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Union of Industrial and Employers' Confederations of Europe
Union des Confédérations de l'Industrie et des Employeurs d'Europe

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DRAFT COMMISSION NOTICE ON THE APPLICATION OF THE STATE AID RULES TO MEASURES RELATING TO DIRECT BUSINESS TAXATION

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UNICE Comments

1. GENERAL REMARKS

1.1 The European Commission has prepared a draft notice in which it sets out guidelines defining its policy on State aid control with respect to direct business taxation. For both economic and legal reasons, UNICE supports the Commission's intention to remove tax provisions which unfairly distort competition in the EU. The initiative puts some order in this rather neglected area of indirect subsidies and is in line with UNICE's policy of the past years to press for a reduction in the overall level of State aid in the Community.

However, the principle of competing tax systems in which businesses are taxed directly must be safeguarded. The central question, therefore, is what conditions must apply for specific tax regimes to be deemed to distort competition. Suitable criteria must be developed which permit a reliable distinction to be established between those tax rules with regard to State aid that are dubious and those that are not. UNICE believes that the draft Commission notice could be improved in this respect.

1.2 The notice has to be read in context with the draft procedural regulation on State aid control. Article 14a of the draft procedural regulation states that aid – and thus also preferential taxation – may be backdated for recovery for a period of up to ten years. Whilst the regulation does limit recovery of aid to a specific period in the past, unlike the present legal situation where no statute of limitation applies at all, demanding recovery of aid even for a limited time of ten years can nevertheless result in companies being forced into bankruptcy under certain circumstances.

1.3 In addition, time limitations for recovery under Community law may differ from those under national procedural rules. It is not clear to what extent this would create potential for conflict. It may therefore be necessary to consider both the need to achieve the "effet utile", and national rules that take into account specific rights of the parties. These elements need to be balanced fairly.

1.4 Increased focus of State aid control on tax measures coupled with a widening of the definition of State aid in the form of taxation (as evidenced in the Irish Corporation Tax case) raises the issue of how to apply the rules set out in the notice to tax measures implemented in the past. While certain

tax measures would always have been regarded as State aid, others may appear as such only *ex post* in the light of the notice and subsequent case law.

1.5 In UNICE´s view, applying State aid control to tax rules must take into account the special nature of tax law. Unlike typical State aid which can take the form of subsidies, the aid character of tax provisions under scrutiny is not immediately apparent to taxable businesses in most cases. From the viewpoint of companies the State aid character in fiscal legislation is often simply not obvious. In addition, the political background within which tax rules could be examined to see whether or not they infringe aid rules was not as clearly defined ten years ago as it is today. This means that enterprises have made no provisions whatever for the unperceived risk of contravening State aid rules.

1.6 Thus it is important in the future not to place on enterprises the burden of testing the legitimacy of tax provisions. It is each Member State's inherent duty to ensure that its laws and regulations comply with Article 92 of the Treaty, particularly with regard to State aid control. Enterprises cannot be expected to examine every regulation or tax measure in each particular case to check whether it complies with State aid rules. Member States should therefore be called upon to indicate clearly in any future fiscal legislation whether or not specific tax measures constitute aid with respect to the Commission notice.

1.7 UNICE suggests that the draft procedural regulation and the draft notice be amended to clarify certain issues. In particular, the notice should be more precise and contain more specific formulations. This would also tighten the Commission's wide powers of discretion in this respect and lead to more legal certainty for business *and* Member States.

2. SPECIFIC COMMENTS REGARDING RECOVERY OF AID

2.1 As the aid character of tax provisions is not always apparent to enterprises, particular attention and care should be placed on protecting legitimate expectations when aid which may have been gained "illegitimately" is recovered.

Reservations have been expressed regarding the Commission's plans to revise tax rules along the lines described in No. 4 of its notice. The wording in the notice implies that all tax measures are covered, whether notified or not. While tax measures notified and approved in the past comprise existing State aid for which the Commission can propose appropriate adjustments to the Member States, there is considerable risk that revising rules not notified at the time would impinge on the principle of legitimate expectations.

