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ANTI-COMPETITIVE TAX BREAKS: HOW TO ATTACK THEM UNDER THE STATE AID RULES

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This paper, by way of complement to those by Rhodri Thompson and Christopher Vajda, considers what opportunities are presented by the EC state aid rules to firms whose ability to compete is affected by tax schemes that benefit competitors. This paper is concerned with tactical options rather than with substantive issues as to what is or is not a state aid.

The first issue is to assess whether the tax measure concerned may amount to a state aid measure within the meaning of Article 87 EC at all. Alex Easson's paper on the Primarolo list gives some illustrative indications of when tax schemes may be characterised as state aid measures, and especially the difficult issues arising when considering whether a measure is a general measure or one that is sufficiently "targeted" in its effect to count as "favouring certain undertakings or the production of certain goods" within Article 87(1) EC, and the possibly even more difficult judgment exercise associated with the test whether a measure is "justified by the nature or economics of the tax system". The EC Commission's press release of 11th July 2001[2] announcing the opening of investigations into 11 corporate tax schemes illustrates the nature of the scheme that the Commission considers to have particular effects on the common market.

Assume that those thresholds can be passed, at least plausibly, in respect of a particular measure and that the legal advice is that it can be characterised as a state aid. What then can a firm do about it? The answers depend very much on whether the aid measure has been notified to and approved by the Commission pursuant to the possibilities laid down in Article 88 EC and the Procedural Regulation. Upon the answer to that question depends the legality of the aid and the ability of national courts to offer any relief at all. Essentially, if the aid has been approved, the only

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2 IP/01/982 "Commission launches large scale state aid investigation into business taxation schemes".

option will be to take proceedings in the European Courts to strike down the approval (although it may be possible to raise the issue of legality of the Commission's decision in the national court and have that issue referred for a ruling by the European Court of Justice under Article 234 EC). But if the aid has not been approved, then it is illegal aid and the national courts may offer relief in line with the ECJ's judgment in *FNECPA*.[3]

Taking the Matter Up with the Commission

In fact, finding out whether or not a particular measure has been notified to the Commission is a difficult and essentially haphazard exercise.[4] Transparency has been somewhat improved by the recent addition of a register of state aids on DG Competition's web-site, but the information on it is at the moment rather patchy and opaque. This has the potential, however, to become a useful tool if the Commission is prepared to put the necessary information, including the identity of recipients, on the site and in good time (much of the information provided is historic and difficult to search). In the UK, the Department of Trade and Industry has a unit dealing with state aids who will make enquires about aids in other member states and their notification status on behalf of British firms.

If a measure has been notified but no decision has yet been taken, an opportunity to make representations will only formally be available if the Commission decides to open what is sometimes called, by analogy with EC Merger Regulation proceedings, the Phase II procedure (i.e. that set out in Article 7 of the state aid Procedural Regulation, as described in Rhodri Thompson's article). That does not of course preclude a company from submitting representations to the Commission informally, but there is no requirement on the Commission to take any notice of them.

If there has been no notification, the firm considering its position to be affected may draw the measure to the Commission's attention and call upon it to take action to secure the withdrawal of the benefits conferred upon their competitors.

Clearly, if the Commission takes a negative decision in respect of the notified tax measure, satisfaction will have been achieved for the hypothetical complainant. If, however, the Commission approves the aid, the issue whether it has done so after a Phase I procedure or after a Phase II procedure is critical for determining the basis on which the European Court will determine the admissibility of any action brought

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3 Case C-354/90 [1991] ECR I-5505.

4 Despite these difficulties, there are phrases in the Court's case-law to the effect that a firm which has failed to exercise appropriate diligence in investigating whether an aid has been notified may not be able to rely on legitimate expectations.

by the complainant before it.

