
WHEN DO TAX MEASURES AMOUNT TO STATE AID?

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1. Introduction

- 1.1 The aim of this paper is to consider, by reference to a now quite considerable volume of case-law of the ECJ and the Court of First Instance (CFI), the circumstances in which provisions of tax legislation and the behaviour of tax authorities may give rise to state aid within the meaning of article 87 EC. Full references to the cases mentioned are at the end of the paper.
- 1.2 This paper does not consider the circumstances in which state aid granted through the tax system might be cleared by the Commission: the considerations relevant to the clearing of aid granted through the tax system are unlikely to be different from those applying to other aid measures; and the absolute requirement to notify new state aid measures means that the crucial need is to identify in advance the features of a tax measure that may lead to its being stigmatised as state aid. Reference can be made to the Commission's Notice referred to at the end of this paper.

2. The rules

- 2.1 The state aid rules, contained in articles 87 and 88 (formerly articles 92 and 93) of the Treaty, essentially prohibit the State from using its resources to provide assistance to a commercial undertaking without prior authorisation from the Commission. An obvious example of an aid is a subsidy granted by the State to a manufacturer, but the rules cover a much wider range of situations. As the ECJ explained in the *Banco Exterior* case:

The aim of article [87] is to prevent trade between Member States from being affected by advantages granted by public authorities which, in various forms, distort or threaten to distort competition by favouring certain undertakings or certain products.

- 2.2 Article 87(1) EC accordingly provides:

Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market."

3. The components of state aid

(1) "Aid"

- 3.1 The fact that article 87 covers "any aid" granted "in any form whatsoever" means that the article is well capable of covering measures in the tax field, whether legislative measures relating to the structure of the tax or administrative measures relating to its enforcement and collection¹. Given that taxation involves the payment of money by undertakings to the State, rather than the reverse, it seems at first sight puzzling that a tax measure could amount to the grant by the state of an aid.
- 3.2 However, the ECJ has consistently held that the concept of 'aid' is wider than that of subsidy - i.e. is not confined to payments made by the State to an undertaking. The ECJ held as early as the *Gezamenlijke Steenkolenmijnen* decision in 1961, and has often repeated, that
- the concept of an aid is wider than that of a subsidy because it embraces not only positive benefits, such as subsidies themselves, but also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without therefore being subsidies in the strict meaning of the word, are similar in character and have the same effect.
- 3.3 The waiver of, or abstention from collecting, tax can thus have the same effect as the straightforward payment of a subsidy if a charge to that tax would "normally" have to be included in the undertaking's budget. This introduces the somewhat elusive question of when it can be said that a higher level of tax than that actually charged would "normally" be payable.
- 3.4 A tax advantage - like other forms of aid - will not amount to State aid within the meaning of article 87 if it does no more than compensate for other burdens placed on the beneficiaries of the tax advantage. In *Ferring*, direct sales of pharmaceuticals by manufacturers were subject to a sales tax which was not charged on sales by pharmaceutical wholesalers. However, the French Ministerial Decree on the duties of pharmaceutical wholesalers required them to stock 90% of all medicines currently sold in France, to keep stocks equal to two weeks' supplies and to deliver any medicine within 24 hours. This entailed additional costs for the wholesalers which manufacturers did not incur in respect of their direct sales. The exemption from sales tax was designed to compensate for this. The ECJ held that the advantage deriving from the exemption amounted to State aid if and insofar as it exceeded the additional costs that wholesalers bore in discharging the stockholding and delivery obligations.

(2) "Granted by a Member State or through state resources"

- 3.5 The ECJ has emphasised that the mere conferring of a financial advantage on an undertaking, without a corresponding financial burden upon the State, does not amount to State aid within article 87. A good example of this, from outside the tax field, is the Court's

¹ For examples of European Court decisions concerning the administration/enforcement and collection of tax, see in particular *Ecotrade* (postponing of tax debts under special insolvency procedure), *Italy v Commission (fuel tax credits)* and *DM Transport and Spain v Commission* (behaviour of the tax authority as a creditor).

treatment of legislation setting minimum prices. Such legislation may result in undertakings receiving more money than they otherwise would, because they can charge higher prices than they would be able to command in a situation of free competition, but at the expense of their customers rather than that of the State. But in *Van Tiggele* the Court held that legislation fixing minimum retail prices with the objective of favouring distributors of a product at the exclusive expense of consumers was not an aid within the meaning of article 87 because the advantage was created at the expense of purchasers rather than the state.

