

## § 6 EU State Aid Restrictions to Preferential Tax Treatment: Size-Neutral Tax Incentives and Enforcement of General Anti Avoidance Rules

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### I. Introduction

While European Union law allows Member States a lot of leeway in designing their own tax system, when it comes to size-related tax treatment it are mainly state aid rules that impose certain limitations. When asked to provide an introduction to state aid considerations at a symposium dealing with size-neutral taxation of companies, the first thing that came to this author's mind was not that of special tax treatment of multinationals. Rather it was the special tax treatment of small and medium-sized enterprises, as this is a topic that is too often ignored.

Article 107(1) of the Treaty on the Functioning of the European Union (TFEU) provides the four elements of the definition of state aid: (i) the need for a financial advantage (the tax benefit), (ii) to be granted by the state (or any sub-national level of government), which (iii) threatens to distort competition and intra-EU trade, and (iv) which should be granted selectively and not to all companies alike. Any tax measure meeting these four requirements may qualify as state aid and as such might be incompatible with the EU's internal market unless otherwise provided for.

In paragraph II we will look into the issue of size-related selectivity and the possibility of approval of size-related tax incentives in light of the pitfalls Member States might face. Then paragraph III will briefly touch upon tax rulings. Paragraph IV will focus on enforcement of anti-tax avoidance rules as a means to limit tax planning opportunities by multinationals. Some concluding remarks will follow in paragraph V.

## II. Size related selectivity

### 1. De facto selectivity

The Treaty defines selectivity as “favouring certain undertakings or the production of certain goods”. In the recent *World Duty Free* judgement the Court of Justice of the European Union (CJEU) clarified that we should be on the lookout for different treatment of companies that are in a comparable legal and factually situation, which cannot be justified by the objective of the tax system.<sup>1</sup>

So, can selectivity be raised based on the size of a company? We have seen cases where selectivity was based on companies needing to be active in two continents or in four countries.<sup>2</sup> In another case a tax credit was provided only to investments exceeding ± 15 million Euro, which meant that companies without significant financial recourses would not qualify.<sup>3</sup> In yet another case a combination of investing a minimum of ± 600.000 Euro and creating and maintaining a minimum of ten new jobs within six months also created conditions of selectivity. The Commission pointed out that, at the time, 95% of all businesses in the Member State involved had less than

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<sup>1</sup> CJEU C-20/15P and C-21/15P, *World Duty Free et al.*, ECLI:EU:C:2016:981, para. 79.

<sup>2</sup> See, for instance, Commission decision 2003/51/EC, OJ L 180/52 of 18 July 2003, para. 87-88. In this case the restriction to intra-group financing activities already raised selectivity issues, but the Commission specifically mentioned that the four country criterion as such already sufficed.

<sup>3</sup> CFI T-92/00 and T-103/00, *Ramondín*, ECLI:EU:T:2002:61, para. 39.

ten employees, which by itself excluded the vast majority of companies.<sup>4</sup> What these cases remind us of is that seemingly objective criteria may well lead to *de facto* selectivity, for instance when restricting investment incentives to substantial investments or to investments that need to create a large number of new jobs. (Be advised that such aid might possibly be approved of in less-developed regions, but this does not change the fact that selectivity may arise to start with.) Investment incentives not accessible to small and medium size enterprises (SMEs, in German: KMU) may therefore be questionable from a state aid point of view. However, we should be aware that the opposite could be the case as well.

Tax incentives that focus on smaller medium sized enterprises may also come within the scope of state aid. We tend to forget that tax benefits targeting SMEs, for instance to help them to create jobs, to invest or to attract risk capital, also may require approval from the European Commission.

Article 108(3) TFEU does require the notification of any aid scheme and orders a Member State (or any other level of government) to standstill and to not introduce such aid until approved. Approval may mean a decision not to object, which may already result from a confidential preliminary investigation based on the information provided by the Member State within a few weeks or months. Approval may also result, possibly with conditions attached, after a formal public investigation, but that entire process may take a lot longer (in theory up to 18 months on top of the time needed for a preliminary investigation).<sup>5</sup>

## 2. De minimis aid and the Block Exemption Regulation

As to reduce the European Commission's workload, the need to notify state aid in advance has been substantially reduced. In order to allow the Com-

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<sup>4</sup> Commission Decision 2002/893/EC, OJ L314/17 of 18 November 2002. Also compare Commission Decisions 2002/892/EC, OJ L 314/1 of 18 December 2002 and 2003/28/EC, OJ L 17/20 of 22 January 2003.