The case-law is to the effect that the Phase II procedure is intended to provide "interested parties", which includes competitors or those otherwise affected by the aid, with procedural guarantees to enable them to put forward their views. If those guarantees have not been respected by the opening of such a procedure, then they are entitled to challenge the Phase I clearance decision and standing will be determined simply by reference to the applicant's status as an interested rather than merely officious party. However, if the decision has been taken following a Phase II procedure, the admissibility threshold becomes higher, requiring at least an active and identified role in submitting observations to the Commission[5] or an especially marked impact upon the firm's legal and economic position.[6] This article is not the place for a detailed critique of the limitations on access to the European Courts for private parties, but it should be appreciated that the test for "direct and individual concern" laid down in Article 230 EC, which has to be met by a private party wishing to challenge an EC decision not addressed to it is stiffer than the standing tests applied in domestic judicial review proceedings.

Proceedings by a private party will always be instituted before the EC Court of First Instance (CFI). The defendant will be the European Commission, and there may be interventions, by member states (as of right) and by other persons who can show an interest in the outcome of the proceedings. Naturally, the member state whose scheme is under attack will usually intervene on the side of the Commission. Each party (including an intervener) has a right of appeal on a point of law from the CFI to the European Court of Justice (ECJ).

Not only admissibility but also the standard of review exercised by the CFI will depend on whether or not the Commission has opened a Phase II enquiry. If it has not, the issue before the Court is whether the Commission should have done so, in other words, whether it was indeed able to close its investigation at the preliminary phase and to resolve any doubts as to the compatibility of the aid with the common market at that stage of proceedings. If the Commission has proceeded to a Phase II enquiry, it will be given more latitude because such decisions often involve the exercise of discretion in areas of complex economic and social appraisal and the Court will be in principle reluctant to interfere unless the Commission has manifestly overstepped the boundaries of the margin of appreciation entrusted to it.

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5 It is not enough to have played a significant role in the formulation of representations made by a member state's authorities in the procedure, at least if those submissions do not specifically refer to the impact of the aid measure on the position of the firm in question: see Case T-11/95 *BP Chemicals v Commission (No 1)* [1998] ECR II-3235.

6 As for instance in Case T-435/93 *ASPEC v Commission* [1995] ECR II-1281.

However, under the state aid rules, the Commission may only confer exemption from the prohibition otherwise stemming from Article 87(1). State aid approval cannot be used to give back door exemption from other provisions of Community law, whether deriving directly from the Treaty or from secondary legislation. Thus a state aid cannot, for example, be financed by discriminatory taxation contrary to Article 90 EC. Nor can state aid approval be given to a tax scheme which does not fall within the scope permitted by Community harmonisation measures on indirect taxes or excise duties, such as Directive 92/81 on mineral oil taxation.[7]

In other cases, the Commission will not be persuaded by the complaint that there is any aid element in the national measure complained of, and will either reject the complaint submitted or will take no (apparent) action at all.

The Court of Justice's judgment in the *Sytraval* appeal[8] lays down the scope of the Commission's duty to investigate complaints and the circumstances in which its decision can be challenged by a complainant. The Court of Justice there overturned the ruling of the CFI that the duty to give reasons required the Commission, where it received information from the member state whose measure was under investigation that was not known to the complainant, to consider and address arguments that the complainant would have raised had it known that information. However, the ECJ stressed that this finding does not warrant a conclusion that the Commission is not obliged to extend its inquiry beyond the points which may have been raised by the complainant. The Commission's duty is to conduct a diligent and impartial inquiry, which may well require it to consider of its own motion points which have not been formally raised in the complaint.

The ECJ went on to consider what the duty to give reasons did require the Commission to do. It held (contrary to an express submission of the German Government which said that the Commission was not obliged to give any reasons at all for rejecting the complaint) that the Commission must at least give an adequate explanation why it has come to the conclusion that no State aid is involved or that it is compatible with the common market so that it explains why it reaches a different conclusion from the one put forward by the complainant.

Those reasons should, however, be contained in a decision which is formally addressed to the Member State concerned. In *Sytraval* the Commission had set out its reasons in a letter to the complainant. The Court made it clear that all State aid decisions including rejection of complaints are to be addressed to Member States.

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7 See Case T-184/97 *BP Chemicals v Commission (No 2)* [2000] ECR II-3145. The Commission has appealed against this judgment; the appeal is pending as Case C-448/00 P *Commission v BP Chemicals*.

8 Case C-367/95P *Commission v Sytraval and Brink's France* [1998] ECR I-1719.

Complainants will have to establish in each case their own direct and individual concern in annulling the decision addressed to the Member State.

