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EC INTERNAL MARKET REPORT

JANUARY - MARCH 2003

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PRINCIPAL DEVELOPMENTS:

- Community patent system to be introduced.
- Court of Justice to revisit compatibility of motor vehicle duties with Community law.
- Revised Tobacco Advertising Directive adopted.

I. FREE MOVEMENT OF GOODS

Advocate General Jacobs advises Court on legality of Danish registration duties on new motor vehicles.

In an opinion rendered on February 27, Advocate General Jacobs concluded that the Danish duty on first registration of new motor vehicles was not contrary to Community law, in particular the prohibition in Article 28 of the EC Treaty against quantitative restrictions on imports and measures having an equivalent effect.[1]

In Denmark, new motor vehicles are subject to a first registration duty based on the purchase price. This duty is levied at a particularly high rate: 105% on a portion of the purchase price which is fixed annually by law, and 180% on the remainder of the purchase price. Moreover, the price taken as the tax base already includes 25% value added tax and a flat-rate mark-up of 9% to take account of dealer margin, irrespective of the actual margin charged by the dealer. While most Member States impose a registration duty on new motor cars, the Danish charge is by far the highest, often exceeding 200% of the purchase price. The duty is levied upon the first registration of motor vehicles in Denmark, but not upon any subsequent resale of cars registered in Denmark. When a used vehicle is imported into

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1 Case C-383/01 *De Danske Bilimportører v. Skatteministeriet*, opinion of February 27, 2003, not yet published.

Denmark, however, it is subject to the registration duty.

A Danish court referred to the Court of Justice the question whether a registration duty of the kind outlined above should be regarded as a measure having an effect equivalent to a quantitative restriction on imports, and thus prohibited under Article 28 EC.

Advocate General Jacobs first set out a framework for analyzing provisions which might act as obstacles to the free movement of goods. The Advocate General differentiated between the three different relevant provisions in the EC Treaty: (i) Article 25 (relating to custom duties or charges); (ii) Article 28 (relating to quantitative restrictions); and (iii) Article 90 (relating to discriminatory taxation).

In the Advocate General's opinion, because different consequences flow from the application of each of these articles, only one of them can apply at any one time to a given measure. Moreover, given the broad scope of Article 28, it should first be considered whether a measure is covered by Article 25 or Article 90 and, only if it is not, whether Article 28 applies.

As the duty in question was levied not as a result of crossing the Danish border, but upon the first registration of the motor vehicle for use on the road in Denmark, the duty had to be assessed under Article 90, rather than Article 25. However, because there was no domestic production of motor cars in Denmark, there was no similar or competing domestic production against which any possible discriminatory or protective effect could be alleged. The duty was therefore not contrary to Article 90.

As regards Article 28, the Advocate General doubted whether provisions consistent with Article 90 could be found inconsistent with Article 28. Even in the exceptional circumstances of a manifestly excessive tax, as was the case with the Danish duty, there are two reasons why high taxes should not be assessed under Article 28 and regarded, in themselves, as hindering the free movement of goods.

First, there is a need for legal certainty. The Court has consistently held that Articles 25, 28, and 90 EC have mutually exclusive purposes. Since the three articles concern different types of measures and apply different criteria, it is important that national authorities and affected individuals know which criteria each specific measure must meet. Member States must be able to determine the areas in which their fiscal sovereignty may freely be exercised and be aware of the limits beyond which that sovereignty is constrained. It does not seem reasonable, according to the Advocate General, that a fiscal measure adopted by a Member State should be assessed on the basis of alternative standards. Thus, to ignore the distinctions between the three Treaty articles would introduce uncertainty in an area where clarity is required.