<sup>5</sup> See Council Regulation 2015/1589, OJ L 248/9 of 24 September 2015 (the Procedural Regulation), Article 9.

mission to focus on the more important cases from an internal market perspective and to prevent it losing too much time on more standardized cases, two regulations are of importance.

First of all, there is the *de minimis* regulation. Based on this regulation any aid that is limited to up to € 200.000 over a period of three fiscal years is deemed not to affect trade and competition, as to keep such aid out of the scope of state aid control.<sup>6</sup> While the CJEU has reminded us that no such minimum exist when it comes to Article 107(1) TFEU as small amounts of aid may affect trade in areas of strong competition,<sup>7</sup> the adoption of the regulation exempting such aid from prior notification effectively resulted in aid recipients receiving such ‘smaller’ amounts to be in the clear from a recovery perspective.<sup>8</sup>

When it comes to direct taxes like a corporate income tax or a local business tax, trying to rely on the *de minimis* exemption is not a recommendable course of action. First of all, the € 200.000 limit applies per economic entity. It may consist of a group of legal entities performing one economic activity together and it may hence involve multiple registered taxpayers. Second, the limit applies to any kind of aid received by any level of government during the three year period, which may include cash subsidies, government guarantee schemes and alike, offered Gemeinden, by Länder, or by the Bund. We need to look how much state aid they give in total and if it would be € 200.001 the whole amount would qualify as state aid and we cannot use this *de minimis* exemption. The problem is that these general safeguards requirements that apply to *de minimis aid* are often not fulfilled when direct taxation is concerned.

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<sup>6</sup> Commission Regulation 1407/2013, OJ L 352/1 of 24 December 2013. Article 3. Aid conditional upon export of goods or services or upon using domestic instead of imported goods is excluded from the application of the *de minimis* exemption (Article 1), as is aid to sectors like fishery and agriculture to which different rules apply.

<sup>7</sup> ECJ C-303/88, ENI-Lanerossi, ECLI:EU:C:1991:135, para. 27.

<sup>8</sup> As confirmed by the CJEU (after the conference) in C-518/16, ZPT, ECLI:EU:C:2018:126, para. 36, based on Article 109 TFEU.

If we assume for a moment that the *de minimis* exemption would not apply, we should again look at the possibilities to approve of state aid.<sup>9</sup> The General Block Exemption Regulation (GBER, in German: Allgemeine Gruppenfreistellungsverordnung) is meant to reduce the Commission's workload.<sup>10</sup> Of all new aid reported, 97% is currently dealt with under this GBER.<sup>11</sup> It will allow Member States to check whether a number of criteria by type of state aid have been fulfilled in order to be exempt from the need to notify aid in advance and wait for approval. In the context of SMEs there are special rules covering regional aid, investment aid, aid for consultancy in favour of SMEs, risk financing, support for start-ups and alternative trading platforms, research and development (R&D), just to name a few. The GBER criteria indicate how much aid would be acceptable in a particular situation in light of each of the aforementioned objectives.

The problem here is that the GBER operates under the assumption that the amount of aid a company is going to receive will be known in advance. Also, firms in financial difficulty will be excluded from its application. Most EU Member States have introduced tax benefits to smaller or medium sized enterprise that do not fulfil either of these criteria. In *Dilly's Wellnesshotel*, the CJEU reminded us of the need to read the fine print of the GBER, as not fulfilling conditions means that no waiver of notification exists and aid may therefore violate Article 108(3) TFEU.<sup>12</sup>

For this and other reasons the GBER has been amended in June 2017, by imposing new obligations on Member States that many governments still seem unaware of.<sup>13</sup> Article 12(2) GBER now reads:

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<sup>9</sup> This contribution will not address aid related to transport, agriculture or to services of general (economic) interest, as they are each covered by separate regimes that often have no direct link to SMEs.

<sup>10</sup> Commission Regulation (EU) 651/2014 declaring certain categories of aid compatible with the internal market in application of Article 107 and 108 of the Treaty, OJ L 187/1 of 26 June 2014, as amended.

