THE RELATIONSHIP BETWEEN THE EU'S STATE AID LAW AND NATIONAL TAXATION SYSTEMS: CONFLICTING, CONCURRENT OR COMPLEMENTARY?

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Introduction

Globalization and international institutions have created an economic market calling for strong competitive policies. For this reason, it is convenient for many states to relinquish some of their sovereignty for an increased influence amongst other competitors. The European Union (EU) is the leading example of supranational integration. Its establishment and expansion has significantly strengthened its position in the global market. Alongside these accomplishments, the EU has *in tandem* been blamed that it has encroached its Member States' national sovereignty in a whole range of areas, with tax being no exception.

Against this background, there has been considerable debate on the relationship between the EU's competences and the fiscal sovereignty of Member States in the context of the EU's State aid system. The EU's State aid rules target those instances whereby national governments hand over subsidies to a particular firm or sector of their economy. Where the recipients of these subsidies manifestly gain an advantage over others, there will be distortion of competition, affecting trade within the Internal Market. The provisions in place contained in the Treaty on the Functioning of the European Union (TFEU) call for *ex ante* control by the European Commission to protect the proper functioning of the Internal Market and intra-competition and trade.

Both the European Commission, as well as the European Courts, have delivered elaborate reasoning for determining certain fiscal measures to be selective. In

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doing so, however, no parameters of 'selectivity' have been established, and this has extended the scope of the provisions that are found in the Treaty. A great amount of literature has called for a dividing line between general and selective aid, and the need for a more effects-based policy, especially given that the use of fiscal aid is a very appealing mechanism for states to persuade international mobile business to relocate to their jurisdiction.

The 2009 economic and financial crisis has contributed to increase the haze of the boundaries of 'selectivity', albeit it being suitable to tackle the moral hazard that had been caused. Moreover, the EU's political approach of employing State aid rules to end the harmful tax competition has also attracted significant debate on the real aims of the EU's State aid law.

The aim of this article is to contribute to an inter-disciplinary analysis of the EU's State aid law and policy in order to portray the pivotal role that it possesses both at EU as well as at national level. At the same time, it aims to cover the limits that are, or should be, in place for European law on Member States' fiscal policy sovereignty in matters of international tax law, but also on taxes levied by local authorities.

The methodology undertaken to produce the above critical issues is as follows; the first part attempts to analyse the legal interpretation of the provisions on State aid contained in the Treaty on the Functioning of the European Union (TFEU) through selected judgments of the Court of Justice of the European Union (CJEU).

Next, the importance of an economic analysis is presented to emphasise the reasons for a concomitant legal and economic study to determine the existence of 'selective aid', given the highly inter-disciplinary nature of the rules in question.

The final part attempts to identify the role of the European Commission in State aid control, whether the EU's State aid rules have proven to be efficient and sufficient, and the dividing line between the European Union's competences against the Member States' fiscal sovereignty, through a discussion on selected challenges that State aid law and national tax regimes have faced and continue to face.

This contribution makes no claim to be exhaustive; its main aim is not to come up with a pure philosophical system, as more often than not, in taxation and policy making, as in other fields, the law will try to reflect a combination of principles standing behind it. Rather, it aims to make a contribution to a sound discussion on a more efficient system of granting and controlling State aid within the Internal Market.

I. The Legal Interpretation of State Aid Rules

1.1. The Concept of State Aid

The State aid law is generally applicable where an anticompetitive practice or competition-distorting state aid has an actual or potential effect on trade between the Member States of the European Union (EU). This 'effect on trade' concept has consistently been interpreted by the European Commission and the European Courts in a very wide manner. Consequently, even practices and conduct that seem to affect only local trade are likely to be deemed to satisfy this concept and hence fall within the scope of EU competition and State aid law. This is because the European Commission has always striven to ensure that markets in the EU are as competitive as possible by respecting the Market's competition principles – in the belief that only competition will lead to the maximization of consumer welfare and the attainment of market integration.[2]

Article 107(1)[3] of the Treaty on the Functioning of the European Union ("TFEU") provides legal constraints to the granting of State aid in the EU. The granting of an economic advantage to an undertaking is incompatible with the common market, and therefore in general prohibited, thereby imposing a limitation on the tax sovereignty of Member States. This was proclaimed in the famous *Altmark*[4] ruling, whereby the Court of Justice addressed the question of whether financial support, granted by public authorities merely to compensate an undertaking entrusted with a public service obligation for the costs of providing the service, constituted an economic advantage and was therefore caught by Article 87(1) EC.[5]

In line with the principle that State aid is identified by its effects, and not its form, the Court of Justice has consistently held that the fiscal nature of a measure is not sufficient to shield it from the application of Article 107(1) TFEU.[6]

2 E. Buttigieg, 'Market Liberalisation, Competition and Consumer Welfare – Are We There Yet?' (European Documentation and Research Centre, Malta, 2004)

3 After the entry into force of the Lisbon Treaty on 1 December 2009, Article 107 TFEU replaced Article 87 EC.

4 Case C-280/00 *Altmark Trans GmbH and Regierungspräsdium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH* [2003] ECR I-7747

5 Now Article 107(1) TFEU.

6 Case 173/73, *Italy v Commission* [1974] ECR 709; Case C-56/93, *Belgium v Commission* [1996] ECR I-723; Case C-241/94, *France v Commission* [1996] ECR I-723; Case C-409/00, *Spain v Commission* [2003] ECR I-10901; Case C-487/06 P, *British Aggregates v Commission* [2008] ECR I-1.

However, a distinction is made between selective and general measures. Selective measures usually favour certain undertakings or the production of certain goods, and constitute illegal State aid, whereas general measures are those that benefit all undertakings in a Member State, thus not qualifying as State aid.

In its bid to combat harmful tax competition, the Commission has in the past set very high thresholds in order to be convinced that a tax measure constitutes a general measure, and not a selective one. This has attracted significant criticism towards the real aims of the EU's State aid policy. However, the 2009 financial turmoil and the responses to it from Member States have presented dramatic challenges to the Commission's competition and State aid policy, both in terms of the quantity as well as the nature of the measures that had to be put in place. Significant changes to the substance and procedure of State aid control have been adopted over the past years to reflect the evolving market conditions, and recent decisions indicate that the Commission could be taking a more lenient stance on this issue.[7]

1.2. Application of Article 107(1) TFEU to tax measures

A definition for State aid is not provided in the TFEU as such, neither for the granting of a fiscal benefit, but the criteria for the granting of such aid are provided in Article 107(1) as follows:

> 'Save as otherwise provided in the Treaties, 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, in so far as it affects trade between Member States, be incompatible with the internal market.'

Accordingly, a fiscal aid is qualified as State aid when it fulfills the following conditions cumulatively: (i) the aid is granted from state resources; (ii) it confers an economic advantage to undertakings; (iii) the measure is selective; and (iv) the measure is liable to distort or threaten to distort competition and affects intra-EU trade.[8] If one of the conditions is not satisfied, the law on State aid does not apply.

1.2.1. Use of State Resources

The Court of Justice of the European Union has repeatedly held that the notion of aid encompasses not only positive benefits such as subsidies, loans or direct

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7 C Ahlborn & D Piccinin, 'The Application of the Principles of Restructuring Aid to Banks' [2010] Eur. St. Aid L.Q. 2, 47

8 Case C-237/04, *Enirisorse* [2006] ECR I-2843; Case C-169/08, *Presidente del Consiglio dei Ministri v Regione Sardegna* [2009] ECR I-10821

investment in the capital of enterprises, but also interventions by which, public authorities, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which therefore, without being subsidies in the strict sense of the word, are of the same character and have the same effect.[9] Examples include providing preferential interest rates, loan guarantees on particularly favourable terms, providing goods or services on preferential terms or covering operational losses. There is not an exhaustive list of the forms that State aid can take.

In the *Regione Sardegna* case, the Court held that the tax on stopovers for tourist purposes by aircraft used for the private transportation of persons, or by recreational craft, that was imposed only on operators whose tax domicile is outside the region also amounts to State aid,

> "...even if it does not involve the transfer of State resources, since it involves the renunciation by the authorities concerned of tax revenue which they would normally have received."[10]

During the time of writing, it has been reported that the Commission approved the French State aid consisting of a loan guarantee of €7 billion to restructure Europe's second-largest carmaker PSA Peugeot-Citroën group, following a 14% drop in sales in the first half of 2013.[11]

For the purposes of a coherent record for the types of aids that are granted, the European Commission reports in its 2012 State Aid Scoreboard Autumn update that the direct grant is the most widely used by Member States to grant aid, both in 2011 and during the period 2008-2011, representing roughly 57.3% and 53.9% respectively of aid grant. Following this are aids granted through tax exemptions, accounting for approximately 35.9% and 39.7% respectively. Loans, guarantees, and other aid instruments only represented a minor fraction, around 6.8% and 6.4% respectively.[12]

9 Case C-156/98 *Germany v Commission* [2000] ECR I-6857, paragraph 25; Joined Cases C-341/06 *P* and C-342/06 *P Chronopost and La Poste v UFEX and Others* [2008] ECR I-4777, paragraph 123; Case C-169/08, *Presidente del Consiglio dei Ministri v Regione Sardegna* [2009] ECR I-10821, paragraph 56.

