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The modernisation of EU state aid law and taxation

Some international tax lawyers may, occasionally, be made uneasy by the realisation that their subject is now much affected by, and indeed considered by some to be a branch of, international trade law. The question of how trade law should deal with direct tax issues has had some attention in the academic literature.¹ It deserves, perhaps, much more attention than it receives. Views will, inevitably, vary on the precise nature of the relationship between tax law and trade law. In states where trade law is part of the law of regional integration, to which national law must be

¹ J. Slemrod and R.S. Avi-Yonah, "(How) Should Trade Agreements deal with Income Tax Issues" (2001–2002) 55 *Tax Law Review* 533. See also: P.R. McDaniel, "Panel IV: The Pursuit of National Tax Policies in a Globalized Environment: Principal Paper: Trade and Taxation" (2000–2001) 26 *Brooklyn Journal of International Law* 1621; R.S. Avi-Yonah, "Treating Tax Issues through Trade Regimes" (2000–2001) 26 *Brooklyn Journal of International Law* 1683; P.R. McDaniel, "Impact of Trade Agreements on Tax Systems" (2002) 30 *Intertax* 166; P.R. McDaniel, "The David R. Tillinghast Lecture, Trade Agreements and Income Taxation, Interactions Conflicts and Resolutions" (2003–2004) 57 *Tax Law Review* 275.

subservient (as is the case in the EU), the prospect of tax law being subject to trade law, in the form of state aid rules for example, is likely to cause little surprise. In states which have to consider, primarily, the relationship between their tax law and World Trade Organisation (WTO) rules, the reaction may be somewhat different. On one matter, however, there is likely to be substantial agreement, namely that, if one has state aid rules, they have to address the role of taxation if they are to be effective. As Professor McDaniel has said: "...failure to place special tax provisions under the state aid structure would create an enormous loophole in the state aid regime."²

Trade and tax law

The growth of bilateral trade agreements is greatly increasing the scope for tax law to be governed by concepts from outside its discipline. So far as multilateral agreements are concerned, there has for a long time been the General Agreement on Tariffs and Trade (GATT) and GATT 94 to keep in mind. As is well known, the prohibition on export subsidies led to a series of important cases in the early 1980s affecting certain European states and the US.³ Subsequently, the treatment of the foreign sales corporation in the US resulted in considerable litigation.⁴ The agreements established at the conclusion of the Uruguay Round have, of course, significant implications for tax systems.⁵ The current dispute over some provisions of Argentina's profit tax before the WTO confirms that.⁶ The fact that a number of states wish to intervene in the dispute suggests that the implications of the case are unlikely to be confined to the parties.

So far as EU law is concerned, it has for very many years been clear that tax falls within the ambit of state-aid law.⁷ It is not only Member States which must have regard to the concept of state aid. The trading partners of Member States must also pay attention to it.⁸ The importance

² McDaniel (2002), above fn.1, 170.

³ Panel Report, *Tax Legislation—United States Tax Legislation (DISC)*, L/4422, adopted December 7–8, 1981, BISD 23S/98; Panel Report, *Tax Legislation—Income Tax Practices Maintained By France*, L/4423, adopted December 7–8, 1981, BISD 23S/114; Panel Report, *Tax Legislation—Income Tax Practices Maintained By Belgium*, L/4424, adopted December 7–8, 1981, BISD 23S/127; Panel Report, *Tax Legislation—Income Tax Practices Maintained By The Netherlands*, L/4425, adopted December 7–8, 1981, BISD 23S/137.

⁴ United States—Tax Treatment for "Foreign Sales Corporations." WTO Doc. WT/DS108/AB/R, February 24, 2000; Dispute Settlement: Dispute DS108/AB/RW, "United States—Tax Treatment for 'Foreign Sales Corporations'" January 14, 2002—Recourse to Article 21.5 of the DSU by the European Communities; Dispute Settlement: Dispute DS108/AB/RW "Tax Treatment for 'Foreign Sales Corporations'"— Second Recourse to Article 21.5 of the DSU by the European Communities, February 13, 2006.

⁵ See, e.g. the General Agreement on Trade in Services which under General Exceptions in Art.XIV permits exceptions to the national treatment rule provided that the differential treatment in question is aimed at ensuring "the equitable or effective imposition or collection of direct taxes" and as a result brings tax law firmly within the ambit of the agreement. See also *WTO Report*, IFA Cahiers de droit fiscal international, 2008, Vol.93a, 73, Daly. For an example of a comparable provision in an EU agreement see the EU/South Korea FTA at arts 7.50 and 15.7, OJ L127/6, 14.5.11, but note also arts 2.9–2.11, 7.8, 7.24.