Second, the Court's jurisprudence in relation to Article 28 is inappropriate for the assessment of taxation as an obstacle to the free movement of goods. If taxes were so high as to impede the free movement of certain goods, it must be the case that lower taxes would not have such an effect. This would require the identification of some threshold of applicability below which taxes would be permitted; yet the Court has consistently held that there is no *de minimis* exception to Article 28, and in any event, any practically applicable threshold would necessarily be somewhat arbitrary. The Court has also consistently held that provisions contrary to Article 28 cannot be justified (under Article 30) on economic grounds. Yet, because the primary purpose of taxation is economic, subjecting taxes to an analysis under Article 28 would prevent Member States from justifying the tax on the basis of the very reason for which it was levied, namely, the financing of public expenditure through taxation.

For these reasons, the Advocate General admitted that there appears to be certain gaps in the EC Treaty. It seems incompatible with the aims of the internal market for a Member State to be able to tax certain imported goods to such an extent that the flow of intra-Community trade is appreciably affected. However, as he points out, any solution must ultimately be legislative in nature, not least because of the implications for fiscal policy in the Member States. Given the political sensitivities surrounding harmonized taxation, it would indeed be surprising if the Court of Justice opted for a radical approach that effectively imposed harmonization by the back-door.

New directive on tobacco advertising and sponsorship adopted.

On March 27, the Council adopted a directive on the advertising and sponsorship of tobacco products.[2]

The directive is not entirely new in substance, since it largely replaces Directive 98/43/EC, which was annulled by the Court of Justice in its judgment of

2 OJ 2003 L 152/16.

October 5, 2000.[3] The Court's principal criticism was that the earlier directive was incorrectly adopted using Article 95 EC as a legal basis. The Court reasoned that Article 95 EC — which empowers the Community legislature to adopt harmonization measures which have as their object the establishment and functioning of the internal market — did not constitute an appropriate legal basis for the near-total prohibition of tobacco advertising and sponsorship imposed by Directive 98/43 largely for health and other social reasons. However, the Court clearly suggested that Article 95 EC could be used as the appropriate legal basis for a directive imposing a more limited ban on tobacco advertising and sponsorship.

The new directive regulates (i) the advertising of tobacco products in media other than television, *i.e.*, in the press and other printed publications, in radio broadcasting and in information society services, namely the Internet; and (ii) the sponsorship by tobacco companies of radio programs and of events or activities involving several Member States or otherwise having cross-border effects. Television advertising of tobacco products and sponsorship of television programs by undertakings whose principal activity is the manufacture or sale of tobacco products are already prohibited by the Television Without Frontiers Directive.[4]

The directive prohibits tobacco advertising in the press and other printed publications other than in publications intended exclusively for professionals in the tobacco trade or in publications printed and published in third countries which are not principally intended for the Community market. This provision also applies to information society services, *i.e.*, the Internet. Likewise, the directive bans all forms of radio advertising for tobacco products, as well as sponsorships of radio programs by tobacco companies. Finally, the directive prohibits tobacco companies from sponsoring events or activities involving or taking place in several Member States or otherwise having cross-border effects. This prohibition includes any free distribution of tobacco products in the context of the sponsorship of the above-mentioned events having the purpose or the effect of promoting such products.

Member States are required to lay down rules on penalties for the infringements of the national provisions adopted pursuant to the directive. The penalties must be effective, proportionate and dissuasive. Member States must transpose the directive into their legal systems by July 31, 2005, at the latest.

II. ENERGY

Council adopts new directive on energy performance of buildings.

On January 4, Council Directive 2002/91 on the energy performance of buildings came into force.[5] The directive requires Member States to adopt a number of regulations with respect to the energy-efficient construction and maintenance of old and new buildings.

In particular, the directive requires Member States to subject new buildings to minimum energy efficiency requirements, tailored to the local climate, and identifies major renovations of old buildings as an opportunity to enhance energy efficiency. The Directive requires Member States to determine a transparent methodology for the calculation of the energy performance of buildings, taking into account indoor climate conditions, local conditions, and the designated function and age of the building.

Member States are also required to introduce a certification process administered by "independent experts," to generate awareness of the need for compliance with energy-efficient standards. More particularly, Member States must lay down measures to ensure that inefficient boilers and high-powered air conditioning systems are inspected regularly.