10 Case C-169/08, *Presidente del Consiglio dei Ministri v Regione Sardegna* [2009] ECR I-10821, paragraph 57

11 EU observer, "Brussels approves French State aid for Peugeot", <http://euobserver.com/tickers/121013> accessed on 31st July, 2013

12 Commission Staff Working Paper (EC) COM(2012) 778 final Facts and figures on State aid in the EU Member States [2012] Autumn 2012 Update

Figure 1: Expenditure as per aid instrument[13]

Expenditure as per aid instrument (2011)					
EU-27	**In € billion**	**As a % of total aid to industry and services**	**Difference when compared to previous year (in % of total aid to industry and services)**	**Trend 2009-2011 (in % of total aid to industry and services)**	**Difference when compared to previous trend (2009-2011)**
Grants	30.4	57.33%	2.49%	53.95%	3.31%
Soft loans	1.6	2.97%	0.12%	3.16%	-0.22%
Guarantees	1.6	2.96%	0.87%	2.09%	0.59%
Equity participation	0.2	0.42%	-0.55%	1.00%	0.61%
Tax exemption (incl. tax deferrals)	19.1	35.99%	-3.21%	39.72%	-4.38%
Other	0.1	0.28%	0.27%	0.09%	0.09%

1.2.2. Advantage through State resources

In order to establish whether an advantage that has been granted through State resources constitutes State aid, it is necessary to examine the national taxation system that is applicable in the relevant Member State.[14] Through an examination of the relevant framework at stake, rather than comparing it to the tax systems in the other Member States, the 'advantage' can be analysed and deemed to establish a more favourable tax treatment for certain undertakings than for others.

In determining the existence of an 'advantage', the above-mentioned 2004 Commission Report[15] refers to a decision related to cross-border transactions[16], where the Commission had to decide whether an Irish scheme exempting certain categories of foreign income from national tax *"where such income was repatriated for investment aimed at creating or safeguarding employment in Ireland,"*[17] amounted to illegal State aid.

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13 Taken from *Ibid.*

14 As demonstrated by paragraph 16 of 'Report on the Implementation of the Commission Notice on the Application of the State Aid Rules to Measures Relating to Direct Business Taxation, Doc. COM(2004)434 of 9 February 2004', <http://ec.europa.eu/competition/state_aid/studies_reports/rapportaidesfiscales_en.pdf>

15 *Ibid.*

16 Commission Decision of 17 February 2003 (OJ L 204/51) on aid scheme C54/2001 (ex NN55/2000) Ireland – Foreign Income

17 Commission Notice (n 13), para 16

It found that the scheme derogated from the rules applied in Ireland to prevent double taxation by way of tax credit, since it was based instead on the exemption method:

> "The ordinary tax credit method involved deducting from national tax the tax that had already been paid abroad within the limit of the amount of tax normally due in Ireland on the same income. Under the exemption method, on the other hand, no national tax was paid at all, irrespective of the amount of tax due abroad. The Commission found that the Irish scheme could in practice confer an advantage on firms benefiting from it where the tax due abroad was less than that normally payable in Ireland on the same income."[18]

In another case concerning the French economic interest grouping (EIG) tax scheme, the Commission undertook an in-depth investigation into the French tax system and concluded that the tax scheme at stake for financing assets leased by an EIG constituted illegal State aid as the scheme mainly benefited the maritime transport sector owing to the selective advantage it conferred and to the discretionary nature of its conditions of grant.[19]

Under the French tax rules, the tax deductible depreciation of assets leased by an EIG – a fiscally transparent structure – may not exceed the amount received by way of rent. Article 39 C, second paragraph, of the French *'Code Général des Impôts"* provides for an exception to this rule, subject to prior ministerial approval, in that operations involving assets depreciable over a period of more than eight years are not subject to the above restriction.

> "Besides the removal of the depreciation ceiling, the operations in question also benefited from a one-point increase in the depreciation coefficient normally applicable to the asset concerned and, where appropriate, from exemption from capital gains tax in the event of the asset being sold by the EIG to its user."[20]

Recently, in July 2013, the Commission has re-opened an investigation on the Spanish tax scheme allowing tax deductions in connection with the acquisition of shareholdings in non-Spanish companies. Originally, in 2011, the Commission had already ruled that this scheme constituted an illegal form of State aid. However, in March 2012, the Spanish authorities extended the scope of application of the

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18 *Ibid*

19 European Commission Press Release IP/06/1852 20/12/2006, <http://europa.eu/rapid/press-release_IP-06-1852_en.htm>

20 *Ibid*

measure also to financial goodwill deriving from indirect acquisitions, provoking a new inquiry to confirm whether this results in a selective economic advantage.[21]

The Commission considers these advantages to be manifestly derogating from the normal system conferring an advantage on certain economic sectors. As illustrated from the above examples, the design of the fiscal measures in issue is of little or no assistance at all in determining whether it constitutes a more favourable treatment than general taxation measures. An assessment needs to be conducted against the background of the relevant tax framework at issue, in order to determine whether certain undertakings are the beneficiaries of a more favourable treatment in comparison with other undertakings. This necessarily leads to an examination of the next criterion, specifying whether a measure is selective or otherwise.

1.2.3. Selectivity

The concept of selectivity refers to undertakings in a comparable position that are treated unequally due to the conferral of benefits limited to some, and not all, of these undertakings. Selectivity is perhaps the most disputed undetermined issue in the discussion on State aid. In the past decade, the concept has been widened, in part due to the thin line in practice between the advantage and selectivity criterion. An increasing number of literature has bitterly resisted this broad concept, with many submitting that the reason behind the wide application of 'selectivity' is, on the one hand, the Commission's indirect attempt to harmonize direct taxation, and on the other hand, to prevent harmful tax competition.

Despite existing criticism, it must be noted at the outset that, due to the heterogeneous nature of the twenty-eight EU fiscal legislations, it is very difficult to draw up general rules which are valid for all the states. A paradigmatic example is the difference existing between a material selective measure and a geographical advantage. Arguments applied to determine the existence of a material-selective benefit are insufficient to assess a regional State aid. Besides, the reasoning used to determine whether or not a geographical advantage is selective is not helpful for material-selective cases.[22]

1.2.3.1. Advantage vs. Selectivity

The Commission and the Courts bring into play the elements of 'selectivity' and 'advantage' to determine the limits of the freedoms

21 European Commission Press Release IP/13/701, 17 July 2013, http://europa.eu/rapid/press-release_IP-13-701_en.htm

22 Following the Azores case (Case C-88/03, *Portugal v Commission* [2006] ECR I-7115), regional selectivity depends on the level of political decentralization, which has no relevance for analyzing material-elective cases.

enjoyed by Member States when designing their own national tax systems outside the scope of the prohibition laid down by Article 107(1) TFEU, and consequently, outside the obligation to notify the Commission every single newly adopted fiscal measure.

In order to establish the existence of an advantage, a comparison must be made between the tax treatment provided by the national tax regime and the treatment under the contested tax scheme.[23] For a measure to be an advantage it should not be applied to all undertakings as this purports to lose the features of an 'advantage', which must benefit a group within the total.[24]

On the other hand, in order to assess whether a scheme favours certain undertakings or production of certain goods, it is necessary to establish a reference framework and ascertain whether the scheme at stake departs from it without being capable of being justified by the nature or general scheme of the tax system.

Consequently, the first step to determine the existence of a tax advantage and the assessment on whether that advantage is selective relies on the same approach, i.e., establishing whether there is a departure from the general tax system. Yet, the mere fact that a measure departs from the general tax system does not mean that it is selective *per se*.[25] In practice the distinction between advantage and selectivity is not very well defined. In a number of cases, the advantage test has overlapped the selectivity test with the result that similar considerations were used unclearly for the determination of both.[26] This has led to enormous legal uncertainty in making a proper delimitation of the concept of State aid necessary.

23 Schön, State Aid in the Area of Taxation, in: Hancher/Ottervanger/Slot (eds.), EC State Aids, 3 ed., 2006, pp. 256 -257.

24 H. López, 'General Thoughts on Selectivity and Consequences of a Broad Concept of State Aid in Tax Matters' [2010] Eur. St. Aid L.Q. 4, 807

25 If a Member State decides to reduce the tax burden with respect to some factors of production, it will be deviating from the general scheme in order to pursue non-fiscal economic objectives. This deviation will fall under the definition of aid under Article 107(1) TFEU. Nevertheless, there is no reason to start proceedings against such Member States because this aid is not selective insofar as it does not favour certain undertakings or the production of certain goods as Article 107(1) TFEU requires.

26 Case C- C-169/08, *Presidente del Consiglio dei Ministri v Regione Sardegna* [2009] ECR I-10821, paragraph 63

In this context, the Gibraltar tax case[27] has been a landmark case. The Court of Justice of the European Union (CJEU) held a company tax on business buildings and on payrolls capped at 15% of business profits to be regionally and materially selective. The Court upheld the selectivity of the measure for the reason that the tax was not applicable to companies that had no such business buildings or payrolls in Gibraltar. The features of this tax scheme excluded from the outset any taxation of offshore companies, given that they have no employees and also do not occupy business property in Gibraltar.[28] The Court understood this structure to be a broad tax that was then deliberately reduced in scope, albeit there being no evidence of this. It held that a tax regime designed in such a way that offshore companies avoid taxation constitutes State aid.

Much of the furor that was raised in literature was mostly based on the fact that the Court seemingly assumed a hypothetical 'normal' tax to be used as a standard of comparison. To this extent, Advocate General Jääskinen had warned against the comparison of a real tax with a 'hypothetical and non-existent' system, in order to decide whether a tax rule is selective.[29]

The case raised several issues for international tax planners particularly because the Court agreed with the Commission that *"State aid cannot be buried in clever drafting of a generally applicable law."*[30] It was also discussed by various scholars against the background of the consequences for offshore regimes, for regional autonomy on taxation in the EU, and for the concept of 'selectivity' in general.[31] These issues will be dealt with at a later stage in this contribution.

