

REGULATION OF TAX PREFERENCES AND STATE AIDS IN THE EUROPEAN TAX LAW – A CASE STUDY

Éva ERDŐS*

ABSTRACT: *What is the connection of State Aids (aids granted by the state) with tax preferences in EU tax law? What is the criterions of the compatible and incompatible State Aids in the European tax law? In the EU the State Aids are forbidden and incompatible with the law of EU, because they distort the internal market, and distort the competition. Tax preferences work same as State Aids, they may drive to harmful tax competition, and discrimination. To give tax allowances, preferences, tax deduction or State Aid to the foreigners or to selective subjects are prohibited in the fight against of harmful tax competition. In this study I try to highlight the elements and criterions of the definition of incompatible State Aids and tax allowances in EU law, demonstrating it through the judgement of the Court of the European Union, demonstrate these criterions in a case study.*

KEY WORDS: *European tax law, incompatible and compatible state aids, aid granted by the state, incompatible tax preferences*

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1. THE REGULATION OF THE TAX ALLOWANCES AND STATE AIDS ACCORDING THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION

In the European Union it is a very important question to allow competition. In the European Union the four main principles are the freedom of goods, services, capital and persons movement and the freedom of its' competition. However the competition is free in the EU, the competition of tax is prohibited in the EU's law. As a result of globalisation the frontiers have been removed, the free movement of capital has commenced, which has led to a conflict of the sovereign state's taxation systems. The phenomenon of double taxation has appeared and the problem of harmful tax competition has come to light. The EU tries to solve these conflicts because the tax

* PhD. Associate Professor University of Miskolc, Faculty of Law, HUNGARY

competition is not allowed in the member states and in the EU, also. The prohibition of discrimination is a main principle in the international and European tax law, therefore the tax allowances and incentives are always the matter of the examination by the EU. To give tax allowances to the foreigners are prohibited *in the fight of harmful tax competition*.

What is the connection of state aids with tax preferences in EU tax law? What are the criterions of the compatible and incompatible state aids in the European tax law? In the EU the state aids are forbidden and incompatible with the law of EU, because they distort the common internal market, and distort the competition. Tax preferences work same as state aid, they may drive to harmful tax competition, and discrimination. To give tax allowances, preferences or state aid to the foreigners or to selective subjects are prohibited in the fight against of harmful tax competition. In this study I try to highlight the elements and criteria of the incompatible state aids, tax allowance through the judgement of the Court of the European Union, show in a case of it.

The State Aids belong to the field of the Competition Law if the Treaty on European Union contains no special provisions according them. Within the meaning of the Article 107 (1) of the Treaty Functioning on European Union (TFEU) the State Aids are vitally forbidden, because they can disfigure and hinder the development and functioning of the Common Internal Market. As described in the Article 107 (1) the aid granted by the member states or from state resources, which disfigure or can disfigure the competition through favouring certain enterprises and production of certain goods, is incompatible, if it affected the trade between member states. „ Save as otherwise provided in this Treaty, any aid granted by Member State or through State resources an any form whatever 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.”(TFEU Article 107.) The Article 107 (2) and (3) of the Treaty on European Union list the criterions and the scope of the state aids which are compatible with the European common internal market, recognizing that certain state aids are allowed in the European Union, so their prohibitions are not limitless.

The State Aids appear often in the form of a tax arrangement, principally such as tax incentives, taxable reducing allowances, tax credits, tax preferences or tax reductions. Between the selective, that's why treated as a state aid, respectively general provisions are hard to make a distinction, the Commission issued a Statement about the direct business taxation, facilitating to the interpretation and the separation¹.

According to this a tax benefit is a subject to the Article 107 (1) of the Treaty on the European Union², if this refers to certain enterprises or to the production of certain goods. A tax allowance - which has various forms – shall be considered to be specific and hereby selective, if it means an exemption to the generally operative tax regulations, or if it follows from the discretion of the tax administrations. It is made specific if the

¹ OJ C 384., 1998.12.10.see further : TÓTH Tihamér: Az Európai Unió versenyjoga, (*Competition Law of the EU*) Complex Kiadó Budapest, 2007. p 551., together with about the allowed state aids in the EU see under: VARNAY Ernő – PAPP Mónika: Az Európai Unió joga,(*The Law of the EU*) KJK-KERSZÖV Jogi és Üzleti Kiadó, Budapest, 2004 , pp: 550.- 575., and about the state aids see under: EU-JOG (*EU- Law*)(szerkesztette: OSZTOVITS András), HVG Orac Lap-és Könyvkiadó Kft. Budapest, 2012. pp. 538-546.