⁶ See DS 453 in which complaint is made by Paraguay about the Argentine Decree 1344/987 as amended by Decree 1037/00.

⁷ *Commission v Italy* (C-173/73) [1974] ECR 709 at [13], where the Court noted that EEC law distinguished between State measures by reference to their effects not their causes or aims. "Consequently, the alleged fiscal nature or social aim of the measure in issue cannot suffice to shield it ..."

⁸ See Commission Decision of February 13, 2007 on the incompatibility of certain Swiss company tax regimes with the Agreement between the EEC and the Swiss Confederation of July 22, 1972, C(2007) 411 final. Art.23(1)(ii) of the EEC/Switzerland Agreement of 1972 contains a provision very similar to the prohibition of state aid in the EEC

of state-aid law in the context of taxation has become particularly important in recent times. In his speech at the Competition Forum in February 2014, Commissioner Algirdas Šemeta, responsible for taxation and customs union, statistics, audit and anti-fraud, specifically noted that competition policy in general and state-aid law in particular could “greatly reinforce our tax policy work.” He went on to say:

“Recently, as mentioned by Vice-President Almunia...,⁹ the Commission is gathering again information on tax planning strategies under state aid rules.

We are looking at various instruments that play a role in tax planning, such as tax rulings.

...

[P]ursuing cases under competition rules can make a real difference as they can be enforced directly on the basis of the EU Treaty and should provide results in a precise timeframe.”¹⁰

The statements of the Commission are confirmed by its actions. Shortly after that speech in February, on March 24, 2014, the Commission announced that it had adopted two information injunctions against Luxembourg seeking information about its tax ruling system and intellectual property tax regime. A few days later, on March 27, 2014, the Commission announced an enquiry into French reductions in the “contribution au service public de l’électricité” for “large energy consumers.”¹¹ The same day it announced that it had changed its views on the UK’s rules on tax relief in respect of video games, noting the removal of the territorial spending obligations.¹² The latter part of 2013 had also seen activity in relation to state aid and taxation. In December 2013, an in-depth enquiry was announced into the exemption for “young innovative companies” from Belgian payroll tax on part of the remuneration paid to scientific personnel.¹³ That had been preceded, in November 2013, by the announcement of an in-depth state-aid investigation into French tax exemptions for certain maritime chartering services in France.¹⁴ Back in October 2013 the Commission had, as is well known, published its preliminary view that the tax system of

Treaty. It prohibits “any public aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods”. Contrast the approach of the EU/Korea Free Trade Agreement OJ L127/6, 14.5.11 at Art.11.11.

⁹ Commissioner Joaquin Almunia is the European Commissioner for Competition and one of the Vice-Presidents of the Commission.

¹⁰ “EU Tax Policy and Competition Policy—A Complementary Approach to Fair Taxation”, speech of Commissioner Šemeta at the Competition Forum, 11.2.2014, European Commission—SPEECH/14/117 available at: http://europa.eu/rapid/press-release_SPEECH-14-117_en.htm?locale=en [Accessed March 31, 2014].

¹¹ “State aid: Commission approves aid for on-shore wind power in France; opens in-depth inquiry into tax reductions for large energy consumers” European Commission Press release IP/14/327, 27.3.2014, available at: http://europa.eu/rapid/press-release_IP-14-327_en.htm?locale=en [Accessed March 31, 2014].

¹² “State aid: Commission approves UK video games tax relief plan” European Commission Press release IP/14/331, 27.3.2014, available at: http://europa.eu/rapid/press-release_IP-14-331_en.htm?locale=en [Accessed March 31, 2014].

¹³ “State aid: Commission opens in-depth investigation into tax exemptions given to certain Belgian companies” European Commission Press release IP/13/1203, 4.12.2013, available at: http://europa.eu/rapid/press-release_IP-13-1203_en.htm [Accessed March 31, 2014].

¹⁴ “State aid: Commission opens in-depth investigation into fiscal exemptions for certain maritime chartering services in France” European Commission Press release IP/13/1043, 6.11.13, available at: http://europa.eu/rapid/press-release_IP-13-1043_en.htm [Accessed March 31, 2014].