- 3.6 Since tax revenue is, almost by definition, State resources, the foregoing of tax will generally fulfil this part of the criteria for an aid. However, the Court has held that, where a measure is not in substance concerned with tax, the fact that it will have the consequential effect of reducing tax revenue is not sufficient to make it an aid.
- 3.7 Thus *Sloman Neptun* concerned provisions of German maritime law under which employment contracts between shipowners and sailors who were not of EC nationality did not (unlike contracts of employment for EC nationals) have to be covered by German law and did not have to respect the minimum wage levels under that law. One consequence of the contracts not being governed by German law was that the employer did not have to pay social security contributions; a consequence of the absence of minimum wage levels was that the sailors' pay did not reach the German income tax threshold.
- 3.8 The ECJ rejected the argument that this gave rise to state aid in favour of shipowners employing non-EC sailors. It held

21 The system at issue does not seek, through its object and general structure, to create an advantage which would constitute an additional burden for the State or the abovementioned bodies, but only to alter in favour of shipping undertakings the framework within which contractual relations are formed between those undertakings and their employees. The consequences arising from this, in so far as they relate to the difference in the basis for the calculation of social security contributions, mentioned by the national court, and to the potential loss of tax revenue because of the low rates of pay, referred to by the Commission, are inherent in the system and not a means of granting as particular advantage to the undertakings concerned.

- 3.9 Similarly, *Ecotrade* concerned a special form of insolvency procedure for certain categories of company. Various features of the scheme were held to amount potentially to State aid, but the Court dismissed one argument of the Commission, to the effect that the scheme amounted to State aid on the general ground that postponement of the company's debts would reduce its creditors' profits and thus their tax liability. The Court held

That consequence is an inherent feature of any statutory system laying down a framework for relations between an insolvent undertaking and the general body of creditors and the existence of an additional financial burden borne directly or indirectly by the public authorities as a means of granting a particular advantage to the undertakings concerned may not automatically be inferred therefrom (see, to that effect, *Sloman Neptun*, cited above, paragraph 21).

- 3.10 On the other hand in *Germany v Commission (new Länder)* Germany had given a form of rollover tax relief to investors in certain categories of company in the former East Germany. The Court upheld the Commission's decision that this was a form of State aid in favour of those categories of company: State resources were involved, in the form of a 'renunciation of

tax revenue which [the State] would normally have received', and the companies were favoured through a reduction of their costs of raising capital.

- 3.11 *Germany v Commission* can be distinguished from *Sloman Neptun* and *Ecotrade*: in *Germany v Commission* the foregoing of tax was the *instrument* by which the companies were favoured, whereas in the other two cases the loss of tax revenue was merely an incidental result of a scheme whose principal effect was on the financial position as between private persons.

(3) "Favouring certain undertakings"

- 3.12 In order for a tax measure to amount to State aid, it must be possible to contrast the treatment of one group of taxpayers with the less favourable treatment of another group; without that, there will be no conferring of advantage that can be stigmatised as aid. In addition, in the terms of article 87, the advantage must be targeted at "certain undertakings or the production of certain goods".
- 3.13 The Commission's Notice expresses the view that, while measures pursuing general economic policy objectives through a reduction of the tax burden - such as for example tax relief for environmentally friendly products or processes or for research or training - will be too general to be classified as state aid, but measures which favour certain regions of the state or sectors of the economy will amount to aid. While this distinction can give rise to difficult borderline questions, the Court has not infrequently rejected arguments to the effect that a particular tax measure was too general in its scope to be described as favouring "certain undertakings".
- 3.14 The following types of tax measure have been held to favour "certain undertakings":
- (1) *Italy v Commission (textile manufacturers)*: a tax exemption for employers in the textile industry.
 - (2) *Banco Exterior*: a general exemption from tax for public credit institutions; the Court ruled that a tax exemption for public undertakings amounted to State aid, thereby indicating that a class of 'all public undertakings' were 'certain undertakings' for the purposes of article 87.
 - (3) *Ecotrade*: a special insolvency procedure applied to undertakings having 300 or more employees and owing debts, amounting to 80,000 million Lire or more and exceeding five times the paid-up capital of the company, to credit institutions, social security institutions or companies in which the State had a majority holding.
 - (4) *Italy v Commission (fuel tax credits)*: a fuel tax credit system applying to haulage contractors but not to manufacturers who carried out their own haulage.
 - (5) *Belgium v Commission (Maribel)*: a reduced rate of employers' social security contributions applying to certain listed sectors of the economy in respect of employees working at least 51% of the normal working week..
 - (6) *Germany v Commission (new Länder)*: tax relief on investment in capital companies having their registered office and central administration in the former GDR or Berlin.