1.2.3.2. Regional Selectivity

In its judgement of 6 September 2006, in *Portugal v Commission*[32], the

27 Joined Cases C-106/09P and C-107/09P, *Commission v Government of Gibraltar and United Kingdom* [2011] ECR I-n.y.r.

28 *Ibid*, para 100-102

29 J Temple Lang, 'The Gibraltar State Aid and Taxation Judgment – A "Methodological Revolution"?' [2012] Eur. St. Aid L.Q. 1, 805,

30 L. A. Sheppard, 'Do Tax Havens Violate the TFEU' [2011] TA 1, 521.

31 Rossi-Maccanico, 'Gibraltar and the Unsettled Limits of Selectivity in Fiscal Aids' [2009]] Eur. St. Aid L.Q. 1, 63-72; Greaves, 'Autonomous regions, taxation and EC State aid', [2009] E.L.R. 34, 779-793; Lindsay-Poulsen, 'Regional Autonomy, Geographic Selectivity and Fiscal Aid: Between the Rock and a Hard Place', [2008] E.C.L.R. 1, 43; Luja, 'Fiscal Autonomy, Investment Funds and State Aid: A Follow-Up' [2009] E.T. 7, 49.

32 Case C-88/03, *Portuguese Republic v Commission of the European Communities,* 6 September 2006, ECR I-7115

Court considered for the first time the issue of regional fiscal autonomy in the context of State aid, establishing general criteria for the interpretation of selectivity in certain regions or municipalities within the territory of a Member State. Therefore, a tax measure that confers an advantage for a part of the national territory of a Member State, does not necessarily result in being selective as per the definition of Article 107(1) TFEU.
The Court held that,

> "In order to determine the selectivity of a measure adopted by an infra-State body which, like the measure at issue, seeks to establish in one part of the territory of a Member State a tax rate which is lower than the rate in force in the rest of that State it is appropriate…to examine whether that measure was adopted by that body in the exercise of powers sufficiently autonomous vis-à-vis the central power aid and, if appropriate, to examine whether that measure indeed applies to all the undertakings established in or all production of goods on the territory coming within the competence of that body."[33]

This is an exception to the rule, whereby a measure is classified as State aid according to the effects on intra-State competition and trade. It is necessary, demands the Court, to ascertain whether the regional authorities have procedural, institutional and economic autonomy in the exercise of their powers. Only if this autonomy exists would it be possible for regional aid to fall within the parameters of accpetable State aid.

1.2.4. Distortion of competition and effect on EU trade

Finally, the criteria of effect on trade and distortion of competition do not usually pose considerably difficulties to be detected once the existence of the 'advantage' which favours certain undertakings or the production of certain goods is already established.

As regards the effect on trade, the Court does not require an actual effect on trade; a possibility or foreseeable prospect that there is an effect on trade is enough.[34] The same can be said where the aid at stake strengthens the position of an undertaking compared with competing undertakings, resulting in a distorting effect. This does not require an evaluation of the position of the undertaking's competitors but

33 *Ibid.,* paragraph 58

34 Case C-142/87 *Belgium v Commission* [1990] ECR I-959, paras 35 – 40.

rather, whether the undertaking's financial position as a whole is improved by the aid.[35]

To illustrate this, if a local ferry between islands of the same country is subsidized, the trade between Member States is not affected and the European State aid law does not apply. But when the ferry connects two different Member States, the aid in question would be incompatible with the common market due to its distorting effects.

1.3. Compatibility of State Aid with the Internal Market

It is worth mentioning that measures that fall within the scope of Article 107(1) TFEU may nevertheless be, or be declared, compatible with the Internal Market if they satisfy the requirements provided in Article 107(2)[36] or 107(3) TFEU, and may therefore be implemented.

Three types of aid are considered to be compatible with the internal market[37]:

a. Aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;

b. Aid to make good the damage caused by natural disasters or exception occurrences;

c. Aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.[38]

Article 107(3) gives the Commission the discretion to grant exemptions to State aid prohibitions in five cases[39]:

a. Aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious

35 Joined cases 62/87 and 72/87 *Exécutif Régional Wallon and SA Glaverbel v Commission* [1988] ECR 1573

36 In cases where aid falls within the scope of Article 107(2), the Commission has the right to check that the aid does not exceed the amount that is necessary.

37 Article 107(2) TFEU.

38 The so-called 'Deutschland clause'.

39 The Commission's discretion under this article has been confirmed in cases including Case C-730/79 *Philip Morris v Commission* [1980] ECR 2671 paragraph 17.

underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation;

b. Aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

c. Aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;

d. Aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest;

e. Such other categories of aid as may be specified by decision of the Council on a proposal from the Commission.

A substantial body of soft law has been developed by the Commission highlighting the circumstances whereby State aid is to be considered as compatible with the Internal Market under Article 107(3). Particularly, this article is the legal basis for the granting of regional aid, sectoral aid, horizontal aid (for example aid for environmental protection), and restructuring aid following the recent financial crisis. Measures falling within the scope of this article must be notified to the Commission, before implementation, that will in turn scrutinize the compatibility of such measures with the rules on State aid.

In July 2013, the Commission has opened a consultation on the second draft for a revised Regulation on small aid amounts (the *de-minimis* aid),[40] whereby aid measures below a certain ceiling will not constitute illegal State aid given that they have no impact on competition and trade in the internal market. This is a welcome development, as it conveys that the EU's State aid policy is directed towards the imperfections of the present regime, yet it should, at the very least, raise the limit on the *de minimis* aid to small enterprises.

Block exemption regulations for aid for training, employment and small and medium-sized businesses have also been open to consultation.[41] State aid that is granted within the permissible limits of these block exemptions is deemed to satisfy the requirements of Article 107(3) TFEU and therefore do not require prior notification. This simplifies the rather long process of notification thresholds when

40 European Commission Press Release IP/13/699, 17 July 2013, http://europa.eu/rapid/press-release_IP-13-699_en.htm

41 European Commission Consultation on a draft General Block Exemption Regulation (the GBER) on state aid measures, 8 May 2013, http://ec.europa.eu/competition/consultations/2013_gber/index_en.html

the conditions are met, which is much needed if such regulations are to be administered by authorities throughout the EU.

To address the challenges raised by the financial and economic crisis, the Commission has set out Rescue and Restructuring Guidelines to mitigate the impact of the crisis on the national economies. This ensures that aid is given only to companies and industries with a realistic prospect of viability and without highly distorting competition within the Internal Market.

1.4. New and Existing Aid

Article 108 and 109 TFEU contain the procedures that are to be followed by Member States, the Commission, and the Council, in relation to new or existing aid. More detailed rules on the application of this article in this regard are contained in Commission Regulation 794/2004 on the implementation of state aid.[42] The Commission keeps existing aids under review and if it considers that an aid scheme is no longer compatible with the internal market, it will notify the Member State concerned to rectify the scheme. In the absence of rectification, the Commission will open a formal investigation.

Member States are obliged to notify any new aid to the Commission and must not put the aid into effect until the Commission has delivered its decision[43], otherwise this will be unlawful aid. This is known as the standstill obligation, and has been confirmed in the *CELF* judgments[44] to be a provision preventing unlawful aid from being implemented. Unlawfully granted aid is then subject to a repayment obligation.

The Commission's Autumn 2012 State Aid update reports that,

> 'From 1 January 2000 to 30 June 2012, the Commission took 986 decisions on unlawful aid. In 23% of unlawful aid cases (224 cases), the Commission took a negative decision finding the aid measure incompatible. Such negative decisions normally require the Member State concerned to recover the illegally awarded aid. In a further 3% of unlawful aid cases (28

42 Commission Regulation (EC) 794/2004 of 21 April 2004 implementing Council Regulation (EC) 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty [2004] OJ L 140/1 (Implementing Regulation),

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004R0794:EN:NOT

43 Article 108(3) TFEU.

44 Case C-199/06 *Centre d'exportation du livre français (CELF) and Ministre de la Culture et de la Communication v Société international de diffusion et d'édition (SIDE)* [2008] ECR I-469 *("CELF 1");* Case C-1/09 *Centre d'exportation du livre français (CELF) and Ministre de la Culture et de la Communication v Société international de diffusion et d'édition (SIDE)* [2010] ECR n.y.r. *("CELF 2").*

> cases), the Commission took a conditional decision. In addition, 265 unlawful aid cases are pending and thus under scrutiny by the Commission. Those cases are usually taken up by the Commission in reaction to a complaint or *ex officio* (at the Commission's own initiative). The figures also include cases notified by a Member State but where the measure was fully or partially implemented by the Member State before the Commission's final decision (i.e. cases where the standstill requirement was not breached).'[45]

1.5. Conclusions

Tax competition has increasingly led Member States to move capital in States that offer the most favourable tax incentives rather than opting for an efficient allocation of resources. Due to the resulting lower corporate taxes, this leads to a loss of tax revenue, in turn leading to increased taxes of non-mobile bases. Following the 2008 financial and economic downturn, this is particularly worrying, hence the Commission's struggles to tackle the limits of harmful tax competition.

Tackling this situation brought about a wide interpretation of 'selective' measures that fall foul of the EU's State aid law. Yet, it has been submitted that 'over-stretching' the interpretation of the selectivity criterion might lead to other harmful consequences. A strict separation of the concepts of 'selectivity' and 'advantage' may not always be ideal albeit making crucial differences in legal analysis. From the point of view of State aid policy, a difference should be made the right of Member States to design their own tax regimes which could include several tax exemptions (not to be considered as a benefit), and the conferral of a benefit by a Member State to an undertaking that ultimately effects trade within the Internal Market.