Gibraltar contravened state aid rules in relation to passive, inter-company, loan interest and royalty income.¹⁵

Against the background of all this activity involving the application of state aid law, it has to be borne in mind that state aid law itself is subject to development. Its ability to encompass tax law at all shows that, as the Swiss would no doubt testify. The whole project of EU state aid law modernisation is, therefore, of great potential significance to tax practitioners. The project was announced on May 8, 2012.¹⁶ It was intended that modernisation should foster growth in a more dynamic internal market, focus enforcement on cases with the biggest impact and create streamlined rules facilitating faster decisions. So far there have been guidelines issued in a number of areas including risk finance and aviation and new regional state aid guidelines.¹⁷ Consultation is continuing in many other areas. One particular aim of the Commission is to clarify and better explain the notion of state aid. This was the subject of consultation between January 17, 2014 and March 14, 2014. The consultation document took the form of draft guidance contained in a Draft Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU.¹⁸

The Draft Notice

As the aim of the Draft Notice is to clarify and better explain, it does not reduce the value of the existing Commission Notice on the application of state-aid rules to business tax¹⁹ and the subsequent Report.²⁰ It does contain, however, a useful statement of the scope of the state-aid rules so far as tax is concerned. At paragraph 53 it states:

“A positive transfer of funds is not necessary, as a foregoing State revenues is sufficient. Waiving revenue which would otherwise have been paid to the State constitutes a transfer of State resources. For example, a “shortfall” in tax and social security revenue due to exemptions or reductions in taxes or social security contributions granted by the Member State, or exemptions from the obligation to pay fines or other pecuniary penalties, fulfils the State resources requirement of Article 107(1) TFEU.”²¹ (footnotes omitted).

¹⁵ *State aid SA.34914 (2013/C) (ex 2013/NN)—Gibraltar Corporate Income Tax Regime* OJ C348/184 (28.11.2013).

¹⁶ *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, EU State Aid Modernisation (SAM) COM/2012/ 0209/ final.*

¹⁷ For details of those areas where work has been concluded or is continuing see the Commission’s web-page on State Aid Modernisation (SAM) available at: http://ec.europa.eu/competition/state_aid/modernisation/index_en.html [Accessed March 31, 2014].

¹⁸ European Commission, *Consultation on the Notice on the notion of State aid and Communication from the Commission—Draft Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU* (the Communication), available at: http://ec.europa.eu/competition/consultations/2014_state_aid_notion/index_en.html [Accessed March 31, 2014].

¹⁹ Notice on the application of the state aid rules to measures relating to direct business taxation OJ C384/3 (10.12.98)

²⁰ *The report on the implementation of the Commission notice on the application of the state aid rules to measures relating to direct business taxation* C(2004) 434, 9.2.2004, available at: http://ec.europa.eu/competition/state_aid/studies_reports/rapportaidesfiscales_en.pdf [Accessed March 31, 2014].

²¹ The Communication, above fn.18.

There is nothing here to cause any surprise. The broad scope of state-aid rules is now well understood.²² Even the statutory instruments dealing with very narrow areas of taxation recognise that. For example, the provisions governing the community infrastructure levy recognise that the provision of state aid has to be avoided by local authorities applying the rules governing discretionary relief for exceptional circumstances.²³

Although the entirety of the Communication is worthy of study, it is its specific statements in relation to fiscal state aid which are of particular interest for present purposes. These are preceded by considerable discussion of material selectivity and regional selectivity²⁴ and it is no surprise to see references to the recent litigation affecting Gibraltar.²⁵ Matters concerning selectivity are of particular significance in relation to taxation as the document acknowledges. Nevertheless, more than a further six pages of the 50 page document are devoted specifically to fiscal state aid. That is an eloquent demonstration of just how important DG Competition regards this whole area.²⁶ There are specific sections dealing with co-operative societies, undertakings for collective investment, tax amnesties, tax settlements and rulings, depreciation and amortisation rules, flat tax regimes for specific activities, anti-abuse rules and excise duties. It is these specific sections rather than the general discussion to which attention is paid below.

So far as co-operative companies are concerned, it is acknowledged that they are not in a comparable legal or factual position to commercial companies. Preferential tax treatment for them may, therefore, be permitted subject to certain conditions.²⁷ In relation to undertakings for collective investment, it is made clear that provisions designed to achieve tax neutrality, preventing double economic taxation, will not be regarded as selective. Tax neutrality in this context is the establishment of equivalence between direct investment and indirect investment in, for example, government securities or shares.²⁸ What is said about tax amnesties, that is, immunity from criminal prosecution, fines and interest, will be of significance to many Member States. They are considered a “general measure” if certain conditions are met. The first of these is that

“the measure should be of an exceptional nature, provide a strong incentive for undertakings to voluntarily comply with the tax obligations, and enhance tax debt collection.”²⁹

Reference is made amongst other things to their limited temporal application while being open long enough to permit all those who benefit from it to apply.