- (7) *Diputación Foral de Álava v Commission*: tax relief (i) for companies making investments of 2500 m Pesetas or more and (ii) for newly established companies investing at least 80 m Pesetas.
- (8) *Adria-Wien Pipeline*: rebate of energy taxes for undertakings whose activity consists primarily in the production of goods.
- (9) *Ferring*: abstention from charging sales tax on supplies of pharmaceuticals by wholesalers, which tax charged on direct supplies by manufacturers.
- (10) *Heiser*: a transitional VAT measure which permitted suppliers of exempt medical services to recover input tax.
- 3.15 A tax measure will also favour a particular undertaking if it results from the application of a discretionary power: see section 7 below.
- 3.16 In a number of cases the Court has used the concept of 'selectivity' to distinguish between general tax measures and those amounting to State aid. In *Ecotrade* it noted that the special insolvency procedure was 'intended to apply selectively to large industrial undertakings in difficulties which owe particularly large debts to certain, mainly public, class of creditors'. In *Italy v Commission (fuel tax)* the legislation was said to '[meet] the condition that it should apply to specific undertakings, which is one of the defining features of State aid'. In *Belgium v Commission (Maribel)* and *Adria-Wien Pipeline* the Court held, by contrast, that a measure which is justified by the nature or general scheme of the system of which it is part (as to which, see section 4 below) does not fulfil the criterion of selectivity.
- 3.17 By contrast, in *Professional Contractors' Group*, the measures known as 'IR 35' were held not to satisfy the criterion of selectivity. These were measures announced in the 1999 Budget to counteract a form of tax avoidance where individuals who would normally work as employees instead set up one-man companies which provided their services (usually) to a single 'client'. The tax advantage lay in escaping taxation under schedule E and liability to employee's National Insurance contributions.
- 3.18 The anti-avoidance measures broadly took the form of deeming the individual's receipts from his one-man company to be taxable under schedule E and subject to Class 1 NICs.
- 3.19 The Court of Appeal held that the scheme did not satisfy the condition of selectivity because it applied generally to people who provided through one-man companies services that were normally provided by employees. They also referred to *Ferring*, from which they concluded that a tax measure would not amount to aid if it put two groups of undertakings on an equal competitive footing. In that regard they held that the relevant comparison was not between one-man companies and other suppliers of services but between individuals operating through such companies and individuals operating as employees.

(4) Distortion of competition and effect on trade between Member States

- 3.20 A measure which fulfils the other criteria for characterisation as a state aid will fairly readily be held to distort competition and to affect trade between member states. Distortion of competition will be produced if the favoured undertakings compete with other, unfavoured undertakings, and inter-state trade will be affected if the aid strengthens the favoured undertaking's position compared with that of other undertakings which are competitors in

inter-state trade. This will broadly be so if inter-state trade takes place, at the stage in the distribution chain at which the favoured undertaking operates, in the product or service which the favoured undertaking supplies. It is not necessary for the favoured undertaking itself to be engaged in inter-state trade if, for example, the undertaking faces competition from imports.