To determine the proper benchmark of whether a measure is unlawful or otherwise, the nature and structure of a tax system must be analysed as a whole, possibly including a more economically-sophisticated analysis to the legal analysis, and not only by reference to the initial tax base, where all but few are exempt from a tax or – contrarily – where all but few are entitled to a tax benefit.

The next part attempts to highlight the importance of including an economic analysis in determining unlawful State aid. In the absence of such an analysis, there risks to be a comparability analysis rather than a determination of a State aid violation, and this will lead to a more complex legal analysis of State aid. Further

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45 Taken from Commission Staff Working Paper (EC) COM(2012) 778 final Facts and figures on State aid in the EU Member States [2012] Autumn 2012 Update, page 47

than that, given that it is a deeply controversial issue, it is likely to raise eyebrows among those who are concerned with competence issues.

The following part will then be dedicated to the 'competence' issue and critically examine the role of the Commission in controlling State aid against the background of the rapid succession of events and the sheer scale of material involved since the financial crisis, together with recent judgments that have developed the concept of 'selectivity' even further.

II. The Economics of Granting and Controlling State Aid

> "Public spending should become more efficient, effective and targeted at growth-promoting policies that fulfil common European objectives."[46]

2.1. The Role of Economics in State Aid Analysis

Constraints on national budgets and concerns about the effectiveness of State aid have increased the political pressure towards a more economics, effect-based approach in the granting and controlling of State aid. The recent financial crisis has threatened the single market's integrity and the political mandate both at national and European level is targeted towards *"making Europe a smart, sustainable and inclusive economy."*[47]

This part attempts to explore why an economic analysis of State aid is indispensable for an effective study on State aid control and why an increased reliance on economic insights can contribute towards the objective of effective State aid control.

At the outset, it must be highlighted that State aid control is relevant to various angles of economics. Firstly, to public economics, given that State aid is a form of public intervention in the economy. In the absence of economic assessment, national governments will not be able to assess the effects of public assistance being granted to enterprises.

Secondly, State aid relates to the economics of competition due to the fact that state aid confers an advantage to some undertakings, with a potential distorting effect on the competitive process. This is central in an economic analysis on State aid, i.e. establishing whether an aid is potentially general or selective in nature, and consequently establishing the extent to which an aid confers an economic advantage

46 Communication (EC) COM(2012) 209 final *EU State Aid Modernisation (SAM)* [2012]

47 *Ibid.*

to the recipient. Whereas in some instances it is fairly straightforward to determine the size of the economic advantage conferred, e.g. when it relates to direct subsidies that are granted to companies, in other situations, it is less clear especially in the context in which governments invest in companies or provide loans or guarantees.

Thirdly, State aid control is also relevant to international trade theory, as State aid can affect trading conditions. This incentivises national governments to employ state aid tools in order to pursue national economic or political goals, which in turn provides a rationale for European (or supranational) State aid control.[48]

Despite the close relation of State aid to these well-developed areas of economics, most of the analysis on European state aid is not embedded into these economic principles.[49] There are a number of reasons for this. Firstly, as discussed in the previous part, the legal principles and the wide interpretation underlying State aid is quite challenging, making it more intricate to establish legal certainty.

Another reason for the lack of an economic-based study on State aid control is that by its very nature, State aid is intrinsically a political, rather than an economics-based, tool, leading therefore to a desire to shift political influence rather than attain economic effectiveness.

In the existing legal context of European State aid control, the competition analysis and the assessment of the negative effects on trade lie at the basis of future changes to existing regulations. Economic analysis of the compatibility of a given measure is limited mainly to the assessment of the 'economic advantage' of the measure. In principle, a balancing of the benefits of the aid together with the distortive effects of the aid is foreseen. In practice, however, the approach taken rests largely on the definition of the eligible costs and the use of maximum aid intensities.

Applying this approach fails to identify the effectiveness of aid and the actual impact on the markets. Combining it with the rather wide approach taken when considering whether a measure is selective or otherwise (as discussed in the previous part), confirms why the current State aid approval system is imprecise, sometimes 'overstretched', and lacks legal certainty, resulting in tension between the supranational EU level and the national level with no clear distinction between the 'good' aid measures and the 'bad' aid measures.

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48 J Haucap, U Schwalbe, 'Economic Principles of State Aid Control' [2011] Dusseldorf Institute for Competition Economics, Discussion Paper No 17, page 2

49 H. W. Friederiszick, L. Roller, V. Verouden, *European State Aid Control: An Economic Framework* (Working Paper, MIT press, 2006) page 1, 2

2.2. The Rationale for Granting State Aid

In order to assess whether the EU's State aid rules aim to promote economic efficiency, it is pertinent to first assess the context of such an assessment. It is necessary to examine why, in the first place, national governments grant aid, and subsequently, why the EU needs to put constraints on aid being granted within the Internal Market. This examination would then allow addressing the issue of whether existing EU rules comply with what the theoretical principles on state aid prescribe.

2.2.1. State Aid as a Tool for Correcting Market Failure

There is a large volume of literature contributing to the discussion on whether, when, and how governments should aid their companies and their industries. It is generally accepted that aid may be justified when it aims in principle to ease to the so-called market failure. In contrast to what common usage may suggest, the term market failure in economics describes *"a relatively narrowly defined field of inefficient market outcomes."*[50]

Haucap and Schwalbe put forward in their Discussion Paper that,

> "Market failure is present when the market does not provide effective results with the free play of forces. No market failure exists, however, when markets deliver efficient, though not politically desired, results."[51]

Various reasons are cited for market failure in economic literature including externalities, public goods, imperfect competition, asymmetric information distribution, and adjustment or coordination deficiencies.[52] These reasons justify government intervention, subsidies, and incentives for investment and production processes.

2.2.2. State Aid and Politically-Motivated Reasons

Government intervention in the market mechanism can lead to significant distortions of competition, causing severe economic costs. Since government spending is paid primarily from tax revenue, it represents a reduction of income for the government that is in turn distributed to privileged companies. As discussed

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50 J Haucap, U Schwalbe, 'Economic Principles of State Aid Control' [2011] Dusseldorf Institute for Competition Economics, Discussion Paper No 17, page 5

51 *Ibid.*

52 Nicolaides, *Essays on Law and Economics of State Aid* (Maastricht 2008), page 74

in the previous part, selective aid will cause undesirable effects such as price distortions, which then leads to additional state-support payments.

Nevertheless, despite such disadvantages of government intervention, the political reality is that aid is granted even when other measures are more targeted to competitive purposes from an economic point of view. It is part of a political process, influenced by political decisions, in which the responsible actors also pursue their own interests. The risk of self-serving behaviour by political decision-makers is particularly high, as it will affect the success or otherwise of a political party in power. Therefore, in populist terms, it is easily conveyed that certain aid helped to, for example, permanently create or preserve jobs in a particular region, whereas in reality this would be an inefficient method of allocating aid.

Article 107(3) TFEU itself includes normative reasons for granting aid, such as the adjustment of living conditions, and the development of certain economic activities or areas amongst others. These political objectives refer to both the economic conditions in different Member States and the discrepancies in the standard of living among regions within a single Member State.[53] EU legislation permits aid to support the standard of living in some regions in view of its objective of improving the solidarity within the Union. However, at the same time, it is not only the living conditions that are the political objective of aid policy; it is also development, i.e. changing the living conditions that are supposed to be on a uniform level within the European Union.[54] It is in this context that normative fiscal policies become exceptionally justified when they relate to a state's aspiration to promote to promote outcomes such as reduced poverty, higher standards of living, and macroeconomic stabilization.[55]

53 J. Haucap, *The More Economic Approach to State Aid Control: A New Institutional Economics Perspective* (2007) 98f

54 *Ibid.*

55 Inevitably fiscal policies are approached both from the practical and the normative side, due to the political and economic issues involved. The principal question that economics literature raises is the effect that such policies have on economic growth, and on the efficient use of resources in the national economy. Practical policies tend to generate the needed public revenues without any serious distortions; they can be said to be neutral and avoid distortions in economy behavior. On the other hand, practical policies would be highly unlikely to yield sufficient revenues to fund socially useful expenditure without producing substantial inequity. Undoubtedly, normative fiscal policy is critical to have a competitive, attractive, and efficient system of taxation. For example, in the UK, after the 2007 economic crash, one of the very first general measure was a VAT-free holiday in order to encourage people to keep spending through the Christmas period, in order to attempt to balance the economy. As condemned as it may be, there is no single Government that does not try to use normative measures in structuring a state's fiscal policy.

2.3. The Rationale for State Aid Control

It is submitted that government intervention relates to the conduct of (national) market participants through economic policies. It follows that these economic policies, particularly those affecting the trade of goods or mobile factors of production, will generate cross-border effects within the Internal Market. As long as these effects are positive, there will be no need for controlling this government intervention as member states will be benefitting from the state aid policy of other members. On the other hand, when a national aid policy generates negative cross-border effects[56], regulations at an EU level (supranational rules) are deemed to be essential to protect the interests of the Internal Market.

In this context, the EU's regulations on State aid control aim not only to eliminate these negative effects, but also to introduce more transparency and predictability in the Member States' fiscal policy-making.[57] This permits companies to plan their investments easier. In other words, the purpose of State aid control is to prevent, above all, Member States within the Internal Market from using government intervention in order to circumvent competition rules by gaining an unfair advantage with the support of the domestic industry.