2.2 The fiscal provisions involved are or were applicable national law, and thus a basis on which companies were able to place their trust in the majority of cases. The prospect of having to repay aid granted in the past would result in companies having to live for years with the threat of possible recovery, whereby their ability to plan with certainty would be greatly affected. The clock cannot simply be turned back ten years for company balance sheets. Companies would otherwise be forced to pay the ensuing burden from current revenues or by liquidating essential assets.

2.3 The State aid policy envisaged by the Commission in the area of direct taxation could well become a burden for businesses, even though they are not responsible for the illegality of tax provisions or may not be able to recognise where they have infringed State aid rules in individual cases.

2.4 It is true that the second sentence of Article 14 (1) of the proposed procedural regulation states that the Commission will not demand recovery of aid when this would "contravene a general principle of Community law". However, this pointer to general legal principles leaves much room for interpretation, thus leading to serious legal uncertainty. This uncertainty would be shouldered by businesses, as they can only obtain clarification of their legal position after years of court proceedings. Consequently, the second sentence of Article 14 (1) actually runs counter to the purpose of the regulation to create more legal certainty in the area of State aid control.

2.5 The legal principles of Community law referred to therefore need to be clarified in respect to legitimate expectations. UNICE proposes that the second sentence of Article 14 (1) of the draft procedural regulation be changed as follows:

> "The Commission will not demand recovery of aid when this would contravene a general principle of Community law, *in particular when recovery would run counter to the principle of protecting legitimate expectations.*"

The Commission's suggestion to comment on this legal principle in an appended protocol is seen as useful, though insufficient to protect companies' legitimate expectations.

2.6 The principle of legitimate expectations may differ when State aid rules are applied to different forms of aid. This is especially true for State aid in the form of tax measures. The present endeavour by the Commission to outline its policy on State aid control vis-à-vis tax measures should pick up this topic, which so far is not the case. In addition to the more precise wording in the Procedural Regulation suggested by UNICE under 2.5 above, the notice could include more details as to what the principle of legitimate expectations means with respect to tax measures. A paragraph in the notice dealing with the principle of legitimate expectations would serve to define how this legal concept should be applied in the specific context of taxation. This would provide for greater legal certainty in this area.

2.7 The paragraph in question could be inserted in Section D of the notice. It should clearly state that there does not yet exist a reliable body of case law regarding the extent to which tax measures do constitute aid, and it should acknowledge that in many instances companies do not even know that they are benefiting from exemptions from a general tax regime. It should also make clear that the Commission will apply the principle of legitimate expectations when the beneficiary has acted in good faith regarding the compatibility of national legislation with Art. 92, since the applicability of this principle may not be confined to cases in which the Commission has itself set the cause for any such expectations. Otherwise this principle would be practically inapplicable in cases of State aid in the form of tax measures.

3. DETAILED COMMENTS ON THE TEXT OF THE COMMISSION NOTICE

The Commission notice is primarily meant to be a guide for interpretation. However, UNICE would point out that the notice binds the Commission's discretion in applying Article 92 of the Treaty to tax measures. Thus a clarification of specific issues in the notice seems helpful to narrow the wide discretionary powers of the Commission in this respect.

This is particularly important in terms of the Commission's policy goal of improving consistency and equality of treatment between Member States. The wording in No. 4 of the notice can be interpreted as an attempt by the Commission to expand its competences in order to reach its policy objective of enhanced consistency in the European Union. If the Commission notice is understood as a tool to bind the Commission's discretion it would not only contribute to a higher degree of legal certainty, but also to confinement of the Commission's powers to its core competences.

3.1. Distinction between general measures and State aid (Nos. 13 et seq.)

3.1.1 The distinction between general measures and measures with a selective character needs further clarification. The Commission recognises tax measures as legitimate where their objective is horizontal (research and development, environmental protection, training, employment, No. 13). This list does not provide legal instances with the necessary concrete distinctions.

3.1.2 UNICE also sees a need to clarify the list of "purely technical measures", treated under No. 13 as not constituting aid. This catalogue of examples should be extended and defined in such a way that it is comprehensive and serves as a positive "white list" for those technical measures which do not constitute aid. Even though this list cannot be exhaustive, it should encompass general rules on determining profits. The same should apply to loss reserves and carry-overs. The list should signal clearly which measures fall within the "technical" area.

