the authorities as a result of the imposition of exceptional charges on certain kinds of production or on certain undertakings or as a result of the grant of exceptional benefits. In regard to exceptional burdens those are frequently interventions by the authorities which are known in modern management terms as burdens imposed with a view to regulating conduct. They occur more and more frequently in environmental and planning policy. In a certain sense they are the mirror image of exceptional benefits or aid which seek to influence the conduct of market participants by means of incentives rather than disincentives.

65. For specific distortions the original EEC Treaty provided for two instruments. In regard to specific distortions as a result of public measures imposing a burden (the term imposing a burden must be more broadly construed than in a purely financial sense since concomitant requirements may also impose burdens), the procedures under Articles 101 and 102 of the EEC Treaty (now Articles 96 and 97 EC) were applicable. For distortions as a result of ‘the grant of aid’, that is to say for distortions attributable to the specific policy instrument of ‘State aid’, Articles 92, 93 and 94 of the EEC Treaty (now Articles 87, 88 and 89 EC) provided for a specific Community competence. That specific competence is characterised by more rigorous provisions, more thorough supervisory machinery and wide implementing and monitoring powers for the

Commission.

66. The major differences between the machinery of Articles 96 and 97 EC, on the one hand, and Articles 87 to 89 EC, on the other, are a reflection of a diametrically opposed application in practice. The former provisions are more or less never applied whilst the latter form the basis of a comprehensive policy practice and more and more abundant and refined decisions by the Court.

67. The latter observation does not however alter the fact that, in terms of the history and structure of the Treaty, Articles 87 to 89 EC are, by virtue of the specific nature of the intervention instrument, namely the grant of State aid, to be viewed as *leges speciales* under the aegis of the general rules laid down in Articles 96 and 97 EC. That calls for great circumspection before a differential burden arising as a result of the imposition of an exceptional burden on a given economic activity in a part of a sector is classified without more as State aid.

Exceptional burden or State aid?

68. Specific distortions as a rule result from a derogation from a general regimerestricted as to subject matter or as to the persons to which the derogation applies. That derogation is in the nature either of an exceptional burden or of a specific concession having a monetary value which is directly or indirectly charged to the State.

69. Normally such exceptional measures seek to influence the behaviour of market participants in a targeted way. It follows that the distortions which they create must not per se be judged negatively.

70. A selective tax on cars without a catalyser creates a distortion in competitive conditions on the relevant market with a view to having a negative effect on the production and sales of such cars. Such a distortion may be justified by environmental policy objectives. Conversely, a specific grant of aid, for example in favour of certain investments in weaker regions, creates a distortion to the detriment of more prosperous regions. That specific distortion is justified by freely and generally accepted objectives of regional economic policy.

71. It is clear from the wording of Articles 87 and 96 EC that specific distortions in the common market are not per se impermissible. Article 96 EC by implication confers a margin of discretion on the Commission in its determination as to whether to act against a specific distortion. That is to be inferred from inclusion of the wording: ‘and that the resultant distortion needs to be eliminated’. Article 87(2) and (3) EC respectively provide for mandatory and discretionary exceptions to the general prohibition under Article 87(1).

72. The major difference in legal consequences attaching under the EC Treaty to distortions stemming, respectively, from exceptional burdens or from the grant of aid calls for a careful demarcation between the two types.

73. A connecting factor must always be sought in the specific source of the distortion: is it a burden or the grant of aid? The notion that a distortion created by an exceptional burden may be viewed as the grant of aid in favour of the economic operators who continue to come within the general rule is in principle incorrect on both legal and economic grounds and on policy grounds.

74. It is incorrect on legal grounds because the mere introduction under a general provision not constituting the grant of aid of a higher rate restricted *ratione materiae* or *personae* would have the effect of turning that provision into the grant of aid in favour of the market participants to whom the general rule has continued to apply. Firstly, that would be to extend the substantive scope of the prohibition on State aid far beyond the limits contemplated by the framers of the Treaty; secondly,

it would be to impinge on the scope of Articles 96 and 97 EC.

75. From an economic point of view as well the reclassification as the grant of aid of a national measure which by its nature and purpose is general may have undesirable consequences. That could mean that the level of burden for market participants coming under the general provision would have to be brought up *ex tunc* to the level of burden on market participants affected by the specific measure. Such a general change in levels of burden for a large group of market participants or wide categories of market sectors may be undesirable from an economic point of view. Moreover, an adjustment of that nature in respect of a general measure incorrectly classified as State aid would almost inevitably give rise to new general distortions on the common market. Thus, one mischief would replace another.

76. From a policy point of view such a change of label may have the consequence of limiting the Member States’ opportunities to apply selective taxes as a policy instrument even if such application were entirely justified and could never give rise to the application of Articles 96 and 97 EC. To revert to the example given in point 70, I consider that if the selective tax therein mentioned on environmentally unfriendly cars were to constitute the grant of aid in favour of the production and sale of environmentally friendlier cars with the consequence that the lower tax imposed on the latter cars would have to be brought up to the level of the imposition on environmentally unfriendly cars, the Member State concerned would be deprived of a policy instrument essential to it for the attainment of a generally accepted policy objective. The consequences of that perverse result are all the more serious since classification of the lower general rate in the example given as the grant of aid would remove from the Member State concerned competences conferred on it by the Treaty.