2.3.1. Cross-Border Spillover Effects

Regulation of national fiscal policies is justified for various reasons, albeit being highly disputed. In principle, the first and most prominent justification is that government intervention may cause negative spillover effects on other European states. In this context, State aid control avoids wasteful subsidies and prevents *'tit-for-tat'* strategies where other member states may be induced to intervene with aid to their comparable industries.[58] Governments may easily get caught in a sort of *'prisoners' dilemma'* situations in relation to a broad set of situations involving forms of state aid, from launching aid in the aviation industry or other types of research and development aid, to attracting foreign direct investment, or providing rescue and restructuring aid.

Friederiszick, Roller, and Verouden put forward in their discussion paper the following example to illustrate the above justification for state aid control:

> "To give an example, consider a situation in which rescue and restructuring aid is given to a failing firm in one member state producing

56 An example of a negative effect would be the reduction of welfare of other countries.

57 n. 51, page 76

58 This is also the rationale behind the scrutiny of state subsidies by the World Trade Organisation, and was also the main aim for including State aid control as part of the Treaty of Rome in 1957 in order not to endanger the creation of the Single Market.

> products for markets located outside the EU and facing competitors located in other European countries. Assume that the industry is in decline, forcing a gradual exit of certain producers. In such a situation the order of exit will typically depend on firms' ability to commit to stay in the industry. A unilateral commitment to subsidize one of the firms can alter the order of exit, and induce the immediate closure of other (non-domestic) firms."[59]

Similar situations have been subject to strong criticism amongst scholars, legislators, and politicians alike, amidst the numerous bailouts that have been given by the EU in the last decade, as well as the rescue and restructuring aid given to numerous companies and industries.

2.3.2. Efficiency Maximisation

A further justification for State aid control relates to what economists term as *'soft budget constraints'* which refers to the idea that national governments may not commit to specific rules and a fixed budget *ex ante*. In this context, companies and industries will not have an incentive to become efficient, as they (rightly) anticipate that the government will bail them out when the need arises. As a result efficiency and welfare is reduced.

An example of this is provided by the Hungarian economy in the 1970s. Hungary, at that time still a socialist economy, was experimenting with the introduction of market reforms. Despite the introduction of incentives for state owned firms to maximize their profits, firms were always bailed out when exhibiting long term losses. This *'insurance against bankruptcy'* resulted in severe dynamic inefficiencies.[60]

These are common problems in rescue and restructuring. Equally important issues in this context are public-private partnerships that sometimes continue, after some years, as fully public entities.

2.3.3. Safeguarding the Internal Market

Related to the above is the safeguarding of the proper functioning of the Internal Market. Consistent with this justification, the latest State aid modernisation communication provides that,

> "Robust State aid control is also essential to ensure a well-functioning single market...State aid modernization can improve the functioning of the internal market through a more effective policy aimed at limiting

59 n. 48, page 22

60 n.48, page 24

> distortions of competition, preserving a level playing field and combating protectionism."[61]

State aid control therefore aims to increase competition and allow companies to restructure and achieve scale, thereby promoting economic growth. This has repeatedly been held in the EU's formal communications on the EU's state aid policy.[62] It has at the same time been the source of apprehension within the Community given that some Member States perceive the Commission's aims to strengthen the Internal Market through the regulation of State aid rules as encroaching on their sovereignty (ultimately harmonizing national fiscal policies) and attempt to disguise this by emphasizing the need to combat harmful tax competition.

This criticism has been endorsed by the Advocate General Jääskinen in his Opinion on *Commission and Spain v Government of Gibraltar and the United Kingdom* delivered on 7 April 2011[63], whereby he considered that the European Commission had gone beyond the boundaries of State aid control in reviewing the tax measures at issue and overstretched the notion of selectivity in order to counter the harmful tax competition.[64]

2.4. The 'Balancing' Test

Determining whether any sort of government intervention should be justified begs the following tests to be put into place in order to analyse its impact on efficiency:

i. Firstly whether the aid addresses a market failure or other objective of common interest;

ii. Secondly, whether the aid being granted is appropriately targeted towards the established aim;

iii. And finally whether the positive effects of the aid generally outweigh distortions of competition.

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61 n. 45, para 15

62 In the recent State Aid Modernization Package (2012) *[vide footnote 45]*, one of the objectives for the reform of state aid is to foster growth in a strengthened, dynamic and competitive internal market.

63 Opinion of Advocate General Jääskinen in Case C-106/09 P *Commission and Spain v Government of Gibraltar and the United Kingdom*

64 *Ibid,* para 134; the Court of Justice did not uphold the interpretation of the Advocate General in this case, and enlarged the concept of selectivity even further as has been pointed out in Part 1 of this contribution. The Court of Justice of the European Union is also allowed to look at the general tax regime and analyze whether the effects of general regime applicable create a 'privileged' category of undertakings which are in a comparable situation to other undertakings.

This permits a balance between the positive and negative elements of the aid in the sense of a cost-benefit analysis. Scholars have submitted that in order to further increase the effectiveness of EU state aid control, a more *effects-based* approach is warranted, in particular for large amounts of aid. This would be a means to better distinguish 'good aid' from 'bad aid.'[65]

Essentially, it also would lead to limit any form of wasteful government intervention in the economy, with the possibility of distorting competition within the Internal Market. Naturally, this begs the question whether there is the need to have supranational rules and authorities to curb the Member States' wasteful spending. Given that, politically, it is undesirable for governments to deny some form of 'aid' to industries and companies, the intervention of supranational rules are suitable to 'tie the hands' of Member States in order not to squander fiscal resources in illegal State aid schemes.

As Lorenzo Coppi rightly puts it,

> "In conclusion, the balancing test seems unnecessary and inadequate if the aim is to protect the internal market and to prevent State aid from provoking wasteful subsidy races; but it is an appropriate instrument if the aim is to promote budgetary discipline with regard to Member States' fiscal spending."[66]

2.5. Conclusions

It has been submitted that determining the existence of aid that is contrary to Article 107(1) TFEU, or that is compatible with Articles 107(2) and 107(3) TFEU, has not in many years taken into account the economic approach but has rather focused on a thorough legal analysis. Recent developments, such as the European Commission's continuous plans for reform of its State aid regime, as well as novel interpretations given by the Court of Justice with reference to national tax measures in existence, seem to be undertaking a commitment towards a more analytical framework for the analysis of the relative provisions.

This development is welcome given the Commission's overall objective of promoting efficient, effective and growth-promoting policies in the context a modernized state aid control regime to correct market failure. Of course, the extent to which the economic framework will be taken into account both by the

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65 n.48, page 37.

66 L Coppi, 'The role of economics in State aid analysis' in E Szyszczak (eds), *Research Handbook on European State Aid Law* (1st, Edward Elgar, Cheltentham, UK 2011), page 77

Commission as well as by the Court of Justice of the European Union remains to be seen in upcoming judgments and future legislation.

Against this background, there are strong opponents against the European Commission's approach in the field of State aid law, essentially due to the delimitation of competences between the EU and the Member States. At the outset, Member States remain free to design their own national tax systems as long as they are in line with the Treaty. Stretching the State aid rules too far would generally add more legal uncertainty to the determination of illegal State aid, and would be impinging on the Member States' ability to design their own tax regimes.

An additional question that may be put forward against this background is whether there exists a constitutional basis for entrusting State aid law with such an intrusive function to the Commission. This type of question is really and truly the point of inter-disciplinary work, and what economists may see as fully reasonable may be regarded by lawyers as deeply problematic. That is why economists and lawyers should be concomitant rather than miles apart from each other.

The discourse between national taxation systems and the supranational rules will be the subject of the discussion in the next part. In particular, the discussion will focus on the balance of competences and the lack of certainty emanating from the Court's recent interpretations of 'selectivity', also taking into consideration the areas that are critical in times of austerity. Reference will also be made to the use of State aid law to counter harmful tax competition, and the resulting reactions from its Member States to illustrate and understand whether the rulings on State aid are giving a new impetus to the Commission and the EU to meddle in national taxation systems, prompting more discourse within the Community.

III. The EU's State Aid Policy and National Tax Systems: A Clash of Fundamental Principles?

> "It is neither the intention or avowed aim of EU law to call into question the limits of any inherent power of taxation or to disturb the order of priority of one allocation of tax competences as between Member States, and that, in the absence of EU harmonization, the court is not competent to interfere in the concept or organization of the tax systems of Member States."[67]

67 Panayi, Christiana, HJI, *'Harmonisation and Direct Taxes – Is it Really Needed?'* in *Studies in European Public Law: Thematic, National and Post-National Perspectives* (Sakoulas Publications, 2010)

3.1. (Im)Balance of Competences?

The discord between intergovernmentalism (the traditional state-to-state relations) and supranationality (the sharing of national sovereignty) has pervaded the EU ever since its establishment. With the ambition of realising an 'ever-closer-union'[68], the founding Member States of the EU agreed to share national authority in certain policy areas. As more and more states joined the European bloc, Governments were evidently not enthusiastic about sharing their sovereignty, yet appreciated at the same time that it was in their national interests to do so.

Over the years, this relationship between intergovernmentalism and supranationality has not remained static. The two concepts have proven to complement as well as conflict each other at different times, albeit the two not being irreconcilable. Some view the surrendering of national sovereignty as a factor to strengthen the EU's influence in the global markets. Euro-sceptics, however, are uncomfortable with the passing on of their national sovereignty to an institution that in their opinion is sometimes obscure in its aims. Certainly, the European Commission has acquired increased supranational powers through the years, but its influence in the EU system has *"waxed and waned."*[69] In a number of policy areas, legislation at the EU level is rarely enacted in the face of strong national reservations, especially on the part of influential member states.

