

Analysis

The consequences of unlawful state aid

The European Commission's recent announcements of state aid investigations into tax rulings by a number of member states (including Ireland's treatment of Apple and Luxembourg's treatment of Fiat) should have reminded tax lawyers that the EU's state aid rules have important tax implications.

This article explores the consequences of the application of the state aid rules. But, for the benefit of those who would appreciate a reminder of the basic principles, it may be useful to recap briefly on when the state aid rules apply in the tax field.

State aid: a summary

The state aid rules apply where a member state confers an advantage, out of its resources, on one or more undertakings that it does not grant to other undertakings in a similar factual and legal position, and where that advantage potentially affects competition and trade between member states. With exceptions laid down in EU regulations, member states are prohibited by TFEU art 108(3) from implementing a state aid before the aid has been cleared by the Commission. Aid implemented without such clearance is referred to as 'unlawful aid'. A waiver of tax, or a favourable tax settlement or ruling not justified by the tax rules, or a rule providing for no or reduced tax for some taxpayers compared to others in a similar position, can all be state aid.

The beneficiary's nightmare: recovery of the aid

The principal risk faced by a beneficiary of unlawful aid is that the member state will be required to recover the aid from the beneficiary.

When will recovery be ordered? Recovery may be ordered either by the Commission or by a national court.

Looking first at the Commission, art 14(1) of Council Regulation 659/99 requires the Commission to order recovery when it finds that there has been unlawful aid, which it would not have cleared had it been notified. The Commission has no discretion here; it *must* order recovery in full. The Commission need not specify a precise sum that must be recovered (though it often does), provided that it sets out parameters that enable the amount to be calculated. If it does that, it will be for the national authorities to calculate the exact amount to be recovered, with any dispute being for the national court to resolve. In a tax case where the value of the aid depends on a complex calculation of what the correct tax should have been, it is likely that the calculation will be left to the national authorities.

The only exceptions to the principle that the Commission must order recovery of unlawful aid are: when the Commission itself created a legitimate expectation that the measure was not state aid (statements by the member state itself are irrelevant); and (under art 15 of Regulation 659/99) when the unlawful aid was paid more than ten

SPEED READ A finding that a tax advantage is an unlawful state aid has unpleasant consequences for the taxpayer who benefited from it. Recovery of the aid is almost inevitable, and there are few defences to such an order. The amount recovered will usually be the difference between the tax actually paid and the tax that would have been paid without the advantage, in addition to compound interest. For competitors, a finding of unlawful aid gives rise to a possibility of damages; and competitors also have rights to ask a national court to stop the advantage, or get it suspended.



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years before the Commission's decision. It should be noted that almost any communication about the aid between the member state and the Commission, which need not be known to the beneficiary, restarts the clock (so a beneficiary would be unwise to break open the champagne just because ten years have passed since the aid); see *Scott* [2005] ECR I-8437 (C-276/03P).

A recovery order by the Commission binds both the member state and its courts. It is irrelevant that the member state or beneficiary may have sought annulment of the recovery order in the general court. Only if the general court has itself suspended the order (which it will do only if suspension is necessary to prevent irreparable damage to the beneficiary) will the member state be relieved from its obligation to seek immediate recovery.

The courts of the member state must set aside any constitutional or procedural rule that stands in the way of recovery. In *Lucchini* [2007] ECR I-6199 (C-119/05), the Italian courts had previously ruled that the Italian government was contractually obliged to make a grant to the beneficiary. However, they were told by the CJEU that, despite that previous judgment and the principle of *res judicata* in the Italian civil code, they were obliged to implement a recovery order and require the beneficiary to repay the grant. Another illustration of that principle is *Commission v France* [2006] ECR I-10071 (C-232/05). In that case, the French authorities started recovery proceedings by issuing a statutory demand (the relevant procedure in French law). But the beneficiary challenged that demand in the courts – and, under French administrative law, that challenge had an automatic suspensive effect. The CJEU held that France was required to set that rule aside and recover the aid immediately.

