The interaction between the EU freedoms and the State aid rules: discrimination and selectivity in the light of recent cases

Université Paris 1 Panthéon-Sorbonne
Atelier Droit Fiscal, 17 June 2015

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Discrimination

„...the application of different rules to comparable situations or the application of the same rule to different situations” (C-279/93 Schumacker, par. 26)
Elements of State aid

Article 107(1) TFEU:
Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market.
"The main criterion in applying [Article 107(1)] to a tax measure is therefore that the measure provides in favour of certain undertakings in the Member State an exception to the application of the tax system. The common system applicable should thus first be determined. It must then be examined whether the exception to the system or differentiations within that system are justified "by the nature or general scheme” of the tax system, that is to say, whether they derive directly from the basic or guiding principles of the tax system in the Member State concerned. If this is not the case, then State aid is involved.” (1998 Notice on the application of the State aid rules to measures relating to business taxation par. 16)
“...The only question to be determined is whether, under a particular statutory scheme, a State measure is such as to favour ‘certain undertakings or the production of certain goods’ within the meaning of Article 92(1) of the Treaty in comparison with other undertakings which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question” (C-143/99 Adria-Wien Pipeline, par. 41)
“In order to classify a domestic tax measure as ‘selective’, it is necessary to begin by identifying and examining the common or ‘normal’ regime applicable in the Member State concerned. It is in relation to this common or ‘normal’ tax regime that it is necessary, secondly, to assess and determine whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure derogates from that common regime inasmuch as it differentiates between economic operators who, in light of the objective assigned to the tax system of the Member State concerned, are in a comparable factual and legal situation [...]” (C-78/08 to C-80/08 Paint Graphos, par. 49)
“... case-law does not make the classification of a tax system as ‘selective’ conditional upon that system being designed in such a way that undertakings which might enjoy a selective advantage are, in general, liable to the same tax burden as other undertakings but benefit from derogating provisions, so that the selective advantage may be identified as being the difference between the normal tax burden and that borne by those former undertakings.

Such an interpretation of the selectivity criterion would require,..., that in order for a tax system to be classifiable as ‘selective’ it must be designed in accordance with a certain regulatory technique; the consequence of this would be that national tax rules fall from the outset outside the scope of control of State aid merely because they were adopted under a different regulatory technique although they produce the same effects in law and/or in fact.” (Joined Cases C-106/09 P and C-107/09 P Gibraltar, par. 91-92)
“....the regime at issue, by combining those bases, even though they are founded on criteria that are in themselves of a general nature, in practice discriminates between companies which are in a comparable situation with regard to the objective of the proposed tax reform, namely to introduce a general system of taxation for all companies established in Gibraltar.” (par. 101)

“...the criteria forming the basis of assessment which are adopted by a tax system ... such as to characterise the recipient undertakings, by virtue of the properties which are specific to them, as a privileged category, thus permitting such a regime to be described as favouring ‘certain’ undertakings or the production of ‘certain’ goods within the meaning of Article 87(1) EC.” (par. 104)
Selectivity - Discrimination

- Bottom line: both discrimination and selectivity are specific expressions of the principle of equality
Convergence of analysis - fundamental freedoms, State aid

- Prima facie infringement: differential treatment of objectively comparable situations
  - comparability criterion: unclear

- Justification on treaty grounds and grounds developed by case law:
  - Freedoms: mandatory requirements
  - State aid: nature and general scheme of the tax system
  - Reasons external to the tax system?