Taxation is the perfect image of this stalemate. The Court has consistently held, since its early judgments that Member States are free to design their own national tax systems as they deem fit with their economic policies, as long as they are consistent with the general freedoms laid down in the Treaty and with the State aid rules.[70] Yet the EU's position on taxation has at times been a far cry from the views taken on by its Member States. Initiatives such as the Common Consolidated Corporate Tax Base (CCCTB)[71] or the recent Financial Transactions Tax (FTT)[72] saga highlight the manifest contrast in the approach taken by the European Commission and some of its Member States when it comes to tax policy making.

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68 Treaty of 1957 establishing the European Economic Community

69 D Dinan, *Ever Closer Union: An Introduction to European Integration*(3rd, Lynne Rienner Publishers, USA 2005) 2

70 Case C-279/93, *Finanzamt Koln-Altstadt v.Schumacker,* ECR I-225, paragraph 21

71 The CCCTB Proposal has been in discussion for over ten years and it is envisaged that not all 28 EU Member States will subscribe to it.

72 Since the beginning of the discussion of the FTT, several countries were staunchly against the introduction of such a tax as it would severely affect their financial markets. The UK, in particular, has been strongly opposing it so much so that in 2013, it launched a legal challenge at the European Court of Justice against plans for a European Financial Transaction Tax. Other countries opposing the tax include Sweden, Luxembourg, Malta, Bulgaria, Cyprus, Czech Republic, and Denmark.

The United Kingdom, widely perceived as a strong critic towards the EU's policies in general, and taxation in particular, has recently reported this impasse in the EU's tax policy making process, stating that, unlike the UK's consultative approach, the European Commission fails to provide clear consultation documents, consulting all relevant target groups, leaving sufficient time for participation, publishing the results, and providing feedback.[73] The UK rightly justifies its position by submitting that while it recognizes international action to be necessary in the face of international competition, it is still wary at the EU's attempts to encroach national sovereignty.

Against this background, State aid law can be termed as the litmus test of the conflict between the Member States and the Commission, given that the latter (supranational rules) supersede the former (national tax regimes). Those who are familiar with the nuts and bolts of State aid law will understand how national governments become ever more resentful of decisions made at a supranational level that restrict their right to prop up failing industries and companies. This is even more so in the light of the arbitrary, and sometimes confusing, interpretation given by the Commission and the Courts. At the same time, a justification for the exchange of formal sovereignty has been quoted to be real influence on other blocs[74], which is crucial for the European Union in the context of international tax competition.

For this reason, this part attempts to identify the extent to which (if at all) the European Commission has been overtly entrusted with a 'watch-dog' function of State aid law, and if there should be any limits to this function, when determining if a tax measure is selective or acceptable. This is discussed from the angle of the recent interpretations delivered by the Court in favour of the Commission's actions.

Naturally, this begs the question of whether the existing and proposed State aid rules are sufficient, efficient and effective. This will be critically examined in the light of the methods used by the Commission to employ its State aid rules to tackle the harmful tax competition; and the approval of aid granted by national governments following the 2009 economic and financial crisis.

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73 The British Bankers' Association Response to "The Government's review of the balance of competences between the United Kingdom and the European Union: call for evidence on taxation", November 2012, accessed from: <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212018/taxation_report_evidence.pdf> on 20th June, 2013

74 "Barroso: EU States must sacrifice 'sovereignty for influence'", 3 January 2013, Public Service Opinion, accessed from <http://www.publicserviceeurope.com/article/2903/barroso-eu-states-must-sacrifice-sovereignty-for-influence> on 15th March, 2013.

The current *status quo* of State aid rules is undoubtedly facing challenges and an examination of the Commission's new proposals to modernize State aid will shed light on whether such challenges can be overcome in the next few years.

To conclude this whole discussion would be worth mentioning the resulting attitude amongst the Member States, their perception of the Commission's intervention on government aids, the role of sovereignty in the modern age, the balance of competences, and ultimately, the implications of modernizing the State aid regime.

3.2. The Development of 'Selectivity' through Selected Recent Case-Law

Taxation can be termed as the most effective tool that can be used as an incentive or a deterrent in order to regulate the general behaviour of undertakings, against the background of the general economic policy of a state. The wide interpretation by the Commission and the Court of specific tax measures so as to fall under the label of 'selective aid' restricts the tools that are available to national Member States to design their own tax regime as they see fit. The potential negative effects of such wide interpretation have many a time been highlighted by several Advocate Generals in their opinions to the Court. [75] The below decisions illustrate the development of 'selectivity' in landmark cases.

3.2.1. The *Adria-Wien* Pipeline[76] Judgment

It is well-established that the determination of a general or specific nature of a measure follows a two-step approach; firstly, that the measure in question is *prima facie* selective, and secondly, that the measure by the nature of general scheme of the system. This methodology is well-summarised in the *Adria-Wien* judgment in paragraphs 41 and 42, where the Court states that:

> "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 [107](1)

75 AG *Jacobs* in *France v Commission* (C-241/94) [1996] ECR I-4551 in paragraph 30 put forward the danger of *"the distinction between prohibited aid on the one hand and general social and economy policy on the other (becoming) blurred."* AG *Geelhoeld* in *GIL Insurance e.a.* (C-308/01) [2004] ECR I-4777 underlined in paragraph 76 the danger of depriving a Member State of a policy instrument essential for the attainment of a generally accepted policy objective. AG *Maduro* in *Enirisorse SpA v Sotacarbo SpA* (C-237/04) [2006] ECR I-2843 emphasises in paragraphs 45-46 the dangers that over-extension of the State aid rules might result in all economic policy decisions of Member States being brought under the scrutiny of the Community authorities, without any distinction being made between direct interventions in the market and general measures to regulate economic activities.

76 Case C-132/99, *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke* [2001] ECR I-8365.

> 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…[…] According to the case-law of the Court, a measure which, although conferring an advantage on its recipient, is justified by the nature or general scheme of the system of which it is part does not fulfil that condition of selectivity."

3.2.2. The *Azores*[77] Judgment

The *Azores* case represented a step forward to this methodology. As discussed earlier, there may be a preliminary step to identify the geographic relevant framework in which the assessment of selectivity takes place. In this case, the Court of Justice accepted that a measure benefiting undertakings located in a particular region of a Member State may not be considered as selective on the grounds that the measure can be attributed to a genuinely autonomous infra-State body.

This decision represents a groundbreaking reasoning in the context of the boundaries between State aid law and the Member States' exclusive competence to taxation. It gives Member States more flexibility to exercise their taxing powers in certain regions as long as the aid in question is distributed within a geographic framework of reference granted by the regional or local authority that is autonomous from the institutional, procedural, and the financial point of view.[78]

3.2.3. The *Gibraltar* Tax Judgment

The relevant framework of reference was however the central dispute in the *Gibraltar* tax case[79], a landmark decision that switched on the red light due to the mismatching interpretations of 'selectivity' by the Commission, and then by the General Court and the Court of Justice, possibly leading to some confusion as to the exact parameters of the EU's State aid law.

In its judgment, the General Court dismissed the Commission's argument that the proposed tax reform in Gibraltar was selective against the reference framework of the whole territory of the United Kingdom. In the General Court's view, it should have considered Gibraltar as a region by itself, just as was determined in the *Azores* judgment.

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77 Case C-88/03 *Portugal v Commission* [2006] ECR I-7115.

78 M. Prek & S. Lefèvre, 'The Requirement of Selectivity in the Recent Case-Law of the Court of Justice' [2012] Eur. St. Aid L.Q. 1, 336

79 The facts of this case have been discussed more elaborately in the first Part of this contribution.

For the General Court,

> "to classify a tax measure as selective, [the Commission] must begin by identifying and examining the common or 'normal' regime under the tax system applicable in the geographic area constituting the relevant reference framework."[80]

Observing that the Commission had not identified any such benchmark, the General Court postulated that,

> "In the absence of identification and examination of the common or 'normal' regime, the Commission cannot establish to the requisite legal standard that certain of the elements of the notified tax system constitute derogations, and are therefore prima facie selective, vis-à-vis the common or 'normal' regime."[81]

From the above, it can be deduced that the approach taken by the General Court required the identification of the scheme of reference as a necessary step [in this case being the common regime of taxation that was employed in Gibraltar]. In its absence, there can be no finding of selectivity.

Although the Kingdom of Spain disputed the relevant reference framework in its appeal, the Court of Justice did not even take a stand on it, finding the proposed tax measures to be selective on a material basis, rather than deciding against the proper framework, i.e. the normal taxation regime.[82]

The Court of Justice overturned this decision and upheld the Commission's findings. Admitting that the reference framework is crucial in the case of tax measures[83], the Court still held that the reference framework could also be constituted by the fiscal measure itself alone[84] under which the offshore companies enjoy selective advantage. In its judgment, it held that the criteria forming the basis of assessment that are adopted by a national tax system, must also, in order to be determined as conferring a benefit, be such as to characterize the recipient undertakings as a 'privileged category' due to the peculiarities of the measure at stake.[85]

80 Joined Cases T-211/04 & T-215/04, *Government of Gibraltar and United Kingdom v Commission* [2008] ECR II-3745, paragraph 170

81 *Ibid*.