77. That line of argument leads to the conclusion that a specific distortion created by an exceptional burden can never be regarded as the grant of aid in favour of the market participants coming under the general measure. In this connection two further consequences must be considered: if the relevant distortion must be eliminated in the interest of the common market the Community will have to eliminate the source of that distortion, namely the exceptional burden; in that connection it must make use of its competences under Articles 96 and 97 EC and not those under Articles 87 and 88 EC.

Facts of the main proceedings

78. The application of the above reasoning to the facts of the main proceedings, as stated in points 24 to 32 hereof, produces the results set out below.

79. The introduction of IPT in 1994 at a generally applicable rate of 2.5%, subsequently increased to 4% and then to 5%, must be deemed to be a general (tax) measure applicable in principle to all insurance contracts.

80. The supply of other goods and services attracts VAT at the rate of 17.5%. The difference in the basis of assessment as between IPT and VAT made it attractive to disguise the supply of certain services as services under an insurance contract.

81. On the market for household appliances the consequence of that was that service contracts ancillary to rental and purchase agreements were disguised as insurance contracts entered into with insurance companies linked with suppliers of those appliances.

82. The consequences of that were twofold: in the first place normal service contracts were all but supplanted with the further consequence that the United Kingdom Treasury lost the VAT attributable thereto. Secondly, in this sector of the insurance market direct insurance – where the

consumer takes out insurance directly with the insurer – was for the most part superseded by connected agreements whereby the supplier of the household appliance acts as intermediary.

83. Those altered competitive conditions were directly attributable to the disparity between the amount of the IPT rate and the rate of VAT. Suppliers were able to take advantage of that disparity where they supplied services ancillary to the main contract by presenting them as insurance contracts.

84. Higher-rate IPT is to be regarded as a specific tax restricted *ratione materiae* to certain types of insurance contract. From its purpose and effect, it is to be classified as a regulatory charge specifically disincentivising the conclusion of those contracts. It thus had the intended effect on market conditions: the classic service contracts liable to VAT returned and on the smaller market for ancillary insurance contracts the proportion of direct insurances rose again.

85. As is apparent from the proposed reply to the first two questions, this intervention was not contrary to the Sixth Directive. So long as no counter measures were adopted by the Council on a proposal by the Commission, they must be regarded as lawful. The Commission's acquiescence indicates that the possible distortion in trade between the Member States stemming from this specific tax measure was not considered serious enough to warrant action against it.

86. It follows from the foregoing that that specific tax measure can in no way constitute the grant of aid possibly requiring the United Kingdom Government to repeal *ex tunc* this specific tax measure which was lawfully adopted and is justified as to its purpose.

87. It further follows from the foregoing that the possible remedy under Articles 96 and 97 EC must be directed to the cause of the specific distortion, that is to say to the specific tax measure itself and not the generally applicable rate of IPT in regard to which the higher rate constitutes a specific exception.

88. That leads me to the conclusion that, in the context of the facts underlying the main proceedings, Articles 87 and 88 EC are not applicable. Thus, Questions 3, 4 and 5 raised by the VAT and Duties Tribunal are based on a manifestly incorrect view of Community law.

89. In light of that view Questions 3, 4 and 5 do not require to be answered.

VI – Conclusion

90. In light of the foregoing I propose that the Court should reply as follows to the questions submitted by the VAT and Duties Tribunal:

– Question 2: Article 33 of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, does not preclude the introduction of a tax on insurance premiums which is calculated by reference to the services supplied; which is proportional to the price of the services supplied; which is charged at the final stage of sale to the consumer; which is passed on to the final consumer in a manner characteristic of value added tax so that the burden of tax rests on the final consumer; which applies to the whole territory of the United Kingdom; but which does not apply generally to all transactions relating to goods and services.

– Question 1: For the introduction of a higher rate of such a tax on insurance premiums, which is compatible with Article 33 of the Sixth Directive, prior authorisation of the Council under Article 27 of the Sixth Directive is not required.

– Questions 3, 4 and 5: There is no need to reply to these questions since a specific tax measure under which a higher rate of tax restricted *ratione materiae* is introduced cannot be presumed to constitute the grant of aid measure within the meaning of Articles 87 and 88 EC.

1 – Original language: Dutch.

2 – OJ 1977 L 145, p. 1

3 – It appears from the order for reference that in 1968 67.5% of television sets in the United Kingdom were rented whilst in 1998 the figure was only 8.1%. As for video recorders 69.6% were rented in 1979 which had fallen to a mere 4.4% by 1998.

4– Case 295/84 *Rousseau Wilmot* [1985] ECR 3759.

5 – Case C-200/90 *Dansk Denkavit and Poulsen Trading* [1992] ECR I-2217.

6 – Case C-130/96 *Solisnor-Estaleiros Navais* [1997] ECR I-5053. See also Case C-437/97 *EKW and Wein & Co* [2000] ECR I-1157.

7 – Case 324/82 *Commission* v *Belgium* [1984] ECR 1861.

8 – Case 391/85 *Commission* v *Belgium* [1988] ECR 579.

9 – Case C-390/98 *Banks* [2001] ECR I-6117.

10 – Case C-53/00 *Ferring* [2001] ECR I-9067.