4. **When is a tax burden less than what would “normally” be payable? - Express tax exemptions**

4.1 If a tax measure takes the form of a provision granting an exemption from another tax rule of general application, the Court will readily find that it amounts to an aid. Thus in *Italy v Commission (textile manufacturers)* an Italian law on the restructuring of the textile industry contained a provision reducing the employers' contribution rate in respect of family allowances from 15 to 10%. This was held to be State aid. In *Banco Exterior* the Court referred to the *Gezamenlijke Steenkolenmijnen* dicta and added

14 It follows that a measure by which the public authorities grant to certain undertakings a tax exemption which, although not involving a transfer of State resources, places the persons to whom the tax exemption applies in a more favourable financial situation than other taxpayers constitutes State aid within the meaning of [article 87].

4.2 In *FFSA* the CFI applied this dictum in the case of a tax exemption for the French public post office, *La Poste*.

4.3 In *Italy v Commission (fuel tax credits)* Italy had introduced a system under which haulage contractors could set off against their other tax liabilities a percentage, varying according to the weight of the vehicle, of the amount spent by them on fuel. The tax credit was intended to operate as a partial rebate of fuel tax. The Court upheld the Commission's decision that this was a State aid favouring the hauliers. It rejected the Italian government's argument that it could have achieved the same result either by reducing the rate of fuel tax generally or by introducing a lower rate of fuel tax for heavy goods vehicles. (Italy explained that a general tax reduction on all diesel fuel would have led to an unacceptable loss of revenue and a reduced rate for HGVs would have given scope for fraud.) The Court repeated the reasoning in *Banco Exterior* and continued

Since that legislation meets the condition that it should relate to specific undertakings, which is one of the defining features of State aid, no purpose would be served by determining whether other tax rules from which the sector also benefitted would have escaped classification as aid within the meaning of [article 87].

5. **Measures justified by the 'nature or general scheme' or 'logic' of the tax system of which they form part**
- 5.1 In *Adria-Wien Pipeline* the Court enunciated a general principle derived from its case-law, to the effect that '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 [the] criterion of selectivity' - and therefore cannot constitute State aid.
- 5.2 The first reference to the 'nature or general scheme' of the tax system was in *Italy v Commission (textile manufacturers)*. There, Italy had reduced the employer's contribution rate in respect of family allowances for employers in the textile manufacturing industry. Italy's argument was that family allowances are only claimable by a head of household, although contributions are payable in respect of all employees; textile manufacturing employees disproportionately more women than industry generally; women are less likely to be heads of households entitled to claim family allowances; therefore the Italian textile industry had been paying more in contributions to the family allowance scheme than its workers had been receiving: their contributions totalled 65,000 million Lire whereas benefits payable to textile workers only totalled 42,000 million Lire.
- 5.3 The Court held that this was irrelevant as a justification for reducing the contribution rate. The benefits were payable to the workers, not the employers; therefore the fact that a lower than average proportion of the employees of a particular employer could claim the benefit did not put the employer at any disadvantage. On the contrary, the measure was 'intended partially to exempt undertakings of a particular industrial sector from the financial charges arising from the normal application of the general social security system, without there being any justification for this exemption on the basis of the nature or general scheme of this system'.
- 5.4 The first case in which an argument based on the 'logic' of the system succeeded was *Tiercé Ladbroke v Commission*, a complicated case concerning betting levies. The Belgian subsidiary of Ladbroke challenged the arrangements between the French and Belgian totalizator betting organisations regarding bets taken in France on Belgian horse races.
- 5.5 Broadly speaking, the French 'tote' (the PMU) had the exclusive right to take totalizator bets in France, on French or foreign races, but was obliged to ensure that bets taken on foreign races were transferred to the relevant foreign 'tote'. Betting levy in Belgium was 35%, while in France it was 30%, of which 18% went to the State as tax, 10 % to the racecourses and the remainder to the national stud.
- 5.6 Under the challenged arrangements, bets taken by the French PMU on Belgian races were transferred to the Belgian PMU, which deducted 35% levy and gave 9% back to France. Of that, 4% went to the French State and 5% to the French racecourses.
- 5.7 Ladbroke argued that France was thereby giving State aid to the Belgian PMU. The levy chargeable under French law was State resources and, rather than distributing 30% of the stakes between itself and the French racing industry (as it did in the case of French races), France obtained only 9% for such distribution.
- 5.8 The ECJ rejected Ladbroke's argument; the Belgian PMU could not be said to be receiving an advantage merely because a lower proportion of the stake was retained by France than would have been the case for a race run in France. The logic of a system of totalizator betting is that all the stakes are pooled and distributed to winners after deduction of levy. One cannot

sensibly deduct different amounts of levy from different bets on account of the country where the bet is placed. The only logical course is for all bets to be subjected to levy at the same rate, and the obvious rate to use is the rate applicable in the country where the race is run. That is what happened: the bets placed in France were remitted to Belgium and subjected to the 35% Belgian levy. How much of that levy returned to France was irrelevant.