- Proportionality
Overlap - Fundamental freedoms, State aid

- Similar method of analysis – overlap
- Can a measure be an infringement of the fundamental freedoms and State aid at the same time?
- Does either of the regimes have priority in application
- C-169/08 Sardinia case
Most recent trends

- General Court on 7 November 2014 on Spanish goodwill amortisation (T-219/10 Autogrill/Commission, T-399/11 Banco Santander and Santusa/Commission)
  - Annulled the Commission’s earlier State aid decisions
  - No selectivity
  - Exception from the reference framework not sufficient
  - Particularly when a tax measure is potentially accessible to all undertakings
  - Even the fulfilment of certain conditions is not a priori selective
  - Only if a particular category of undertakings is identified which can be differentiated from the rest based on specific characteristics
Most recent trends

- C-66/14 Finanzamt Linz

  Background: The Austrian goodwill amortisation on share deals

  - From 2005 on, Austrian acquiring companies had to amortise the "goodwill element" of the purchase price in share deal acquisitions of target companies over 15 years
  - "goodwill" was defined by a formula set by law
  - The amortisation was mandatory, however it required that the target was included into an Austrian tax group (such inclusion being optional)
  - In effect, this could lead to a significant tax deduction over time
  - Any deducted amount would trigger a fictitious step-down in acquisition cost for the acquired shares (i.e. creating an unrealised gain) the amortisation would be recaptured upon a future sale of the shares
Finanzamt Linz

AUT

Sale - Cap gains taxable

EU MS

Sale - Cap gains not taxable (unless option exercised)

P Co

Sub

Goodwill amortisation

No goodwill amortisation

No goodwill amortisation
Issue: Goodwill amortisation was only possible for acquisitions of Austrian resident companies
- acquisitions of non-resident companies were excluded (even if resident in other EU Member States)

Discriminating acquisition of an EU target as compared to acquisition of an Austrian target → Freedom of establishment infringed?
Opinion of Advocate General Kokott, 16 April 2015:

- Restriction on the freedom of establishment

- Justification: coherence of the tax system
  - **subsidiaries profits** are taxed in the hands of the parent in the case of a domestic group but not in the case of a cross-border group
  - **capital gains** on domestic shareholdings are taxable, on foreign shareholdings not taxable unless the taxpayer opts to be taxed, however, even if such option is exercised, the goodwill amortization cannot be utilized system is not consistent
  - Rule aims at ensuring equal treatment of acquisition of PEs and subsidiaries (if part of a tax group): in case of acquisition of a foreign PE goodwill amortization is also denied if exemption is applied to the foreign PE under a tax treaty system is not consistent because denial of amortization is not dependent on whether exemption or credit is applied
State Aid Issue
- Is the tax advantage from goodwill amortisation State aid?

Key issue: Selectivity
Who receives a selective advantage compared to whom?

Comparisons:
- Legal persons – individuals
- Companies within a tax group – companies outside a tax group
- Companies with domestic holdings – companies with foreign holdings

Are they in the same factual and legal situation, i.e. comparable?
- Legal persons – individuals → no
- Companies within a tax group – companies outside a tax group → no
- Companies with domestic holdings – companies with foreign holdings → YES!
Despite the comparability of companies with domestic shareholdings and companies with foreign shareholdings, the fact that the advantage is only granted to the former does not constitute State aid!

In addition to the advantage, selectivity must be proven inasmuch as the measure has to favour "certain undertakings or the production of certain goods"

Selectivity require that "the recipient undertakings, by virtue of the properties which are specific to them, are characterized as a privileged category" (Gibraltar) \(\rightarrow\) GC Autogrill, Santander

That is, differential treatment of comparable situations is not enough in order to consider a measure selective

Deviation from the ECJ’s settled case law
State aid v fundamental freedoms

- What is the comparability criterion under the two regimes?
- State aid: the objective of the system/objective of the measure
- Fundamental freedoms: ?
- In light of the objective of the measure domestic tax groups and cross-border tax groups are not in a factually and legally comparable situation (relevant differences in the legal rules)
- Does the comparability assessment have to be the same under the two regimes?
How to narrow the scope of State aid?