Those cases show that the obligation to recover aid overrides any argument that national procedural rules preclude recovery. Given the strength of the obligation and the principle of supremacy of EU

law, it is clear that in a case where the advantage was in the form of legislation providing that tax was not due it is clear that, the recovery obligation would even defeat an argument that it was impossible under the national constitution to levy tax, save where authorised by national legislation (for instance, the Bill of Rights 1689). It would also override any national limitation period or national rule of administrative law, such as legitimate expectations, that would normally prevent the tax authorities from recovering tax that they had agreed would not be due. It is only if recovery is absolutely impossible – essentially, if the beneficiary is insolvent and there is no real prospect of recovering in the insolvency – that a member state is excused compliance with a recovery order.

The fact that a beneficiary has very little chance in the national courts to contest a recovery order would be less of a concern, if the beneficiary had a good chance to participate in the procedure leading up to a recovery order. However, it has very limited procedural rights at that stage. (This limitation is justified on the basis that it is not, technically, the alleged wrongdoer, but is no more than an interested party.) The beneficiary is thus largely dependent on the member state to mount a vigorous defence. However, since the member state is unlikely to be as disturbed by the possibility of recovery of the aid as the beneficiary is, the beneficiary may well be concerned that points are not being taken as strongly as they might be.

It is also important to note that, even where the Commission has not taken any action, the national court is obliged to order recovery if it finds that unlawful aid has been granted. That means that a taxpayer that has received unlawful state aid in the form of favourable tax treatment runs the risk that a complainant could obtain an order from the national court requiring the authorities to recover the tax advantage.

How should the amount to be recovered be calculated? The general rule is that recovery should restore the status quo. In a tax case, that will typically mean that the favoured taxpayer has to pay the difference between the tax it was in fact charged and the tax it would have paid absent the aid.

In an important recent judgment concerning different rates of air passenger duty (APD) in Ireland (*Aer Lingus* (T-473/12), 5 February 2015), the General Court held that the favoured airlines, enjoying the lower rate APD, should not be required to pay the difference between the APD actually paid and the higher rate APD that it would have paid absent the aid. In that case, the court pointed out that APD was an indirect tax that, though paid by airlines, was – and was intended to be – passed on to passengers. Since the tax was simply passed on, the tax difference could not be the basis for calculating the amount of the advantage. Rather, the value of the advantage created by the favourable tax treatment was, in that case, the additional business the favoured airlines

obtained as a result of the lower rate of APD.

Even if that judgment survives a likely appeal by the Commission, its limitations should be noted. First, there is nothing to suggest that it could apply to a direct tax advantage of the kind allegedly enjoyed by Apple. Second, even in an indirect tax case, in any situation where the favoured taxpayer was in competition with non-favoured ones it will be hard to show that the tax advantage was passed on. The favoured taxpayer is likely to have charged the same price as that charged by the non-favoured ones and pocketed the tax advantage for itself. The facts of *Aer Lingus* were unusual in that, because the different tax treatment related to the length of the route, favoured taxpayers were not in competition with non-favoured ones, because they would be flying on different routes.

Two other points about quantification need to be made. The first relates to interest. Since 2000, the Commission has required recovery of interest at a compound rate (a rule now enshrined in art 11(2) of Regulation 794/2004); and the rates used (published by the Commission on its website) are not favourable to the payer.

The second is that a favoured taxpayer whose economic behaviour is distorted by the favourable tax treatment it received – for example, by locating in a remote area it would not otherwise have considered – is often left worse off after having to repay the tax advantage than it would have been had it never received the advantage in the first place. That is because it has made a less favourable investment or incurred additional costs. But that disadvantage – what an economist would call a stranded cost – is not reflected in the calculation of the advantage for repayment purposes.