- 5.9 The argument failed in the *Maribel* case (*Belgium v Commission*). There, Belgium had introduced a scheme, known as 'Maribel', for reducing employer's social security contributions in respect of manual workers. Under the original scheme there was a general reduction in employer's contributions at a level depending on the number of manual workers employed. That scheme was not challenged.
- 5.10 Two years later Belgium introduced a 'Mark II' scheme (known in French as Maribel bis); the reductions were increased generally, with further reductions for employers in certain industrial sectors. The 'Mark III' scheme (Maribel ter) further increased the reductions in the specified sectors and added further sectors to the specially favoured category; it also introduced the condition that the workers worked at least half of normal full-time hours. The Commission decided that the Mark II and III schemes were State aid.
- 5.11 It was common ground that a scheme reducing the contribution rate in respect of manual workers generally, or applying generally to manual workers working over half of full-time hours, would have been too general to amount to a state aid; but the introduction of special measures for particular sectors 'rendered those reduction measures selective, so that they fulfilled the condition of specificity'. The Court referred to its decision in *Italy v Commission* and held that 'a measure aimed at promoting the creation of jobs by reducing, for certain undertakings, the amount of social security contributions which they must pay must be regarded as State aid when it is not justified by the nature or general scheme of the social welfare system'.
- 5.12 The Court considered the objectives of the Belgian social security system - namely to protect workers against unemployment, sickness and other such risks - and acknowledged that reduced contributions from certain categories of employer did not derogate from the general system of social protection; it noted that the Member States had a discretion as how they structured their social security schemes and that the Commission had urged them to reduce labour costs. However, it found that the only effect of the Mark II and III schemes was to give an economic advantage to certain undertakings only, 'relieving them from part of the social costs which they would normally have to bear'; this was not justified by the nature or scheme of the Belgian social security system. In other words, there was nothing in the way the Belgian scheme was conceived or structured that it made it appropriate to relieve that particular category of employers.
- 5.13 The history of the Maribel scheme - the progressive extension, sector by sector, of a reduction of the previously prevailing rates - could justify a conclusion that undertakings in the favoured sectors were paying less than they would 'normally' pay. But it is hard to reach that conclusion in the next case to which the Court applied the 'justification' test.
- 5.14 *Adria-Wien Pipeline* concerned a scheme of more general application than the Maribel Mark II and III schemes. Austria taxed the supply of electricity and natural gas, but at the same time provided for a rebate of the taxes insofar as they exceeded a certain threshold. The rebate was only available to undertakings whose activity consisted primarily in the manufacture of goods.
- 5.15 It was common ground that, but for that degree of 'selectivity', the mere fact that the system was structured as a charge mitigated by a rebate would not cause it to amount to State aid.

The Advocate General concluded that the scheme did not amount to State aid even though the rebate was restricted to manufacturing industry.

5.16 He referred back to the *Gezamenlijke Steenkolenmijnen* concept of 'charges normally included in the budget of an undertaking' and was unable to conclude that payment of the tax at the unrebated level was the 'norm' under the Austrian system. The rebate provisions had been introduced at the same time as the charging provisions, so that payment of the tax at the rebated level was the norm for manufacturing industry, even though payment of tax at the unrebated level was the norm for the services industries.

5.17 The Court disagreed. It found that

49 ... any justification for the grant of advantages to undertakings whose activity consists primarily in the production of goods is not to be found in the nature or general scheme of the taxation system established under the *Strukturanpassungsgesetz* of 1996.

50 For one thing, undertakings supplying services may, just like undertakings manufacturing goods, be major consumers of energy and incur energy taxes above 0.35% of their net production value - the threshold above which undertakings manufacturing principally goods are eligible for the energy tax rebate.