<sup>11</sup> Commission press release IP/18/263 as updated on 2 February 2018.

<sup>12</sup> CJEU C-493/14, *Dilly's Wellnesshotel*, ECLI:EU:C:2016:577.

<sup>13</sup> See Commission Regulation (EU) 2017/1084, OJ L 156/1 of 20 June 2017.

“In the case of schemes under which fiscal aid is granted automatically, such as those based on tax declarations of the beneficiaries, and where there is no *ex ante* verification that all compatibility conditions are met for each beneficiary, Member States shall regularly verify, at least *ex post* and on a sample basis, that all compatibility conditions are met, and draw the necessary conclusions. Member States shall maintain detailed records of the verifications for at least 10 years from the date of the controls.”

Knowing *ex ante* what the amount of tax benefit may be is rather difficult in the context of an income tax or corporate tax where the amount of profit may influence the marginal tax rate that applies and hence the exact benefit enjoyed. So instead, a Member State may now do *ex post* checks. It can do random checks and if, after checking a few companies at random, it concludes that on average too much aid was granted, it should take the actions necessary. For all intents and purposes, if a Member State would have to conclude that it introduced an aid scheme that does not comply with the GBER it would have to suspend it, notify and consider recovery in all past cases. So, despite of the fact that most Member State governments still need to get used to the idea of doing *ex post* random checks (to be kept on record for a minimum of ten years), the question is whether this option improved anything. The taxpayer that applies for a tax scheme included in the federal or local tax code, will still be at a loss either way if it turns out the GBER was inapplicable as he may face recovery.<sup>14</sup>

*Ex post* testing is not a solution to the underlying problem, although it offers an important relief of *ex ante* testing which, at least in this respect, improves the changes of survival of direct tax benefits under the GBER. But still, tax benefits incorporated in any entrepreneurial tax or corporate tax are hard to position in the framework that the Commission envisaged for getting automatic approval (and maybe for good reason; tax benefits are not always the most effective method of granting government support).

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<sup>14</sup> Should the Commission decide to approve non-notified aid after all, this could prevent recovery, notwithstanding possible issues regarding interest payments with respect to the period that already passed.

### 3. Tax regimes designed to benefit SMEs or to target larger companies

Some measures may benefit companies with lower profit levels (not necessarily smaller companies); a progressive tax rate may be the best example thereof. Such tax rates clearly fall outside of the reach of state aid control if they follow from the very nature and general scheme of a tax system that may want to address ability to pay, in direct taxation that is. Progressivity in indirect taxation is another matter. We recently saw two examples thereof in Hungary and Poland.

Hungary introduced a tax on advertisements. It was a progressive tax based on total costs of advertising.<sup>15</sup> This was of course a disadvantage to large, often nation-wide operating groups compared to local businesses that advertise. Poland introduced a retail sales tax which was also progressive and there also the Commission concluded that a progressive retail sales tax is targeted against large companies.<sup>16</sup> Sales and profits are not always related, so the Commission essentially questions progressivity in indirect taxation.

### 4. Difference in legal form

In most EU countries tax lawyers are used to the fact that there is an personal income tax and a corporate tax. Smaller, unincorporated companies and self-employed persons often fall within the scope of a personal income tax or a special small trade tax. An incorporated legal entity will often fall within the scope of a corporate tax and a partnership may either fall in either one of these tax regimes depending on national legislation. We more or less start by looking at the legal form to determine which tax will apply.

The problem from an EU perspective is that the focus of state aid rules is on the economic activity we are trying to tax. Sooner or later the CJEU will be confronted with questions on how far differentiated tax treatment of

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<sup>15</sup> Commission decision (EU) 2017/329 of 4 November 2016, OJ L 49/36 of 25 February 2017 (appeal pending, General Court T-20/17)

<sup>16</sup> Commission decision (EU) 2018/160 of 30 June 2017, OJ L 29/38 of 1 February 2018 (appeal pending General Court T-624/17, with regard to the final decision, and T-836/16, with regard to the decision to open a formal investigation.)

incorporated and non-incorporated entities may go. While we may argue that the two are not in the same legal and factual situation, we should keep the *Paint Graphos* case in mind.<sup>17</sup> There the CJEU already warned us that the mere difference in legal form would not be enough to always justify treating certain entities – cooperatives in the case at hand – as transparent for corporate tax purposes, especially if those entities would be performing their economic activities in a similar way to that of other incorporated entities that would not be treated as transparent.