If, rather than dismiss the complaint, the Commission simply fails to reach a conclusion, whether or not accompanied by action on its part to consider and investigate the issues raised in the complaint, the circumstances and means by which such inaction can be challenged under Article 232 EC are set out with great care by the CFI in its judgment in *TF1*.[9]

First, it held that complainants may bring actions against the Commission for failure to address a measure to a member state (as are all measures in the state aid field: see *Sytraval* above) so long as such measures would have been of direct and individual concern to the applicant. The potential measures available to the Commission were the three types of decision concluding a Phase I procedure, namely a decision that there was no aid, or that there was aid which was compatible with the common market, or that a Phase II procedure should be opened. All such measures were of direct and individual concern to an applicant which operated private television channels in direct competition with the state funded broadcaster. The CFI specifically ruled that it made no difference that there might be alternative means of recourse open to the applicant through the national courts.

On the substance, it held that the first question was whether the Commission was under a duty to act. Given the Commission's exclusive jurisdiction to determine compatibility with the common market of a state aid measure, it was under a duty, pursuant to *Sytraval*, to carry out a full and impartial investigation. That investigation could not be prolonged indefinitely; what was an appropriate length depended on the facts of each case. However, the length of time that had elapsed since the complaint was made (some two and a half years) meant that the Commission had no defence to a charge of failing to take a position in that time, having been duly called upon to adopt a position by the applicant.

Action in National Courts

The alternative or complementary route for affected companies consists in taking proceedings before the national courts. As has already been seen, the Commission cannot avoid taking action pursuant to its duties under the state aid rules simply because the complainant is able to bring proceedings before the national courts. Likewise, the national courts have parallel competence with the Commission as

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9 Case T-17/96 *Télévision française 1 v Commission* [1999] ECR II-1757. The Commission and the French Republic unsuccessfully appealed against other aspects of that ruling, but not in so far as it concerns state aid: see Joined Cases C-302/99P and C-308/99P *Commission and France v TF1*, judgment of 21st July 2001.

regards the legality (as opposed to the compatibility) of state aids.[10] Clearly, in exercising that competence, they are under a duty to produce results that further rather than hinder Community aims and are likely to be receptive to arguments for staying proceedings where it is established that the Commission is seised and is actively pursuing a case.

The scope for such proceedings is considerably limited where the Commission has taken a decision approving the tax measure under the state aid rules. In its *TWD* ruling[11], the ECJ held that a beneficiary of an individual grant of aid cannot raise before the national courts the issue of the legality of a Commission decision holding that the aid concerned is incompatible with the common market, and that the national court must accordingly regard the decision as conclusive. That ruling is probably confined to its facts, and does not affect the rights of "interested parties" to raise the legality of an approval of state aid in national proceedings. Nevertheless, the national court has no jurisdiction to hold that a Community measure is illegal, although it may uphold its legality.[12] The best that can be hoped for from the national court in such circumstances is accordingly an Article 234 reference to the ECJ on the issue.[13]

Where the aid measure has not been notified to the Commission, in breach of the obligation placed on the granting member state by Article 88(3) EC, then, as the ECJ made clear in *FNECPA* (above), national courts, which can take no account of whether or not an aid measure may be declared compatible with the common market by the Commission in pursuance of its exclusive jurisdiction, must offer those affected the guarantee that all the consequences will be drawn from that illegality so as to protect their legitimate interests. That may include interim protection to freeze the payment of aid or even provisional recovery of payments made; at the final stage it may include a ruling that the aid was illegally granted and should be recovered, as well as compensation for those affected. Interim relief is in practice particularly important, as it is plainly more important to most firms to prevent the advantage being conferred upon their rivals than to seek later to recover an equivalent benefit by way of damages.

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10 See generally the Commission's notice on co-operation between it and the national courts in state aid matters, 1995 OJ C312/7.

11 Case C-188/92 *TWD v Commission* [1994] ECR I-833.

12 See Case 314/85 *Fotofrost v HZA Lübeck-Ost* [1987] ECR 4199.

13 In the slightly different circumstance where the decision is already being challenged in a direct action before the European Court, the national court may consider staying any national proceedings pending the outcome of the European challenge, as in *DTI v British Aerospace* [1991] 1 CMLR 165.