51 There is nothing in the national legislation at issue to support the conclusion that the rebate scheme restricted to undertakings which primarily manufacture goods is a purely temporary measure enabling them to adapt gradually to the new scheme because they are disproportionately affected by it, as the Austrian Government maintains.

52 For another thing, the ecological considerations underlying the national legislation at issue do not justify treating the consumption of natural gas or electricity by undertakings supplying services differently than the consumption of such energy by undertakings manufacturing goods. Energy consumption by each of those sectors is equally damaging to the environment.

53 It follows from the foregoing considerations that, although objective, the criterion applied by the national legislation at issue is not justified by the nature or general scheme of that legislation, so that it cannot save the measure at issue from being in the nature of State aid.

5.18 Though the Court began its reasoning by referring to the *Gezamenlijke Steenkolenmijnen* concept of 'charges normally included in the budget of an undertaking', its reasoning did not attempt to decide whether the rebated or the unrebated level of tax was to be regarded as 'normal'; it moved straight to considering whether the existence of the (more favourable) rebated level of charge alongside the unrebated level was justified by the nature or scheme of the tax system; it found that it was not. It therefore amounted to State aid.

5.19 That approach may be justifiable where the favoured and disadvantaged undertakings are in competition with each other, since the unequal treatment will distort competition, as article 87 also requires. It is unlikely that that was the case under the Austrian rules, since manufacturing industry does not generally compete with service industries. A State aid may of course fall within article 87 because it distorts competition between the favoured undertakings and their competitors in other Member States - which is what the State aid rules are principally designed to avoid. The intellectual difficulty presented by the Court's decision in *Adria-Wien Pipeline* is that, in the absence of a finding as to which tax system was 'normal', one could just as well say that Austria had placed its service industries at a

disadvantage in competition with their competitors in other Member States as that Austria had placed its manufacturing industries at an advantage in competition with industry in other Member States. Placing one's own industry at a disadvantage is not contrary to the State aid rules.

- 5.20 An example of a case in which different tax provisions placed one group of undertakings at a competitive disadvantage vis à vis their competitors is *Ferring*. A new provision inserted into the French Social Security Code imposed a sales tax of 2.5% on direct sales by pharmaceutical laboratories to pharmacists. There was not (and had never been) any corresponding tax provision for sales by pharmaceutical wholesalers, so that it could not be said that it had ever been 'normal' for pharmaceutical wholesalers to pay such a tax, or to point to any provision of French law that expressly exempted them from such a tax. Nevertheless, there was evidence that the tax on direct sales had been introduced in order to improve the competitive position of the wholesalers - whose operations were more expensive to run, because they had to comply with fairly onerous stockholding and delivery obligations - vis à vis direct sales by the manufacturers, and had had that effect. The Court recited these facts and reasoned

20 It would appear that not assessing wholesale distributors to the tax on direct sales - a tax which is designed to help finance the National Insurance Sickness Fund - equates to granting them a tax exemption. The French authorities have, in practice, waived their right to receive tax payments from wholesale distributors, thus conferring upon them an economic advantage. Consequently, that advantage was conferred through the use of State resources and made wholesale distributors better able to compete with the other distribution channel

- 5.21 The Court went on to hold that the de facto exemption in principle amounted to State aid, unless it merely compensated for the public service obligations imposed on wholesalers (as to which, see paragraph 3.4 above).

6. IPT - the contradictory approaches of the Court of Appeal and the ECJ

- 6.1 Prior to the 1997 Budget, there was a single rate of insurance premium tax (IPT) of 2.5%. The Finance Act 1997 replaced that rate with a 'standard' rate of 4% and a higher rate of 17½% on (broadly speaking) travel insurance arranged through a travel agent or tour operator and on breakdown insurance of cars and domestic appliances sold by the retailer of the goods. The purpose was to deter 'value shifting' by which tour operators and retailers were perceived to be taking part of their profit (which ought to be subject to standard rate VAT) in the form of inflated premiums for insurance (exempt from VAT). The 17.5% rate of IPT was designed to cancel out the VAT advantage from doing so.
- 6.2 Lunn Poly argued that this amounted to the grant of State aid, in the form of an abstention from collecting 17.5% IPT, to suppliers of travel insurance other than tour operators. The Administrative Court and the Court of Appeal agreed.
- 6.3 There were two main planks to the Commissioners' contrary argument: (a) the higher rate IPT was introduced to counteract VAT avoidance in the form of value shifting and (b) the State had not foregone any revenue from the generality of suppliers of insurance who were subject to the standard rate of IPT: they were simply paying at the (slightly increased) rate

set by the Act. Parliament had simply decided that another group of taxpayers should pay at a yet higher rate.

