European Commission invites comments on notice regarding state aid definition with specific examples

Background

On 17 January 2014 the European Commission (the Commission) requested comments on a draft notice (the Notice) aimed at providing practical guidance in relation to state aid.¹

The notion of state aid is an objective legal concept defined by the Treaty on the Functioning of the European Union (TFEU), which can only be interpreted in a legally binding manner through the Court of Justice of the European Union (CJEU). The Commission’s role is thus limited to clarifying how it understands and applies the TFEU provisions in line with the case law of the EU courts. Nevertheless, the Notice is important in that it provides taxpayers and Member States with information on how the state aid rules are applied by the Commission.

Granting illegal state aid is precluded in the TFEU. It is considered incompatible with the European Union’s common market because it distorts competition. EU Member States are obliged to notify the Commission of measures that could potentially be considered State aid, and await for the Commission’s approval before putting the measures in place. This also covers tax measures.

The Commission is in charge of ensuring that Member States do not implement illegal state aid. It may open a state aid investigation if it finds out that a measure that could be considered state aid has been adopted without the Commission’s prior approval and may therefore be unlawful aid. If a company has benefitted from a tax regime that is found to be unlawful state aid, it may have to re-pay the tax saved as a result of the tax benefit, plus interest.
State aid investigations into tax cases have become more frequent over the past years and concern a number of different tax measures, including the Spanish financial goodwill amortization, the tax benefits available to Italian cooperatives, tax incentives granted to undertakings for collective investments (UCIs) or the Luxembourg 1929 holding companies (which were abolished as a result of the Commission’s decision). The Commission has also refused tax measures proposed by Member States on the grounds of state aid, such as the Dutch “interest box.” Also, the Commission sometimes requests information regarding tax rulings from Member States. The last known request was made in September 2013 to a number of countries including Ireland, Luxembourg and the Netherlands.

State aid has therefore become an important element of European tax. It needs to be considered not only by Member States but also by taxpayers, since, in the view of the CJEU, it is part of the duties of any diligent (tax) business person to be aware of the circumstances in which a tax benefit may be considered fiscal State aid.

It is not an easy task to assess the level of risk as to whether new or existing tax measures introduced by EU Member States will be considered fiscal State aid. The Commission Notice is very helpful in this respect. The Commission itself considers the notice to be “a guide through the vast body of EU case-law and decisional practice in the field of state aid law.” However, there are also aspects on which there is no or only limited practice, in which case the Commission “has limited its guidance to what can be inferred from its interpretation of existing case law.”

This Alert analyzes the concepts of the Notice as far as direct tax measures are concerned.

Commission understanding of elements of fiscal state aid

The draft Notice summarizes the Commission’s understanding of the various elements that need to be present in order for a measure to constitute state aid, i.e.:

- The presence of an economic activity (notion of “undertaking”);
- The imputability of the measure to the State;
- Financing through State resources;
- The presence of an economic advantage for the beneficiary;
- Selectivity; and
- Effect on trade and competition.

The Notice contains a specific subchapter dealing with “fiscal state aid,” specifically dealing with cooperatives, undertakings for collective investment (UCIs), tax amnesties, tax settlements and administrative tax rulings, depreciation/amortization rules, flat rate tax regimes for specific activities, anti-abuse rules and excise duties.

Cooperatives

Cooperatives are often subject to different, and sometimes more beneficial tax rules than commercial companies. If they cannot be considered to be in a similar factual and legal situation as commercial companies, this would not be a violation of the EU state aid rules. According to the Notice, cooperatives are regarded as not being in a comparable situation if:

- The cooperative acts in the economic interest of its members;
- Its relations with members are not purely commercial, but personal and individual;
- The members are actively involved in the running of the business; and
- The members are entitled to equitable distribution of the results of economic performance.

If, however, the cooperative society under examination is found to be comparable to commercial companies, a second stage of analysis is needed to establish whether the tax regime in question is justified by the logic of the tax system. According to the Notice, “no valid justification can be found for a national measure that allows for profits from trade with third parties who are not members of the cooperative to be exempt from tax or sums paid to such parties by way of remuneration to be deducted. In any event, the reduced taxation must be consistent with the principle of proportionality and not go beyond what is necessary. Moreover, appropriate control and monitoring procedures must be applied by the Member State concerned.”
Undertakings for collective investments (UCIs)

UCIs often benefit from tax exemptions that are aimed at ensuring tax neutrality for investments through such investment funds. Such exemptions or other benefits would not be state aid as long as these measures do not favor certain collective investment undertakings or certain types of investments, but rather reduce or eliminate economic double taxation in accordance with the overall principles inherent to the tax system in question. The Commission defines “tax neutrality” as meaning “that taxpayers are treated the same whether they invest directly in assets, such as government securities and the shares of joint-stock companies, or indirectly in such assets through investment funds.” By contrast, preferential tax treatment limited to well-defined investment vehicles which fulfil specific conditions to the detriment of other investment vehicles that are in a comparable legal and factual situation should be viewed as selective.