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3 Directive 98/43/EC of 6 July 1998 on the approximation of the laws, regulations and administrative provisions of the Member States relating to the advertising and sponsorship of tobacco products, OJ 1998 L 213/9, annulled by Case C-376/98, *Germany v. Parliament and Council*, 2000 ECR I-8419.

4 Council Directive 89/552/EEC of 3 October 1989 on the coordination of certain provisions laid down by Law, Regulation or Administrative Action in Member States concerning the pursuit of television broadcasting activities, OJ 1989 L 298/23, as amended by Directive 97/36/EC of 30 June 1997, OJ 1997 L 202/60.

5 Directive 2002/91/EC of 16 December 2002 on the energy performance of buildings, OJ 2003 L 1/65.

The directive complements Council Directive 93/76 — which set limits on carbon dioxide emissions by improving energy efficiency — by laying down more concrete standards, and ensuring their wider application. The Commission expressed the hope that this new legislation might help lay the foundation for the development of more stringent, uniform environmental standards across Europe.

Member States must transpose the directive into national law no later than January 4, 2006.

III. Company Law

Proposal to bring EU Accounting Directives in line with international accounting standards adopted.

On January 14, the European Parliament approved the European Commission's proposal for a directive amending the European Union's Accounting Directives. If finally adopted, the amendments would bring existing EU rules into line with current best practice and complement the International Accounting Standards ("IAS") Regulation.[6]

Adopted in June 2002, the IAS Regulation requires all EU companies listed on a regulated market to use IAS for their consolidated accounts from 2005 onwards; Member States may also extend this requirement to unlisted companies and to annual accounts. For those Member States that do not extend IAS to unlisted companies and annual accounts, the proposed amendments would allow them to nonetheless move towards similar, high quality financial reporting. The amendments would allow appropriate accounting for special purpose vehicles, improve the disclosure of risks and uncertainties, and increase the consistency of audit reports across the EU. The Commission supported the Parliament's amendments and the Council of Ministers is expected to adopt the Regulation shortly in a single reading.

The proposed amendments would bring EU accounting requirements into line with modern accounting theory and practice. Notably, it would make it more difficult for a company to 'hide' liabilities by setting up artificial structures (so-called 'special purpose vehicles') which, considering only the shareholdings, appear to be largely unrelated. The Commission sees this as an important step in the proper treatment of off-balance-sheet financing.

Given the link in some Member States between annual accounts and taxation, it is important that each Member State move toward IAS at a pace appropriate to that individual country. Accordingly, most changes are implemented as Member State options, thereby allowing gradual alignment of national accounting requirements with IAS.

The proposed amendments also make clear that, in order to encourage disclosure of relevant key social and environmental aspects, the annual report's analysis of risks and uncertainties facing the company should not be restricted to financial aspects of the business.

By outlining the necessary content of statutory audit reports — which are a valuable assurance that accounts are reliable — the proposed amendments move towards harmonisation consistent with the standards of International Standards on Auditing issued by the International Auditing and Assurance Standards Board.

IV. Insurance

New insurance block exemption adopted.

On February 27, the Commission published a new block exemption regulation which exempts various types of cooperation between insurance companies from the prohibitions contained in Article 81 EC, subject to conditions.[7] This regulation replaces a previous block exemption in this sector[8] which expired at the end of March, and will remain in force until March 31, 2010.

Insurance companies often enter into pools in order to insure risks such as nuclear accidents, aviation, environmental, and other disasters that individual companies would be unwilling to cover alone. The new regulation exempts certain agreements between such companies in situations where coopera-

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6 Regulation 1606/2002 of 19 July 2002 on the application of international accounting standards, OJ 2002 L 243/1.

7 Commission Regulation 358/03 of 27 February 2003 on the application of Article 81(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector, OJ 2003 L 53/8.

8 Commission Regulation 3932/92 of 21 December 1992 on the application of Article 85(3) of the Treaty to certain categories of agreements, decisions and concerted practices in the insurance sector, as amended, OJ 1992 L 398/7.

tion does not prejudice the consumer interest – specifically, policy terms, cover, and premiums.