However, in practice, there are serious difficulties in the way of seeking relief in the national courts, most especially in cross-border situations. In 1998, a survey of the application of EC state aid law by the courts of the member states prepared by the Association of European Lawyers (AEA) and available on the Commission's web site found that there had been only 116 cases in which the state aid rules had been applied, and only three in which firms had succeeded in obtaining relief from the courts in respect of state aid to a competitor. Furthermore, in three member states, it was not possible as a matter of national law to obtain interim remedies against the state.

The AEA report attributes the underuse of national remedies essentially to a lack of awareness by lawyers and understanding by judges of the existence and application of the state aid rules. While those undoubtedly are factors, the report (welcomed by the Commission as showing that the national courts are capable of dealing with many of the issues arising in connection with illegal state aid, and justifying a decentralised approach by the Commission) seriously underestimates the cultural and commercial barriers faced by a company that would be forced to take action in the courts of another member state. Apart from unfamiliarity with legal systems and language barriers which are disincentives and add to costs, it should be appreciated that many companies are unwilling to take action against the public authorities of foreign countries in which they do business for sensible and justified commercial reasons. The same factors reduce the attractiveness of pursuing theoretical remedies under public procurement rules: if you bite the hand that has not fed you, it may not feed you next time either.

A further difficulty with court proceedings in respect of covert subsidies is the need to adduce convincing proof of the existence of the aid. In the case of an aid which is conferred through the tax system, this consideration may not always apply, in that the discrimination may be evident from the face of the laws or regulations adopted by the member state in question. However, where tax subsidies take the form of discretionary exemptions or reliefs, disclosure may be a real impediment to the pursuit of a case.

Such difficulties and disincentives may also present themselves when a company believes that its domestic competitors are being aided through the tax system. However, they are likely to be less acute and where a case can be made it can be a very powerful weapon. It can be used to strike down a provision of primary legislation such as a provision in a tax statute,[14] which cannot be achieved through domestic judicial review, however "irrational" the policy pursued by the statute may

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14 E.g. *R v HM Customs & Excise ex p Lunn Poly and Bishopsgate Insurance* [1999] EuLR 653 (Court of Appeal) concerning the discriminatory impact of insurance premium tax on travel insurance.

be. In such proceedings, it need only be established that the measure at issue constitutes a state aid and has not been notified to the EC Commission.

The argument of illegality for breach of the notification requirement cuts to the quick. Where, as may often happen in tax cases, the aid element is inadvertent,[15] it will not have been notified and the principal issue to be resolved will be whether the measure contains an aid element. The issue of compatibility with the common market is one with which the national court cannot concern itself at all; and by the same token, there is no relevance in the reasonableness of the member state's policy objectives or its belief, if it had one, that the measure did not constitute a notifiable state aid.

The issues in English law of recovery of overpaid tax where there has been a state aid to other taxpayers, and whether damages can be claimed for consequential losses (such as loss of revenue because business has been deflected to subsidised competitors, or for closure of outlets and redundancies) are live in the cases of *GIL v HM Customs & Excise* and *Airtours v same*. A reference has been made to the ECJ in the *GIL* case.

Conclusion

By way of conclusion, it may be said that recourse to the national courts may be extremely effective where non-notified aid is being granted to domestic competitors, but that in other circumstances, notably in cases where the aid is conferred on competitors in other member states, there is likely to be no real substitute for determined action by the EC Commission. The Court of First Instance has demonstrated on several occasions that it is willing to scrutinise most intensively not only the procedure followed by the Commission, but also its substantive analysis, which the Commission must be prepared to demonstrate to the court even if its workings do not have to be shown in the decision.[16]

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15 For example, in *Lunn Poly*, it was not suggested the government intended to assist the insurers who benefited from the lower rate of tax; its aim rather was to correct what it perceived as a practice by travel agents and their related insurers of shifting value from VAT-able services (trips and holidays) to non-VAT-able insurance products.

16 See e.g. *BP Chemicals No.1* (above).