- Add an additional condition of „specific category of undertakings“ (GC, AG Kokott in Finanzamt)
- Examine the condition of „distortion of competition“ more meaningfully
- Recognize external policy reasons as grounds of justification
Progressive turnover taxes in the light of the freedoms and the State aid rules
Progressive turnover tax – Discrimination: Hervis case

**Hervis case (C-385/12) – Facts:**

- special tax on the store retail trade sector
- tax base = net turnover
- tax rate progressive (0% up to HUF 500 million turnover, 0.1% between HUF 500 million and HUF 30 billion, 0.4% between HUF 30 and HUF 100 billion and 2.5% above HUF 100 billion)
- related companies were taxed on the basis of their aggregated turnover to which the progressive rates were applied (the tax liability of each individual company resulted from the proportion that its own turnover represented in the aggregate turnover of the group)
Progressive turnover tax – Discrimination: Hervis case
Progressive turnover tax – Discrimination: Hervis case

- Issue:
  Discrimination against foreign-owned companies which mainly operate in a group structure as opposed to Hungarian-owned companies, which operate in franchise?
Progressive turnover tax – Discrimination: Hervis case

ECJ held:

- Indirect discrimination/de facto discrimination
  - Based on a criterion of differentiation which is legally neutral but in fact leads to the same result as discrimination based on the seat of a company
  - Criteria of differentiation under the law on retail tax: (i) group company v individual company, and (ii) level of turnover

- Group companies are disadvantaged by the rules combination of two factors: (i) obligation to aggregate the turnover and (ii) steeply progressive rates
Progressive turnover tax – Discrimination: Hervis case

- Discrimination only if difference in treatment relates to comparable situations
- Comparability of companies belonging to a group and individual companies (operating in a franchise)?
  - ECJ: the two are comparable, both are subject to the special tax and their turnover is independent of that of other taxable persons
  - AG Opinion: group structures and franchise systems are not comparable, due to the control by the parent the subsidiaries’ turnover is attributable to the parent, which is not true in the case of franchisors/franchisee
Outcome:

- If it is established that group companies are mainly foreign-owned companies, there is discrimination
Progressive turnover tax – Discrimination: Hervis case

**Issues:**

- Does this mean that progressive tax rates cannot be applied by small countries where such rates always disadvantage foreign-owned enterprises?
- The ECJ held that the disadvantage was caused by the combination of two factors (requirement to aggregate + progressive rates) and emphasis was put on the steeply progressive rates (referring court: remedy is the non-application of the requirement to aggregate the turnover of group companies)
- Very complex discrimination analysis (de facto discrimination based on a completely incidental factor) – any alternative?
- Companies operating in a franchise do not pay the retail tax (they stay below the min. turnover limit) as opposed to group companies selective advantage? State aid?
- Relationship between the freedoms and State aid?
Facts:

- Special tax on the media sector
- Tax base = turnover from the provision of advertising services
- Tax rate progressive (0% up to HUF 500 million, 1% between HUF 500 million and HUF 5 billion, 10% ..., 50% above HUF 20 billion)
- Corporate tax losses can be deducted for certain taxpayers
Progressive turnover tax – Selectivity: advertisement tax

Issues:

- No selective advantage but a selective burden
- Majority of potential taxpayers are the aid recipients
- If State aid, how to calculate the amount which would have to be repaid, how much should the aid recipients have paid?
- Progressive tax rate: can it lead to selectivity, in itself, in the context of a turnover tax?
Commission’s reasoning:

- Progressive rates are linked to the ability-to-pay principle.
- Ability-to-pay cannot be the underlying principle of a turnover tax, a turnover tax cannot, by definition, take into account the taxable capacity of persons. Only profit-based taxes can be governed by the ability-to-pay principle, only those taxes can feature progressive rates.
- Progressive rates for turnover taxes can only be justified exceptionally (e.g. if the externalities created by an activity that the tax is aimed at also increase progressively).
Progressive turnover tax – Selectivity: advertisement tax

- Controversial claim, which would have severe consequences as regards the sovereignty of MSs to design their tax systems
- The advertisement tax could be condemned without such far-reaching conclusions
- Gibraltar doctrine applied to a reverse situation