The Commission has also raised the threshold level of market shares below which the exemption applies. Co-insurance pools which, in aggregate, have a market share of 20%, and reinsurance pools that have an aggregate market share of 25%, are able to take advantage of the block exemption. Such a larger resource pooling by insurance companies reduces systemic risk and increases the robustness of the market. Further, an insurance pool that covers a 'new risk' may be exempted for three years regardless of the market share of the participating parties, allowing the expansion of the insurance sector into new product areas.

Assuming the conditions set out in the block exemption are met, the exemption applies to agreements concerning: (i) the joint study and calculation of risk; (ii) the creation of standard, non-binding, policy conditions; (iii) testing of security equipment; and (iv) the establishment and management of insurance pools.

V. FOOD

Court rules on the essence of "chocolate".

On January 16, the Court of Justice held that Italy and Spain failed to fulfill their obligations under Article 28 EC by prohibiting the marketing under the name "chocolate" of products containing vegetable fats other than cocoa butter, and by requiring that those products be marketed under the name "chocolate substitute."[9] The effect of the Spanish and Italian prohibition was that chocolate manufactured in six other Member States could not be lawfully marketed as "chocolate" in Spain and Italy.

The Spanish and Italian governments contended that the prohibition conformed with Community law, since it was based on the applicable Community directive setting down the minimum cocoa content and the use of vegetable fats other than cocoa butter.[10] Spain and Italy submitted that the directive dealing with chocolate content definitely regulated which products could be sold under the name "chocolate," and that products containing vegetable fat substitutes not specified in the directive were not among those permitted. The Spanish and Italian governments maintained that their legislation was based on the need for consumer protection.

The Commission, for its part, argued that the directive had not harmonized national laws on the manufacture and marketing of chocolate products. Instead, the applicable legislation created a two-tier system for chocolate products: (i) one market for Member States admitting only "100% cocoa butter" chocolate products; and (ii) another comprising Member States that allow some vegetable fat content in chocolate, in addition to a minimum cocoa content. Accordingly, the Commission took the view that the obligation to market chocolate products in Spain and Italy as "chocolate substitutes" gave rise to a restriction on the free movement of goods.

The Court found that the Spanish and Italian rules were restrictive of the free movement of goods. The Court first held that the applicable directive expressly allowed Member States to maintain national rules authorizing or prohibiting the addition of vegetable fats to products manufactured within their territory. However, it pointed out that Member States could not impose conditions on products manufactured in other Member States that were contrary to the principle of the free movement of goods. Moreover, the requirement to alter the sales name of the products in question to "chocolate substitutes" could compel traders to incur additional packaging costs and, in any event, could adversely affect how customers perceived those products. Hence, with regard to Article 28, the Court held that Spain and Italy had restricted the free movement of goods and that the restrictions imposed were not merely a selling arrangement that would escape the prohibition contained in Article 28 EC, following the *Keck and Mithouard* line of case law.

In regard to justification, the Court held that the characteristic element of all products bearing the name "chocolate"' is the presence of a certain minimum cocoa and cocoa butter content, and that the addition of small quantities of vegetable fats does not substantially alter the nature of those products. Accordingly, appropriate labeling which notes the presence of vegetable fats would be sufficient to ensure that consumers are informed, and thus protected. In those circumstances, the Court held that the Spanish and Italian rules were disproportionate.

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9 Case C-12/00 *Commission v. Spain*, 2003 ECR I-459 and Case C-14/00 *Commission v. Italy*, 2003 ECR I-513.

10 Council Directive 73/241 of 24 July 1973 on the approximation of the laws of the Member States relating to cocoa and chocolate products intended for human consumption, OJ 1973 L 228/23.

The issues raised by the judgments are now to some extent moot, as Council Directive 2000/36 — which entered into force in June — contains provisions that authorize the addition of vegetable fats other than cocoa butter up to a maximum of 5%.[11]

VI. INTELLECTUAL PROPERTY

Breakthrough reached on Community patent system.