Tax settlements

There is no general presumption that tax settlements are state aid. However, a tax settlement may constitute state aid where it appears that the amount of tax has been considerably reduced without clear justification and where the administration appears to have a more favorable discretionary tax treatment compared to other taxpayers in a similar factual and legal situation or where the tax settlement is contrary to applicable tax provisions.

Tax rulings

The Commission frequently requests information from Member States on a variety of issues, including tax matters such as tax rulings. The latest publicly known request of information on tax rulings was made on 11 September 2013 and concerned a number of countries including Ireland, Luxembourg and the Netherlands. Such an information request is an informal preliminary step in seeking to determine whether companies might have benefited from unlawful state aid through favorable tax rulings in a particular territory. Not only the Commission but also the Ecofin (Economic and Financial Affairs Council) and Code of Conduct group (Business Taxation) have on various occasions looked into certain Member States’ ruling systems. In the context of these previous reviews the Commission accepted that general ruling practices are consistent with OECD principles and that rulings may merely contain an interpretation of a jurisdiction’s general tax rules which provide legal certainty to taxpayers. The Commission also accepted on previous occasions that rulings may merely provide confirmation that all conditions required by law are satisfied without deviating from the law. This position is repeated in the Notice. The Notice clearly states that administrative rulings are not per se state aid. According to the Commission, “administrative rulings that merely contain an interpretation of the relevant tax provisions without deviating from the case law and administrative practice do not give rise to a presumption of aid.”

If any formal State Aid investigations were to be launched on the back of informal inquiries into specific rulings, the Commission would need to prove that these rulings were selective as defined by CJEU case law and summarized in the Notice. According to the Notice, advance administrative rulings involve selectivity in particular where:

- The tax authorities have discretion in granting administrative rulings;
- The rulings are not available to undertakings in a similar legal and factual situation;
- The administration appears to apply a more “favorable” discretionary tax treatment compared with other taxpayers in a similar factual and legal situation;
- The ruling has been issued in contradiction to the applicable tax provisions and has resulted in a lower amount of tax.

According to the Notice, the absence of publication of tax rulings and the room for manoeuvre which tax authorities sometimes enjoy support the presumption of aid. Rulings allowing taxpayers to use alternative methods for calculating taxable profits, e.g., the use of fixed margins for a cost-plus or resale-minus method, may involve state aid.
Depreciation/amortization rules
In general, tax measures of a purely technical nature such as depreciation/amortization rules do not constitute state aid as they would be considered part of the general framework. However, incentives in the form of accelerated depreciation/amortization would be considered state aid if they are not based on the guiding principles of the depreciation system of the Member State or if the tax authorities have discretionary freedoms to determine the rate.

Flat-rate regimes
Flat-rate regimes are not selective, if:

- “The flat-rate regime is justified by the concern to avoid disproportionate administrative burden on certain types of undertakings because of their small size and/or sector of activity (e.g., in the agriculture or fisheries sectors); and
- On average, the flat-rate regime does not have the effect of implying a lower tax burden for them as compared to other undertakings excluded from its scope of application and does not entail advantages for a sub-category of beneficiaries of this regime.”

Anti-abuse rules
According to the Notice, “the provision of anti-abuse rules may be justified by the logic of preventing tax avoidance by taxpayers. However, such rules might be selective if they provide for a derogation (non-application of the anti-abuse rules) to specific undertakings or transactions, which would not be consistent with the logic underlying the anti-abuse rules in question.”

Next steps
The Notice is part of the Commission’s State aid Modernization program launched in May 2012. Comments to the Notice need to be submitted by 14 March 2014 and the Commission aims to adopt the final Guidance Notice in the second quarter of 2014. It will replace the 1998 Commission Notice on the application of state aid rules to measures relating to direct business taxation.

Endnotes:
1. Draft Commission Notice on the Definition of State Aid pursuant to article 107 (1) TFEU.
2. IP/14/30 of 17 January 2014.
3. Idem.
5. Notice, para 163.
7. Notice, para 177.
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