When is a tax derogation a selective advantage? The General Court strikes down a Commission decision finding a Spanish tax provision to be a State aid

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One of the most notoriously tricky issues in State aid law is the question of when a tax provision derogating from a wider tax rule confers a selective advantage on those undertakings benefitting from it. That tricky issue is also one of the most important in practice, since all Member States' tax codes are full of exemptions and derogations of various kinds, and the value of such exemptions can be enormous for those undertakings that qualify.

In an interesting judgment released on 7 November 2014 (Case T-399/11 Banco Santander v Commission, available in French and Spanish but not yet available in English) the General Court (GC) held that the Commission had erred in applying the principle of selectivity to a tax derogation, and gave some useful guidance on the difference between selective and non-selective tax derogations. Its judgment should be read by both State aid and tax lawyers.

In general, Spanish law on corporation tax does not allow the goodwill resulting from the acquisition of a shareholding in a company established in Spain by a company which is taxable in Spain to be entered separately in the accounts for tax purposes.

But there is also a provision of Spanish tax law that states that, where a company which is taxable in Spain acquires a shareholding in a 'foreign company' of at least 5% and holds it without interruption for at least one year, the goodwill resulting from that shareholding may be deducted through amortisation of the basis of assessment for the corporation tax for which the undertaking is liable. The law states that, to qualify as a "foreign company", a company must be subject to a similar tax to the tax applicable in Spain and its income must derive mainly from business activities carried out abroad.

In a decision taken on 12 January 2011 (2011/282/UE, [2011] OJ L135/1), the Commission found that this provision was a derogation from the usual position in Spanish tax law and conferred a selective advantage on those Spanish companies that held qualifying shares in foreign companies. It was therefore unlawful State aid, and Spain was ordered to recover the amount of the advantage from the companies that had benefitted. Santander Bank, which (unsurprisingly) benefitted from the derogation, applied to the GC for annulment of the decision.

In its judgment, the GC made a number of points about what had to be shown in order for a derogation to be regarded as selective, and why the Commission had failed to jump that hurdle.

- The requirement of selectivity involved identifying a defined class of undertakings that benefitted from the measure (although that class could be a large one - see Case C-143/99 Adria-Wien Pipeline (all companies supplying goods)).

- The mere fact that some undertakings benefitted from the derogation but others did not was not enough to show selectivity. It had to be shown that the measure created a difference in treatment between undertakings in a comparable legal and factual situation.

- A measure that applied regardless of the nature of an undertaking's economic activity was in principle not selective.

- A derogation that was nominally open to any undertaking could be shown in fact to be open only to a limited class of undertakings. But it was up to the Commission to show that that was so.

- In the case before the GC, it was not self-evident that the derogation excluded any class of undertakings. It was not enough for the Commission to say that only undertakings with the requisite foreign shareholding could benefit: the Commission had to go further and show that the effect of the measure was to benefit a class of undertakings defined in some other way than by their eligibility for the derogation.

- It was irrelevant for the purposes of selectivity (though it could be relevant to the question of effect on trade) that the measure might assist Spanish companies vis-à-vis their non-Spanish competitors.

Summing all this up, it seems that the following are the key points to take away from the judgment.

First, a tax measure that expressly distinguishes between undertakings based on the nature of their activity (eg whether they produce widgets or bodgets, or are based in Cornwall or east of the Tamar) will on its face be selective.

Second, however, where a tax measure distinguishes between types of transactions that in principle could be carried out by any type of undertaking, the measure will not be selective unless it can be shown that in practice it is available only to certain classes of undertaking: and it is not acceptable

as a way of clearing that hurdle just to point to the class of undertakings that happen to meet the requirements of the derogation, as that line of argument would mean that any derogation was necessarily selective (since, by definition, a derogation applies only to the class of undertakings that meet its requirements).

In relation to that second point, those advising on whether a tax derogation is State aid may well find it difficult to say whether a derogation is one which, like the Ritz, is nominally open to all but which is in reality open only to a limited class of undertakings - a difficulty increased because, as the GC points out, the limited class may potentially be a very large one more easily defined by who is not in it rather than who is. In the present case, the GC appears to have been confident that the Spanish derogation, applying to any undertaking holding a 5% share in any foreign company, was in reality open to all (ie that it was more like more like McDonalds than the Ritz), at least to the extent of requiring the Commission to prove the contrary. But would the position have been the same if the requirement had been a 50% share of a large foreign company? And, if not, where is the dividing line?

The present writer suspects that in practice (as in so many other areas of EU law) much will turn on whether the GC believes that a nominally even-handed measure is, in reality, a device to channel (or at least has the effect of channeling) an advantage to a favoured class of undertakings. But that does not resolve the difficulty: it just re-casts it.

The comments made in this case note are wholly personal and do not reflect the views of any other members of Monckton Chambers, its tenants or clients.

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