On March 3, the Council reached agreement on a "common political approach" for the Community patent,[12] marking a breakthrough in the process started by the Commission's proposal for a Community patent in 2000.[13] The agreed approach covers the main principles and features of the jurisdictional system for the Community patent, the language regime, the role of national patent offices, costs and the distribution of fees.

The object of the creation of the Community patent is to give inventors the option of obtaining a single patent legally valid throughout the EU, thus reducing costs and providing a clear legal framework in the event of dispute. At present, patents are awarded either on a national basis or through the European Patent Office (EPO) in Munich, which grants so-called "European" patents (essentially bundles of national patents). The advantage of the EPO route is that it entails a single application and grant procedure, which means that applicants do not have to file with a series of national patent offices. However, the procedure can be costly, as Member States may require the European patent to be translated into their official languages. As a result, the average cost of the current European patent is around € 50,000 – which is approximately three to five times the comparable costs of patent registration in the United States and Japan.

Further, as national courts have jurisdiction to rule on disputes regarding the European patent, there can in principle be multiple legal proceedings, with different procedural rules in each Member State and a risk of divergent outcomes. For these reasons, the current system is perceived as a barrier to research, development, and innovation.

The proposed Community patent is to retain the feature of a single application and grant procedure within the EU. However, it would have two main advantages over the present system. First, translation costs would be reduced by more than 50% in comparison to the current European patent. The patent would be filed in one of the working language of the EPO (English, French, and German), and claims (*i.e.*, the part of the patent which defines the scope of protection) would be translated into the other two working languages. Upon grant, the claims would be translated into all official EU languages. Second, disputes regarding the new Community patent would be dealt with at first instance by a single judicial panel, the Community Patent Court (CPC) (to be established by Council decision) with appeal to the Court of First Instance. Applications under the proposed system will be made to the EPO or to national patent offices.

The first Community patents are expected to be issued by 2008. However, the EPO will be required to convene a diplomatic conference to revise the Munich Convention of 1973 in order to allow the EPO to issue Community patents. Such a revision would have to be ratified by EPO member countries.

Registration of Community designs available since April 1, 2003.

From April 1, the Office for Harmonization in the Internal Market (OHIM) has been registering Community designs under the EU's new system for the protection of designs, established in 2001.

Designs registered by the OHIM enjoy EU-wide protection for a five-year period, renewable up to a maximum of 25 years, while unregistered designs benefit from protection for up to three years.

The procedure is intended to be simple and inexpensive, with no detailed examination prior to registration. The OHIM reserves the right to annul registrations in the event of successful proceedings for invalidity, although national courts are empowered to deny protection to a registered design in the event of a successful counterclaim for a declaration of invalidity in proceedings for infringement of the design right. Companies will still be able to choose to register designs under national law under the harmonized national design right system of the De-

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11 Directive 2000/36 of 23 June 2000 relating to cocoa and chocolate products intended for human consumption, OJ 2000 L 197/19.

12 See Commission Press Release MEMO/03/47 of March 4, 2003.

13 See Commission Press Release IP/00/714 of July 7, 2000.

sign Protection Directive,[14] which continues to exist in parallel with Community design protection.

VII. TAXATION

Court provides guidance on the determination of the "taxable amount" under the Sixth VAT Directive.

On January 16, the Court of Justice ruled on the meaning of the "taxable amount" for purposes of VAT in circumstances where a retailer accepts price reduction coupons offered by various suppliers to consumers.[15]

For a number of years, Yorkshire Co-operative Ltd., a co-operative society active as a retailer of goods, had accepted price-reduction coupons issued by various manufacturers. Each coupon enabled the customer to obtain a price reduction on the goods' retail price, and included the right for retailers to receive as a reimbursement from the manufacturers a sum equal to the nominal value of the coupons accepted.

For VAT purposes, Yorkshire declared the whole of the normal retail price of the products sold. In the belief that only the amounts paid in cash by customers constituted the taxable amount for VAT purposes, Yorkshire sought repayment from the Commissioners of Customs & Excise of part of the VAT, which it had allegedly paid in excess. The Commissioners rejected Yorkshire's request, and the matter came to the Court of Justice in a preliminary ruling.