### III. Are tax rulings an issue of size?

In recent times tax rulings have been at the center of attention as the Commission found that some of them led to state aid, granted to large multinationals. With all attention going to those rulings, we should be careful not to assume that all rulings are sweetheart deals; the vast majority may simply serve to do nothing more than confirm how national law is to be applied or, in the context of advance pricing agreements, what the proper transfer price should be in accordance with normal standards. That said, lack of exchange of information between tax authorities may even turn some of those regular ('correct') rulings into an instrument that might facilitate tax avoidance by using mismatches in treatment between countries. This phenomenon, however, is something that falls beyond the scope of state aid control. Even improving exchange of information – as with the recently introduced EU tax ruling database – may not solve all issues of double (non)taxation as legal doctrines may simply differ and mismatches may still occur because of that.

If a tax ruling *incorrectly* applies national legislations to the benefit of a company, this may prima facie qualify as state aid. But what if at the time the ruling was being issued national legislation was not clear and national case law was absent or inconclusive? Until one has either the legislator or the court clarify a certain situation the correct application of national tax law remains unclear. Obviously this is a situation any legislator should try to avoid, but once it does occur a tax ruling may be needed at that point in

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<sup>17</sup> CJEU C-78/08 to C-80/08, *Paint Graphos*, ECLI:EU:C:2011:550, in particular para. 74.

time to provide some certainty. If we start looking at tax rulings *ex post* we should be careful not to analyze them with hindsight.

To the extent a ruling would turn out to be incorrect (*ex ante*) and provide a tax benefit with regard to intra-group transactions, we should give some attention to what this could mean from a state aid perspective. Recovery of fiscal aid from companies that are part of a group may also affect other group Members. Should the Commission determine that other group Members indirectly benefited from special tax treatment given to another group member, the initial taxpayer, those other group Member themselves may also become the target of state aid recovery as co-beneficiaries of aid should the initial taxpayer, as a separate legal entity, not be able to pay up.<sup>18</sup> For this reason, such group entities should secure their procedural rights in time (together with the taxpaying entity) as they are unlikely to get a second chance at EU level once they are called upon the pay.

#### IV. Non-enforcement of the ATAD and the future of § 42 AO

On the EU level the so-called Anti-Tax Avoidance Directive (ATAD) has been adopted in 2016, which requires EU Member States to introduce a number of anti-abuse rules in their corporate tax law if they not already have such rules in place.<sup>19</sup> As for the latter, for those Member States that apply the ATAD in a minimalist way we should consider that it is possible to stay out of the ATAD by switching to a legal form that does not fall under the national corporate tax law, as some partnerships may. This raises the question whether ATAD will be as effective as it could be, as long as it is

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<sup>18</sup> We have seen this in nearly all of the recent tax ruling recovery cases to date, although in the *Belgian Excess Profit* case the Commission failed to identify the group Members as co-recipients of aid, which might have hindered effective recovery from those group members if the original taxpayer had not been able to pay the recoverable amount as a legal basis for recovery from non-aid recipients would have been lacking. (See Commission decision (EU) 2016/1699 of 11 January 2016, OJ L 260/61 of 27 September 2016.)

<sup>19</sup> Council Directive (EU) 2016/1164, OJ L 193/1 of 19 July 2016 (as amended).

restricted to corporate taxes and Member States hold the key to determining what entities fall within the scope of such taxes. Possibly the *Paint Graphos* judgement, referred to in para. II.4 above, may play a role here in future.

That said, it is rather unlikely that the general anti-avoidance rule (GAAR) to be introduced in accordance with ATAD will be restricted to corporate taxation in most Member States, as it often is part of procedural regulation with a wider scope of application. In Germany a GAAR already exists in the form of § 42 AO. The question is what will happen to it in 2019. Should it be considered that no change in § 42 AO is necessary to accommodate the ATAD GAAR, then we should realize that as of 2019 this paragraph is to be interpreted in line with the new EU definition, which is likely to be somewhat broader.<sup>20</sup> Article 6(1) and 6(2) of the ATAD state:

“For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. [...] An] arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.”