3.1.3 The Commission's intention to treat as State aid tax advantages granted to public undertakings which operate commercially is both noteworthy and positive (No. 19). Public undertakings which compete directly with private companies, i.e. which do not exclusively perform public services, must be put on the same footing as private undertakings in terms of competition policy. Failure to do so can only lead to severe distortions in competition. Specific tax advantages are thus completely unjustified. This should be expressed more clearly in the first sentence of No. 19, which UNICE suggests could be amended to read:

> "In several Member States, different tax rules apply to *private and public* undertakings."

3.2 Justification of a derogation by "the nature or general scheme of the system" (No. 23 et sq.)

3.2.1 Where tax measures in individual cases have a preferential effect for certain undertakings or economic sectors, special treatment can be justified by the redistributive logic of the tax system in the Member State in question (No. 24).

3.2.2 This justification, based on an inherent aspect of a tax system, represents a high degree of legal uncertainty and will probably be a major area of litigation in future. It will become difficult for parties to present convincing arguments for the inherent redistributive logic of their domestic tax system or, conversely, rebut the logic of another Member State's tax system.

3.2.3 In order to clarify what represents inherent justification and to create more legal certainty, the second sentence of No. 24 should be amended as follows:

> "... but such method may be inherent in the tax system to which they belong. *Rules based on objective and justifiable considerations to determine profits do not constitute State aid in this connection."*

3.2.4 The formulation of No. 27 creates the impression that it provides for an incontrovertible privilege for these sectors. However, Article 92 of the Treaty requires that it should always be possible to examine whether certain rules have assumed the character of State aid in individual cases. It should be clarified that No. 27 is illustrative. UNICE therefore proposes that No. 27 be extended as follows:

> "Specific provisions*, such as may be applicable* to agriculture and fisheries*,* may be justified by the nature and general scheme of the system where they take account*, for example,* of accounting requirements ..."

3.3 Compatibility of State aid in the form of taxation with the common market (No. 28 et sq.)

3.3.1 Where a preferential measure cannot be justified by way of the redistributive logic of a national tax system, the tax provision in question is only permissible where it complies with the derogation rules laid down under Articles 92 (2) and 92 (3) of the Treaty on the prohibition of State aid.

3.3.2 In No. 31 the Commission lays down which sector-related tax relief provisions constitute operating aid that are not prohibited in exceptional cases. However, the third sentence of No. 31 should state that the examples given are exceptions that cannot be perpetuated, and could be subject to change in the future. The following should therefore be added to the third sentence:

> "The Commission authorises it only in exceptional cases, subject to certain conditions*, at present for example* in shipbuilding, sea transport ..."

4. RELATIONSHIP OF STATE AID RULES TO THE CODE OF CONDUCT ON BUSINESS TAXATION

4.1 UNICE wonders about the interaction between the Commission's draft notice and the Code of Conduct on business taxation, adopted by the Council in December 1997, on which it has recently issued a separate position paper. UNICE sees substantial importance in the relationship between State aid rules and the code of conduct, which could lead to legal uncertainties for business. This unclear relationship could also lead to legal uncertainties regarding institutional decision-making procedures. However, it is quite conceivable that State aid granted by way of a particular tax provision may be seen as a harmful distortion of competition within the EU according to the code of conduct, and thus an infringement of the latter. This can be concluded from the second sentence in No. 32, which addresses the problem of tax avoidance within the framework of regionally motivated tax rules.

4.2 UNICE believes that tax rules which have been approved as State aid in accordance with the Treaty should in future not be regarded as being in contravention of fair tax competition when measured against code of conduct rules. Otherwise legal certainty and certainty for strategic business decisions cannot be guaranteed.

4.3 According to Article 92 of the Treaty, the categories of aid described in 92 (2) and 92 (3) are or may be considered to be compatible with the common market. Additionally, the procedure for State aid control allows for a regular examination of all aspects of Community law. The Commission itself repeats this explicitly in No. 29 of its notice.

Examination of all Community law on a case-by-case basis within the framework of the State aid control procedure thus ensures that aid granted conforms comprehensively with the common market. Priority status should be explicitly formulated in future for reasons of legal certainty. Otherwise long-winded procedures before the Commission and the Courts to obtain an exemption from the aid regime might turn out to have been in vain after years of litigation if the exemption is invalid on the basis of the Code. This level of legal uncertainty is unacceptable to business.

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