82 Joined cases C-106/09 P & C-107/09 P, *Commission v Government of Gibraltar & United Kingdom* [2011] ECR n.y.r., paragraphs 183-188.

83 *Ibid*. paragraph 90

84 *Ibid*. paragraph 95

85 *Ibid*. paragraph 104

Consequently, it found the proposed tax reform[86] to be providing a selective advantage to certain undertakings, the offshore companies in this case.[87] The inevitable consequence of the proposed tax measures would be that those offshore companies that have neither employees nor any business premises will have no domestic tax base in Gibraltar thereby avoiding taxation and enjoying a selective advantage over other companies.[88]

Interestingly, in the *Paint Graphos* judgment[89], delivered only a few weeks before the *Gibraltar* judgment, the Court of Justice stressed that,

> "[i]n 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..."[90]

3.3. The Aftermath of the *Gibraltar* Judgment

These decisions emphasise the fact that State aid is a continuous developing legal domain, especially with the concept of 'selectivity'. The Gibraltar judgment [both the General Court judgment as well as the Court of Justice judgment], in particular, has been contested in a great deal of literature for this reason. Rossi-Maccanico[91] argues in favour of the final judgment; he opines that the proposed tax regime would breach horizontal tax neutrality. Yet, as Luja[92] correctly points out, traditional profit taxes cannot be the starting point of State aid review.

The judgment has raised eyebrows amongst 'competence-creeps' as to the extent that Member States can still design their own tax base as they deem fit. It has been submitted that rather than fine-tuning the existent judgments on fiscal State aid, the Court of Justice in Gibraltar exceeded expectations and enlarged the concept of

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86 The tax reform at issue was the replacement of existing company income tax with a system of three charges including payroll tax, business property occupation tax, and a registration fee, with the first two being capped at 15% of the profits. The effect of this cap was that companies would only pay these taxes if they make profit.

87 Joined cases C-106/09 P & C-107/09 P, *Commission v Government of Gibraltar & United Kingdom* [2011] ECR n.y.r., paragraph 106

88 *Ibid.* paragraph 107

89 Joined Cases C-78/08 to C-80/08, *Ministero dell'Economia e delle Finanze e.a. v Paint Graphos e.a.,* [2011] ECR n.y.r.

90 *Ibid.,* paragraph 49

91 Rossi-Maccanico, "Gibraltar and the Unsettled Limits of Selectivity in Fiscal Aids", Eur. St Aid L. Q. 1 (2009), p. 71

92 R. H. C. Luja, 'Fiscal Autonomy, Investment Funds and State Aid: A Follow-Up' [2009] Eur. Taxn , 5

'selectivity' even further, resulting in arbitrary and somewhat confusing interpretations of selective aid.

Applying the Gibraltar interpretation consistently across the EU would practically be opening the floodgates to State aid control on every single economic policy that is employed in the twenty-eight Member States. Further, if future interpretation of selective aid will be consistent with the Gibraltar judgment, then not only the derogations of each system would be subject to scrutiny by the Commission, but the whole national tax regime that is applicable to undertakings would be tested against Article 107(1).

More important questions remain open following these decisions, such as the overall objective of a modernised State aid control regime; and whether there needs to be a more detailed analysis of the actual distortions of competition and effects on trade, rather than determining selectivity on the basis of whether aid has been granted.[93]

3.4. Are the State Aid Rules Sufficient, Efficient, and Effective?

In order to assess the above question, the below will consider two instances whereby the EU's State aid rules have been employed; firstly, the use of State aid rules to combat the harmful tax competition; and secondly, the use of State aid rules to tackle the moral hazard that had been caused by the 2009 financial and economic crisis.

3.4.1. State Aid and Harmful Tax Competition

One of the reasons why fiscal State aid is so topical is clearly because of the EU's political approach of voluntarily ending the harmful tax competition, an aim that was endorsed by the ECOFIN Council in 1997. With the approval of the 1999 Code of Conduct on Direct Business Taxation, the Member States agreed to terminate fiscal measures that were harmful. The Commission has ever since supported the abolishment of harmful tax measures by scrutinizing, in turn, fiscal aid measures applied in Member States.

This necessitates a reference to Court's dicta on the abuse of the fundamental freedoms and tax avoidance, both from the perspective of the EU's extent to which it should control it, as well as from the Member States' attempts to avail of it, in order to understand the acceptable boundaries in designing fiscal regimes. The Court has, since its early case law, provided some parameters for tax avoidance and repeatedly stated that,

93 L Coppi, 'The role of economics in State aid analysis' in E Szyszczak (eds), *Research Handbook on European State Aid Law* (1st, Edward Elgar, Cheltentham, UK 2011)

> "A Community national cannot be deprived of the right to rely on the provisions of the Treaty on the ground that he is profiting from tax advantages which are legally provided by the rules in force in a Member State other than his State of residence."[94]

On the other side of the spectrum, what is unacceptable and prohibited is any existence of an artificial arrangement designed to circumvent national legislation and gain a tax advantage. Together with tax evasion and tax fraud, this justifies the existence of supranational rules over national tax regime, in order to ensure a level playing field within the Internal Market. In line with this, the above-mentioned Code of Conduct has been aimed at 'establishing coordinated voluntary action by the Member States to tackle harmful tax competition,'[95] together with the report of the Primarolo Group. The Commission's report states that,

> "The Commission's state aid work, carried out in parallel with the code of conduct work, has to some extent helped to facilitate the conclusion of an agreement on the code of conduct. The Commission naturally intends to continue its work on tax aid in future, giving priority to aid with a significant economic impact and particularly harmful effects on competition and trade."[96]

Accordingly, the Gibraltar judgment has attracted its fair share of supporters, mainly because the proposed tax system would have led to the creation of a tax haven with different levels of taxation for companies with the same level of profit, depending on their business property and employees in Gibraltar. From the perspective of protecting free competition within the Internal Market, this interpretation has been welcomed to the extent that some scholars add that the EU's State aid law could serve as the legal basis to prohibit harmful tax regimes within the conditions for good tax governance.[97]

Concurrently, one of the repercussions of embracing State aid in the EU's harmful tax competition however would be interpreted as an attempt to remove any tax disparities within the Internal Market, under the disguise of tackling distortive fiscal policies. It should be emphasized in this respect that insofar as any tax regime is shaped within the limits of the fundamental freedoms and the State aid

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94 Case C-364/01, *The heirs of H. Barbier v Inspecteur van de Belastingdienst Particulieren/Ondernemingen buitenland te Heerlen, ("Barbier"),* [2003] ECR I-15013, paragraph 71

95 EC Commission Report (EC) C(2004)434 on the implementation of the Commission notice on the application of state aid rules to measures relating to direct business taxation [2004]

96 *Ibid.*

97 P. Pistone, 'Smart Tax Competition and the Geographical Boundaries of Taxing Jurisdictions: Countering Selective Advantages Amidst Disparities' [2012] Intertax , 87-88

regulations, any attempt to meddle with tax disparities would be encroaching on the Member States' prerogatives.

3.4.2. The Financial Crisis and the Use of State Aid Rules

An analysis of the development of the State aid regime cannot overlook the most virulent stage of the financial crisis in 2009, and the Commission's response to financial institutions across the EU, where the impact of the crisis has been most felt. Within a month of the collapse of Lehman Brothers in 2008, the application of Article 107(3)(b) TFEU was temporarily relaxed. This permitted wide-ranging state interventions to guarantee deposits and other funding instruments in banks in order to cope with the negative effects of the downturn in the European financial sector and therefore *"to remedy a serious disturbance in the economy of a Member State."*[98]

To respond to this phenomenon, the Commission issued a series of Communications[99] *(Crisis Communications)* to provide guidance on the application of the EU's State aid rules for market interventions by Member States towards their institutions. It is reported that in the period from 1 October 2008 to 1 October 2012, the Commission took more than 350 decisions in the financial services sector based on Article 107(3)(b) TFEU. Financial crisis measures have been introduced in all Member States, except from Malta, Bulgaria, Estonia, Czech Republic, and Romania.[100] The most common scheme related to deposit guarantee or liquidity facilities, with more than 20 Member States taking this type of action.

The same report illustrates in figures a marked decrease in the amount of aid approved in 2011 and 2012, and a mismatching need for state support across countries and segments of the European banking sector. Countries still relying strongly on aid are mainly those experiencing sovereign distress [Hungary/Spain] or in countries where particular segments of the banking sector or single banks are undergoing restructuring [Ireland].[101]

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98 Article 107(3)(b) TFEU

99 The "Banking Communication" 2013 C(2013)4119 replacing the 2008 Communication; the "Recapitalisation Communication" OJ 2009 C10; the "Impaired Assets" Communication OJ 2009 C 72; the "Restructuring" Communication OJ 2009 C 195/9; 2010 Prolongation Communication, OJ C 329, 7.12.2010, p.7 and Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis; 2011 Prolongation Communication, OJ C 356, 6.12.2011.

100 Commission Staff Working Paper (EC) COM(2012) 778 final Facts and figures on State aid in the EU Member States [2012] Autumn 2012 Update, page 28.

101 *Ibid.*

The below tables show the overall amount of approved financial crisis aid to financial institutions for each Member State and for the whole of the EU, as well as the overall amount of aid used for the different instruments.[102] It provides an insight on how different states have been hit in different manners through their volatile financial sector.