The Court was asked whether the proper definition of the "taxable amount" under Articles 11 (A)(1)(a) and 11(C)(1) of the Sixth VAT Directive would include the nominal value of the coupon, or whether the taxable amount would be constituted solely by the part of price paid in cash by the consumers.

The Court first pointed out that, under applicable case law,[16] the fact that a portion of the consideration was not paid by the final consumer, but was made available on his behalf by a third party (*i.e.*, manufacturer coupons), is irrelevant for the purposes of determining the taxable amount in the hands of the retailer. The Court emphasized that the coupons merely substantiate the retailer's right to receive a reimbursement from the manufacturer in the amount of the reduction granted to the final consumer, and the sum represented by the nominal value of those coupons constitutes for the retailer an asset item realized on their reimbursement. It follows, according to the Court, that the coupons are to be considered a means of payment.

The Court thus held that, for the proper understanding of Article 11(A)(1)(a) and 11(C)(1) of the Sixth VAT Directive, the "taxable amount" comprises the full retail price, which includes the nominal value of price-reduction coupons issued and reimbursed by the manufacturers.

Court rules on the concept of "supply of goods" within the meaning of the Sixth VAT Directive.

On February 6, the Court of Justice held that the concept of "supply of goods" within the meaning of Article 5(1) of the Sixth VAT Directive must be interpreted as including any transfer of tangible property by one party that empowers the other party to dispose of it as the owner.[17]

The case resulted from a refusal by the *Bundesamt für Finanzen* (Federal Tax Office) to refund Auto Lease Holland BV, a leasing company, the VAT on the fuel supplied in its name and at its expense by German oil undertakings to the lessees of vehicles that were the subject-matter of the leasing contracts with Auto Lease.

Insofar as the German oil companies supplied the fuel and Auto Lease advanced the costs, Auto Lease submitted that it had a right to a refund of the VAT on the basis of Article 17(3) of the Sixth Directive. However, the Federal Tax Office considered that the lessees concerned, and not Auto Lease, incurred the costs relating to the VAT paid on fuel inputs.

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14 Directive 98/71 of 13 October 1998 on the legal protection of designs, OJ 1998 L 50/7.

15 Case C-398/99 *Yorkshire Co-operatives Ltd. v. Commissioners of Customs & Excise*, 2003 ECR I-427.

16 See Case C-427/98 *Commission v. Germany* 2002 ECR I-8315.

17 Case C-185/01 *Auto Lease Holland BV v. Bundes-amt für Finanzen*, judgment of February 6, 2003, not yet published.

The matter came before the Court of Justice in a preliminary ruling. The Court was asked whether the concept of "supply of goods" within the meaning of Article 5(1) of the Sixth VAT Directive would include the supply of fuel from the lessor to the lessees, or rather refer to a direct supply from the oil companies to the lessees in Germany.

The Court noted that a proper interpretation of "supply of goods" implied a transfer of ownership, which first required a determination as to whom — whether the lessor or the lessee — the oil companies transferred that right to dispose of the fuel as an owner.

The Court affirmed that the lessee was empowered to dispose of the fuel as if he were the owner of that property, since he obtained fuel directly at filling stations and had a free choice as to its quality and quantity, as well as its end use. In addition, the Court recognized that the supplies were made at Auto Lease's expense only in principle, since, at the end of the year, the lessee would have to pay a supplementary charge for the actual consumption, and thus would wholly bear the actual cost of the fuel. It followed, said the Court, that the fuel supplies were directly provided by the German oil companies to the lessees. Consequently, there was no "supply of goods" by Auto Lease within the meaning of the Sixth VAT Directive.

If you are interested in more detailed information concerning any items in this report, please contact any of the following individuals at the Brussels office: Maurits Dolmans, Wolfgang Knapp, Nicholas Levy, Robbert Snelders, Romano Subiotto, Dirk Vandermeersch, Antoine Winckler, or John Temple Lang.

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