Is there anything a beneficiary can do about this loss? In *Belgium v Commission* (“*Tubemeuse*”) [1990] ECR I-959 (C-142/87), Advocate General Tesouro speculated that a beneficiary could seek damages against the state for breach of art 108(3). In general, the difficulty with that thought, as pointed out by Advocate General Slynn in *Asteris* [1988] ECR 5515 (C-106/47), is that it cannot in principle be right for the beneficiary to get by way of damages the advantage that it should never have been granted. However, when one remembers that the beneficiary may well be left seriously out of pocket as a result of an unlawful aid which is then reversed by a recovery order, there appears to be some scope for a possible damages action as envisaged by AG Tesouro. The damages would not be for the amount of the advantage, but for ‘out of pocket’ losses and stranded costs – and the measure of damages would be what was needed to put the beneficiary back into the same position as it was before the unlawful advantage.

The competitor’s dream: damages and other relief

For a competitor, the sight of the favoured taxpayer having to pay back the tax advantage may well cause *schadenfreude*. But if it can show loss or

likely future loss as a result of the advantage given to its competitor, it has EU law rights to more tangible remedies, namely injunctive relief and damages.

It should, though, first be noted that a competitor cannot generally obtain relief from the obligation to pay its own tax (see, for example, *University of Sussex v Customs & Excise Commrs* [2001] STC 1495 at para 97). That relief is available only in limited and unusual cases, namely where the tax paid by the competitor was levied in order to grant the advantage to the beneficiary, or was hypothecated to that advantage (see paras 67–70 of *Aer Lingus*).

Injunctive or declaratory relief: A national court must grant an injunction or declaratory relief where it finds that a proposed measure is unlawful aid. Further, a national court is also normally obliged to give interim relief, suspending the measure where there is an arguable case that it is unlawful aid. When the Commission has opened a formal investigation into alleged unlawful aid, the national court *must* proceed on the basis that it is at least arguable that there is unlawful aid (see *Deutsche Lufthansa* (C-284/12), judgment of 24 November 2013). In the UK, judicial review courts have given declarations that tax differences amount to unlawful state aid (see *R v Customs & Excise Commrs, ex p. Lunn Poly* [1999] STC 350). EU law requires that a competitor that shows an arguable case of loss from the measure must have standing; but the liberal standing rules of the English administrative courts would appear to allow a pressure group to bring an action seeking a declaration that a tax advantage is a state aid.

Damages: As far as damages are concerned, it is well established that a competitor that can show loss as the result of an unlawful state aid has a right to obtain damages from the relevant public authorities: see *CELF* [2008] ECR I-469 (C-199/06) at paras 53 and 55. Establishing that loss was caused by the tax advantage given to a competitor and quantifying that loss will inevitably be tricky, but it has been done. A UK example is *Betws Anthracite v DSK*

Anthrazit Ibbenburen [2004] 1 CMLR 12, where a Welsh anthracite producer managed to prove a quantified loss caused as a result of aid given by Germany to a competing supplier.


Unfortunately for the claimant, *Betws Anthracite* also held that the target of such an action must be the granting authority. The claimant failed because it had no right of action against the beneficiary for damages in either national or EU law.

Conclusion

Given the serious consequences of receiving state aid in the form of a 'too good to be true' tax ruling or settlement, or a rule setting a lower rate of tax, taxpayers need to be wary of that risk. It is often said that you should not look a gift horse in the mouth. When the gift horse comes from the tax authorities, though, wise taxpayers will remember the Trojan horse and that one should beware Greeks (or tax authorities) bearing gifts.

Action points

- Taxpayers who benefit from a 'too good to be true' tax ruling or tax settlement need to be aware of the state aid risk.
- If there is unlawful state aid, there are few defences to a recovery order and such an order may be made many years after expiry of the national limitation period for underpaid tax.
- A recovery order will usually involve payment of the full amount of the tax advantage, plus compound interest at a high rate. The taxpayer may well end up worse off than before the advantage was given.
- Competitors have a right to try to stop, or order recovery of, the aid in the national courts. Pressure groups may also be able to seek judicial review of tax advantages that amount to state aid.
- Competitors affected by a tax advantage granted to others can sue the state for damages. It is possible that beneficiaries of aid who suffer stranded costs may also be able to obtain damages from the state. ■

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