- 6.4 The Court of Appeal accepted that measures to counteract tax avoidance and targeted at the avoiders would not confer a state aid on others. However, they disagreed with the Commissioners' evidence about value-shifting. They accepted that tour operators' margins on insurance were higher than those on holidays, and higher than those earned on travel insurance by independent insurers. They also accepted that holidays (though not insurance) were frequently sold at a discount from brochure prices. But they held (perhaps questionably) that that only showed that demand for travel insurance supplied by tour operators was

highly price inelastic. This enables travel agents, in particular, to charge their customers a premium which they should find uncompetitive. They do not do so because they are guided by factors other than price when making their purchasing decision on insurance. Having come to this conclusion, there is no loss of tax which provides an objective justification for the discriminatory rate of tax imposed on tour operators and agents providing insurance. The higher rate, contrary to the stand adopted by the Customs and Excise, cannot be objectively justified as an anti-tax avoidance measure.

- 6.5 What this analysis failed to recognise is that the reasons why tour operators succeeded in obtaining high margins on insurance despite their lower margins on holidays were irrelevant to the issue whether they were cross-subsidising their (standard-rated) holiday business from profits on exempt insurance.
- 6.6 On the second issue, the Court of Appeal held that it could make no difference whether it was the higher or the lower rate that was expressed as the 'standard' rate. 'In either such case the taxpayer who pays at the lower rate has received a benefit from the State as compared with the taxpayer who pays at the higher rate'. The Court went on to hold that the differentiation affected competition between the two types of supplier of travel insurance and was not 'justified by the nature or scheme of the tax system'.
- 6.7 The Court of Appeal did not have the benefit of the *Adria-Wien* and *Ferring* judgments, which came later, but - given that the different rates of IPT applied to potentially competing suppliers of the same type of insurance - the decision was in line with the reasoning in *Ferring*.
- 6.8 In *GIL*, domestic appliance retailers relied on *Lunn Poly* to reclaim higher rate IPT that they had paid on insurance premiums. The Commissioners disputed that the tax had an effect on inter-state trade and the Tribunal referred some questions on that (as well as questions on whether higher rate IPT was a form of turnover tax prohibited by the Sixth VAT Directive) to the ECJ.
- 6.9 Following the Advocate General, the Court pre-empted the questions on effect on trade by considering whether IPT involved a state aid at all and holding that it was not. The Advocate General considered whether the correct analysis was that higher rate IPT was an 'exceptional burden' or that standard rate IPT was a state aid. He found on the facts that higher rate IPT was an exceptional burden placed on retailers in order to deter value-shifting.
- 6.10 The Court recited the *Adria-Wien Pipeline* test of whether the measure was 'justified by the nature or general scheme of the system of which it forms part', but reached a conclusion opposite to its conclusion in *Adria-Wien*. They agreed with the Advocate General that higher

rate IPT was intended to impose a burden on retailers supplying insurance, rather than standard rate IPT being intended to confer an advantage on other suppliers of insurance, and concluded that 'standard rate IPT does not constitute a derogation from the general system of taxation of insurance in the United Kingdom'.

7. Discretionary measures

7.1 A tax measure will fulfil the criterion of 'selectivity' if it applies to an undertaking as a result of a discretionary decision by the tax authority. In *Diputación Foral de Álava v Commission* the Provincial Council of the province of Álava had tax-setting powers under the Spanish federal system, pursuant to which it *inter alia* created a tax credit for investments of over 2500 million Pesetas; the credit was of 45% of the cost of the investment as determined by the Provincial Council. The prospect of this tax credit lured Ramondín SA, a manufacturer of capsules for wine bottles, into moving its factory from the neighbouring province of Rioja into Álava. Rioja complained to the Commission, which decided that the tax credit scheme amounted to State aid.