In the end it will be up to the CJEU to determine what “valid” commercial reasons are (would attaining anything other than a purely fiscal advantage suffice?), and whether the ATAD limitation as such is in line with the fundamental freedoms. But its interpretation is not this author’s main concern. The ATAD requires us to apply the GAAR as a minimum norm. For those Member States where judges and tax authorities are more reluctant

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<sup>20</sup> The *Leur-Bloem* doctrine will probably not apply as long as Member States explicitly clarify that their existing domestic GAAR will apply to situations covered by the ATAD GAAR for corporate tax purposes only, as to not let the CJEU’s interpretation of the ATAD GAAR affect the use of the existing GAAR in respect to other taxes. (See CJ C-28/95, *Leur-Bloem*, ECLI:EU:C:1997:369.)

to invoke a GAAR and use it as a measure of last resort there may be a need to shift gear.

We should seriously consider the possibility that the Commission will use state aid rules to enforce the ATAD and the application of the GAAR in particular. In the field of direct taxation we still need to get used to Directives that provide rules that may negatively affect tax payers, something we know from indirect taxation for a long time already. In the past Directives in direct taxation were often invoked in court proceedings to the benefit of taxpayers, as were the EU's fundamental freedoms. With ATAD it is the exact opposite.

Should a Member State fail to implement the ATAD correctly into national law, the obvious course of action for the Commission would be to start an infringement procedure (Art. 258 TFEU). However, if the ATAD has been implemented correctly but its enforcement is lacking, an infringement procedure is not the only option available to the Commission.

The selective non-application of anti-avoidance rules can be dealt with under state aid rules. With rather specific norms like CFC rules, hybrid mismatches and interest limitations this is something that should not come as a surprise, as the same would be true pre-ATAD when a Member State's tax authorities would decide to look the other way when a large iconic company would normally be caught by an anti-avoidance rule. With more open norms like a GAAR a decision (not) to invoke it may be more a matter of domestic policy and procedural habits, but state aid can still play its part here. Especially after the introduction of an EU-wide minimum norm the European Commission might consider to enforce that minimum norm by questioning their non-application in individual cases as part of state aid investigations.

We must take into consideration that invoking the new ATAD GAAR may happen far more frequently than we may be used to under existing GAARs like § 42 AO, depending on how the CJEU will interpret the scope of the new GAAR. Tax authorities that have been more cautious with invoking GAARs traditionally, may have to reconsider their approach. Otherwise, they might find the Commission on their path with Article 107(1) TFEU. Ironically, a total failure of a Member State to enforce anti-avoidance rules has to be dealt with under traditional infringement proceedings once the ATAD implementation deadline has passed, as it is likely to escape the application of Article 107(1) TFEU as the necessary selectivity will be lacking.

## V. Concluding remarks

In these last few years a lot of attention has been given to recovery of tax benefits provided via tax rulings to large multinational companies. While advance tax rulings and advance pricing agreements may indeed contain state aid if they deviate from national law and national transfer pricing rules (based on the information available at the time such ATR of APA was issued), we tend to forget that the scope of state aid rules is much broader.

It is important to realize that tax benefits to small and medium sized enterprises are also fully within the scope of state aid law. With the exception of introducing some administrative thresholds, Member States often underestimate the conditions they need to fulfil to be exempted from notifying SME tax benefits to Brussels, as there is a lot of fine print to it.

Once the ATAD has been implemented into the national laws of EU Member States, certain loopholes for multinationals will be closed. With the introduction of a general anti avoidance rule in corporate taxation, we now need to implement an EU minimum norm dealing with abuse of law, the enforcement of which may be safeguarded by the Commission using state aid recovery as a powerful tool. As it has retroactive effect, it may prove to be more effective than traditional infringement procedures. When it comes to provisions like § 42 AO the interpretation and the frequency of application of that paragraph may change as of 2019, should Germany decide not to implement the ATAD GAAR via more targeted legislation.

Last but not least, Member States are often reluctant to intervene and submit their opinions to the EU's Courts in state aid cases, even though the Commission is dealing with rather fundamental issues at the moment that may change the international tax system as we know it today. Intervening in a case should not be seen as coming to the defense of another country or as helping the Commission make its case. We simply need Member States to voice their opinions on issues of national and international taxation as there are substantial differences in legal doctrines across the European Union, which should be heard and not ignored.