Figure 2: Approved amounts of aid to financial institutions per instrument and per Member State, 1 October 2008 – 1 October 2012

Member State	Recapitalisation Measures		Gaurantees		Asset relief interventions		Liquidity measures		Total for 2008-2012	
	In € Billion	As a % of 2011 GDP	In € Billion	As a % of 2011 GDP	In € Billion	As a % of 2011 GDP	In € Billion	As a % of 2011 GDP	In € Billion	As a % of 2011 GDP
Belgium	20.40	5.5%	310.00	84.2%	28.22	7.7%	0.00	0.0%	358.62	97.4%
Bulgaria	0.00	0.0%	0.00	0.0%	0.00	0.0%	0.00	0.0%	0.00	0.0%
Czech Republic	0.00	0.0%	0.00	0.0%	0.00	0.0%	0.00	0.0%	0.00	0.0%
Denmark	14.55	6.1%	587.90	245.7%	2.30	1.0%	7.88	3.3%	612.63	256.1%
Germany	114.61	4.5%	455.85	17.7%	66.10	2.6%	9.50	0.4%	646.06	24.1%
Estonia	0.00	0.0%	0.00	0.0%	0.00	0.0%	0.00	0.0%	0.00	0.0%
Ireland	90.61	57.9%	386.00	246.7%	54.00	34.5%	40.73	26.0%	571.34	365.2%
Greece	35.75	16.6%	85.00	39.5%	0.00	0.0%	8.00	3.7%	128.75	59.9%
Spain	209.32	19.5%	320.15	29.8%	13.93	1.3%	31.85	3.0%	575.25	53.6%
France	26.65	1.3%	339.80	17.0%	4.70	0.2%	0.00	0.0%	371.15	18.6%
Italy	20.00	1.3%	110.00	7.0%	0.00	0.0%	0.00	0.0%	130.00	8.2%
Cyprus	1.80	10.1%	3.00	16.9%	0.00	0.0%	0.00	0.0%	4.80	27.0%
Latvia	0.83	4.1%	5.20	25.9%	0.54	2.7%	2.70	13.5%	9.27	46.2%
Lithuania	0.58	1.9%	0.29	0.9%	0.58	1.9%	0.00	0.0%	1.45	4.7%
Luxembourg	2.50	5.8%	6.15	14.4%	0.00	0.0%	0.32	0.32%	8.97	20.9%
Hungary	1.07	1.1%	5.35	5.3%	0.04	0.0%	3.87	3.87%	10.33	10.3%
Malta	0.00	0.0%	0.00	0.0%	0.00	0.0%	0.00	0.0%	0.00	0.0%
Netherlands	37.64	6.3%	200.00	33.2%	22.79	3.8%	52.90	8.8%	313.33	52.0%
Austria	15.90	5.3%	77.84	25.9%	0.50	0.2%	0.00	0.0%	94.24	31.3%
Poland	33.89	9.2%	33.89	9.2%	0.00	0.0%	0.00	0.0%	67.78	18.3%
Portugal	26.25	15.4%	40.67	23.8%	4.00	2.3%	6.06	3.5%	76.98	45.0%
Romania	0.00	0.0%	0.00	0.0%	0.00	0.0%	0.00	0.0%	0.00	0.0%
Slovenia	0.63	1.8%	12.00	33.7%	0.00	0.0%	0.00	0.0%	12.63	35.4%
Slovakia	0.66	1.0%	2.80	4.1%	0.00	0.0%	0.00	0.0%	3.46	5.0%
Finland	4.00	2.1%	50.00	26.4%	0.00	0.0%	0.00	0.0%	54.00	28.5%
Sweden	5.03	1.3%	156.00	40.3%	0.00	0.0%	0.52	0.1%	161.56	41.8%
United Kingdom	114.61	6.6%	458.75	26.3%	248.05	14.2%	51.93	3.0%	873.34	50.0%
EU-27	**777.30**	**6.2%**	**3646.64**	**28.9%**	**445.75**	**3.5%**	**216.27**	**1.7%**	**5085.95**	**40.3%**

102 *Ibid.*

In Ireland, for example, 35 decisions of the European Commission were taken relating to the Irish state and the Irish financial institutions under Article 107(3)(b) TFEU. Fourteen of them related to aid schemes of general application and their prolongation. Three distinct aid schemes have been applied in all: the guarantee scheme for banks in Ireland; the impaired assets vehicle NAMA (National Asset Management Agency); and the resolution scheme for credit unions in Ireland.[103]

The rest related to individual financial institutions, including Anglo, INBS and Quinn.

The foregoing illustrates how rapid the happenings from 2008 onwards were. This, together with the extent of the intervention that has been involved has made it near to impossible to offer a timeline of events and developments since the financial crisis. It remains uncontested that the State aid rules have mitigated the severity of the crisis. Using these rules suggests that the State aid rules were crucial policy tools available for the EU to mitigate critical challenges. This was confirmed in November 2008 by Commissioner Natalie Kroes when approving the Spanish fund for the acquisition of financial assets, who stated that,

> "The decision, once again, shows that state aid rules are part of the solution for the financial crisis."

In fact, Finbarr Murphy submits that,

> "Because of the absence of political agreement amongst the Member States, the State aid regime was virtually the only policy tool available to the Commission and the other EU institutions."[104]

The lack of political resolution also failed to achieve an appropriate system for ensuring liquidity of banks, and a uniform scheme for deposit protection across the EU. This raises serious concerns to the future of the Monetary Union. To describe in detail the effects of the financial crisis would be to divulge from the aims of this contribution, therefore, at this stage, it is pertinent to note that State aid rules have been central since 2008 due to the financial crisis. Having said so, commentators have argued that through the use of State aid rules, the moral hazard has not in itself been tackled because the original owners of the banks' insolvency are almost certainly no longer involved.[105]

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103 F Murphy, 'The Financial Crisis in Ireland and the Use of the State Aid Rules by the EU Commission: Observations' [2013] Eur. St. Aid L.Q. 1, page 267

104 *Ibid.* page 284

105 *Ibid,* 289. This argument was raised again in the arguments against the introduction of a European Financial Transaction Tax (FTT), targeted at stabilizing the financial markets. It has been submitted that by imposing the tax on selected institutions does not distinguish the banks that contributed through their actions to the events that led to massive bailouts. This

3.5. Assessment and Conclusions

The European Union continues to be faced with Member States pleading for budgetary austerity. It is in this framework that State aid control requires sufficient supervisory capacity in order to handle the compensatory measures imposed on financial institutions.

This scenario surely presents numerous challenges to the development of Article 107 TFEU. Questions are directed towards the real aims of the EU's State aid policy, especially in light of the Commission's State Aid Modernisation initiative in 2012; essentially whether this process will increase legal certainty and simplicity. The greatest threat to the Internal Market brought about by the proposed reforms has been quoted to be the additional *ex ante* scrutiny of aid that will most likely have the most significant impact on economic growth. Possibly there will be more open-ended provisions that result in more and more powers being assigned to the EU level.[106]

Pursuant to its plans for modernisation, the Commission faces a number of challenges in the coming years on its State aid rules. It must firstly continue to monitor existing regulations, and distinguish correctly between the 'good' aid and the 'bad' aid. As it has done in recent years, it might have to be more flexible in its approach at times, when unforeseen situations 'seriously disturb' the Internal Market. Secondly, the Commission will need to continue defending its investigations in possible litigation against the introduction of aid that is unlawful under Treaty provisions. The interpretation that it will be adopting will have an impact on the Member States' choice of tax regimes, and therefore it should aim to strike a balance between the Internal Market and the Member States' economic and financial interests. Finally, it should ensure a smooth phase out of the state support that is being granted within the Internal Market.

How this will play out in practice depends on whether there will be satisfactory incentives for compliance. Surely, the Commission's exercise of its existing powers means that it is achieving certain policy goals, contributing to the development of its agenda for the single market and beyond. At the basis of all development lies the fact that the whole integration process within the EU is based on an exchange driven by common interests. The Member States relinquish their unilateral right to take decisions in areas in which the EU now has competence, and in turn they are allowed to exercise their national influence within a greater

is often compared to the *'polluter-pays'* principle, which is not evident neither in the FTT nor in the Commission's use of State aid rules to mitigate the financial downturn.

106 R.H.C. Luja, 'Does the Modernisation of State Aid Control Put Legal Certainty and Simplicity at Risk?' [2012] Eur. St. Aid L.Q. 1, 765

whole.[107] The defective argument to this would be that in taxation, sovereignty is gradually being eroded as part of the creation of the Internal Market.

This reticence will have implications also for international tax law owing to the increasing global competition. In line with the Treaty of Lisbon, it will continue to be up to the Member States to impose direct taxes. At the same time, tax regimes must be aligned with the Treaty provisions. In this standoff, the Court of Justice must continue to find the dividing line between the basic principles of the Internal Market and the economic interests of the Member States. In so doing, both appraisal as well as criticism will continue to be attracted to the Court's methods. However, criticism directed at the Court's interpretation sheds light on the lack of concrete legislation that is available in this area.

This shifts the burden on the Commission that is vested with exclusive rights to legislative action, as the starting point of the decision-making process. Its commitment to simplify and overhaul its State aid rules will need to be backed by the Member States in order to be effective. Given that legislation on taxation [in general] requires unanimity, it is unlikely that there will be any harmonization in the coming years. Essentially, this means that the definition of State aid will continue to be subject to full review by the Court of Justice. The breakthrough for this impasse can only be sufficient political support from the Member States towards policies supporting the interests of the Internal Market as a whole together with the protection of their fiscal interests in a balanced way.

107 S Jansen, *Fiscal Sovereignty of the Member States in an Internal Market. Past and Future.* (1st, Kluwer Law International, Netherlands 2010) 233