7.2 The CFI agreed. It rejected the argument that the Provincial Council merely had power to verify that the conditions for the grant of the tax credit were fulfilled, noting that the Council had not only the power to fix the amount of the allowable investment but also to set further conditions that the qualifying investment must meet. It accepted that the Provincial Council could not act arbitrarily but concluded

35 However, as the Commission points out, in order to preclude characterisation as a general measure, it is not necessary to determine whether the conduct of the tax administration is arbitrary. It need only be established, as it has been in this case, that the administration has a discretionary power enabling it, in particular, to vary the amount of, or the conditions for granting, the tax concession in question according to the characteristics of the investment project submitted for its assessment.

7.3 The Court also held that the measure was selective on the further ground that it applied only to companies able to invest 2500 million Pesetas or more (see section 3 above).

7.4 The discretion enjoyed by the Minister as regards the special insolvency procedure at issue in *Ecotrade* was a further reason why that scheme (discussed below) amounted to State aid.

8. The behaviour of the tax authority as a creditor

8.1 Where an undertaking owes debts to the State, including tax debts, the tax authority may de facto be granting State aid if it treats the debtor more leniently than a commercial creditor would do. This possibility arose in *Ecotrade*. An Italian law provided a 'special administration procedure' for large companies in financial difficulties. Eligible undertakings were those having 300 or more employees and owing debts, amounting to 80,000 million Lire or more and exceeding five times the paid-up capital of the company, to credit institutions, social security institutions or companies in which the State had a majority holding - in other words, debts to the State.

- 8.2 The special procedure derogated from normal insolvency procedure in that tax claims were not given preference, the undertaking was immune from fines for failing to pay social security contributions and sales of its real property were subject to a reduced rate of registration charge. The State was also empowered to guarantee some of the undertaking's debts. The undertaking might be permitted to continue trading, subject to Ministerial approval of its business plan.
- 8.3 As already noted (paragraph 3.9 above), the fact that the special procedure might reduce creditors' profits and thus indirectly the amount of tax paid by them did not make the scheme one of State aid. However (subject to verification of the facts by the national court), the scheme appeared to amount to State aid: it applied selectively to large undertakings whose principal creditors were likely to be the State or State bodies. Ministerial decisions to place an undertaking under the procedure were influenced by a desire to keep the undertaking going (when it might not otherwise be viable). Given the class of undertakings to which it applied and the Ministerial discretion regarding e.g. authorisation to continue trading, the scheme met the condition of selectivity. It placed the undertakings in a more favourable position by enabling them to continue trading and it did so at the expense of the State as creditor.
- 8.4 Similar principles apply to 'one-off' indulgences granted to undertakings by State creditors. In *DM Transport* the Belgian Commercial Court initiated insolvency proceedings in respect of a transport company which was found to have assets of 13 million BFRs and debts of 21 million, of which 18 million was in respect of social security contributions. Under the social security legislation, non-payment of contributions was an offence and the overdue payments carried interest, but the social security institution could give employers time to pay. The Belgian court found that in this case the social security institution had shown 'exceptional patience' towards the company in giving it eight years to pay off arrears. It asked whether this amounted to State aid.
- 8.5 The Court defined the issue as being whether the company had received an economic advantage which it would not have received under normal market conditions. It dismissed the argument that the indulgence could not amount to State aid because the rules governing collection of arrears were the same for all debtors: there could be State aid if the social security body had exercised a discretion as to the precise payment terms it gave the company. It therefore held that
- 25 It is for the national court to determine whether the payment facilities granted by the ONSS to DMT are manifestly more generous than those which a private creditor would have granted. To that end, the ONSS must be compared with a hypothetical private creditor which, so far as possible, is in the same position vis-à-vis its debtor as the ONSS and is seeking to recover the sums owed to it.
- 8.6 In *Spain v Commission (Tubacex)* the ECJ reiterated that the comparison to be made is between the rate of interest charged by the State creditor and that which a private creditor would charge.

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