Of more general interest is the comment on tax rulings:

“If in daily practice tax rules need to be interpreted, they should not leave room for the discretionary treatment of undertakings. Every decision by the administration that departs

²² As the Commission makes clear it is the effect of the rule in question that is material not its formulation: see, e.g. the Communication, above fn.18, para.122.

²³ See the Community Infrastructure Levy Regulations 2010 (SI 2010/948) reg.55(3)(c)(ii).

²⁴ See the Communication, above fn.18, paras 121–156.

²⁵ *Commission and Spain v Government of Gibraltar and United Kingdom* (Joined Cases C-106/09 P and C-107/09 P) discussed in this Review at T. Lyons, “*Commission and Spain v Gibraltar and the United Kingdom: a landmark case on engineered tax regimes*” [2012] BTR 55.

²⁶ The heading “Specific Fiscal Aid Issues” appears in the Communication, above fn.18, 40 at s.5.4, para.157. The section concludes at 47, para.185.

²⁷ See the Communication, above fn.18, paras 158–161.

²⁸ See the Communication, above fn.18, para.163.

²⁹ See the Communication, above fn.18, para.167.

from the general tax rules and benefits individual undertakings leads in principle to a presumption of State aid and must be analysed in detail.”³⁰

That comment demonstrates just how far reaching the state-aid rules are. Their influence, however, in this context is very welcome. Walton J’s aphorism that “One should be taxed by law, and not be untaxed by concession”³¹ is well-known in the UK. He would, perhaps, have been pleasantly surprised to see it reinforced by EU state-aid law. The Communication also makes clear that administrative rulings may give rise to state aid, particularly where they result in reductions in liability “in contradiction” to the tax law.³²

The comments on tax settlements are also likely to be worth careful review. There will be some members of the UK Parliament who may find the following comment of particular interest:

“While the competence of Member States in this field is not disputable, State aid may be involved, in particular, where it appears that the amount of taxes due has been significantly reduced without clear justification (such as optimising the recovery of debt) or in a disproportionate manner to the benefit of the taxpayer.”³³

The negotiation of settlements can be a particularly sensitive activity if entirely domestic considerations are to be borne in mind. The presence of EU state aid law, quite properly, as a material consideration will do nothing to make it simpler.

General depreciation and amortization rules are said not to amount to state aid, as one would expect, though there are specific circumstances in which they may constitute aid.³⁴ Similarly, flat tax regimes for specific activities do not infringe state aid law if they are justified by the need to avoid disproportionate tax burdens and do not entail tax advantages for specific categories of taxpayer.³⁵ So far as anti-abuse rules are concerned, they may be justified by the logic of preventing tax avoidance. Nevertheless, if they are not applied to certain transactions or undertakings, in a way which is inconsistent with their underlying logic, then they too can infringe state aid law.³⁶

The approach in all of these areas tends to exclude discretion from tax regimes and makes their application as broad as possible. It will probably, therefore, be widely supported. It is to be hoped, however, that it will not lead to any rise in attempts to justify treating taxpayers differently by reference to the general nature of the tax system. That justification is not always easy to apply in practice and has been questioned in some quarters.³⁷

³⁰ See the Communication, above fn.18, para.171.

³¹ *Vestey v Inland Revenue Comrs (No.1)* [1977] STC 414; [1979] Ch 177 (Ch. Div) at 197.

³² See the Communication, above fn.18, para.177.

³³ See the Communication, above fn.18, para.172.

³⁴ See the Communication, above fn.18, paras 178–181.

³⁵ See the Communication, above fn.18, para.183.

³⁶ See the Communication, above fn.18, para.184.

³⁷ See e.g. B. Kurcz and D. Vallindas, “Can general measures be ... selective? Some thoughts on the interpretation of a state aid definition” [2008] CMLR 159.

Conclusion

The Communication makes clear that the application of state aid law to tax will continue to be a matter of great importance for the Commission. It can be expected to act accordingly. As we noted, only a short time after publication of the Communication, Luxembourg was being pressed to account for its regime of tax rulings having regard to state aid law. That state of affairs makes clear another significant truth, namely that state aid law is not concerned just with substantive tax law. The administration of a tax system is also within its purview. Sometimes Member States' tax authorities may regard that as something of a mixed blessing. More generally, though, this broad application of state aid law, or trade law as it appears some would see it, is surely likely to meet with general approval from all those who support the creation of an undistorted internal market. [Ⓒ]

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[Ⓒ] Amortisation; Anti-avoidance; Collective investment schemes; Co-operative societies; Depreciation; EU law; Excise duty; State aid; Tax administration