² Beforehand: 87 (1) of the EC Treaty

privileged rule, allowance aim at a certain area, sector, or an internal function of an enterprise, for example at a financial service. Such a case was the *Irish Tax Allowance Case* too.³ In the Irish corporate tax on the producer enterprises are conferred benefit opposite the investment firms. In 1980 the Commission categorized this as a general provisions (allowed state aids), inasmuch as the market of the services had not been liberalized yet, we couldn't speak about common single market in that time. In the end of the 90s the situation has altered in a large measure, so in its Recommendation the Commission suggested the annulment of the preferential treatment for Ireland.

As described in the Article 108 (3) of the Treaty on European Union the Commission must announce every state aids, which are incompatible with the common single market. The Commission can pronounce the tax allowances and the state aids incompatible, which means that these aids can be freed from all obligations of notification⁴ described in the Article 108 (3):

- The allowances given for small and medium-sized enterprises, the grants provided for the Research & Development and innovation, environmental protection, employment and training,
- aid that complies with the map approved by the Commission for each Member State for the grant of regional aid
- minimal aid grants, but the „de minimis” aid grants⁵ which do not in excess of 200 000 Euro, are freed from the obligation of notification for the European Commission.

Inasmuch as despite the above mentioned regulation it isn't easy to decide which aids and grants are incompatible with the common single internal market, the Court of the Justice of the European Union is constantly working up its case-law in this respect to help in the interpretation and the determination.

2. THE C-148/04. UNICREDITO ITALIANO SPA CASE IN RELATION TO THE INTERPRETATION OF THE STATE AIDS

In relation to the interpretation of the state aids the Court of Justice of the European Union made many decisions. One of the most interesting decisions is the decision made in the Italian Unicredito Italiano SpA C-148/04 Case⁶, which was in relation to Validity of Commission Decision 2002/581/EC of 11 December 2001 on the tax measures for banks and banking foundations implemented by Italy⁷, together with the Article 87 of the EC Treaty⁸ and the Article 14 of the Council Regulation No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 (now Article 88.) of

³ See under: XXVII. Versenypolitikai Jelentés (*Competition Report*)(1998) , in Point 210. in: TÓTH T (2007), Page: 551.

⁴ http://europa.eu/legislation_summaries/competition/state_aid/126043_hu.htm, 15 January 2013

⁵ See under: The Commission Regulation 1998/2006/EC , L.379.2006,12.28.

⁶ The Court's decision of 15 December 2005, in the C-148/04. Case , the request of the Commissione tributaria provinciale di Genova (Italy) for preliminary ruling in the proceeding between the Unicredito Italiano SpA and Agenzia delle Entrate European Court Reports(see further: ECR.) 2005. I-11137.

⁷ Commission Decision 2002/581/EC HL 2002.L 184.,27.o.

⁸ Presently: Article 107 and following Articles of the Treaty on Functioning of European Union

the EC Treaty⁹. The application was submitted in the framework of the proceeding, which was started by the Unicredito Italiano SpA against the Agenzia della Entrate, Ufficio Genova 1. in the financial years 1998, 1999 and 2000. The short summary of the case: Italy realized the reform of the bank system through the Act 218/90 about the financial restructuring and the reinforcement of the state credit institutions. This act established the chance to convert the state credit institutions into a public limited liability companies. For this purpose they empowered one state bank (bank foundation), the holder of the property shares to settle the bank institution to one public limited liability company, splitting the transferor legal person (bank foundation), the holder of the bank shares from the public limited liability company that is solely entitled for bank activity. The bank foundation managed the shares of the public limited liability company and it put to use the capital income for the social objectives. In the reconstruction several legislations had decisive impact, the relevant legislation was the Act 461/98, which empowered the Italian government to readjustment of the provisions related to the bank sector, especially to the reconstruction, together with the Act 153/99 about the tax adjustment of the bank reconstruction.

The Article 22 (1) and the Article 23 (1) of the Regulation initiated the tax allowance that means the reducing for 12,5 % of the IRPEG for 5 following financial years in case of the unions or similar reconstructions of the banks, if they compose a separate reserve, unavailable for distribution for 3 years from the profit. The separate reserve profit couldn't exceed the sum of the liabilities and the debits of the banks that participated in union or similar reconstructions, and the difference of 1,2% between the obligations and the liabilities of the biggest Bank that joint that procedure.

By the examination related to the obligation of notification of the state aids the Commission took cognizance that the Italian Republic harmed the Article 88 (3) of the EC Treaty¹⁰, it realized the Act 461/98 and the Regulation 153/99 unjustly. The Commission laid down that the implemented tax measures – except the Regulation 27 (2) – are incompatible with common market's state aid system. These provisions favour the banks, because in this way they can enlarge their size and derive advantage through size-cost-effectiveness, that's why this provision is discriminative.

3. THE REFERRED QUESTIONS OF BASIC PROCEEDING AND THE PRELIMINARY RULING

Based on the Regulation 282/02, the Unicredito Bank paid 244 712 646,05 EUR in form tax and interest, which it partook through the tax allowance, especially tax reduction in the financial years 1998, 1999, 2000. After that in 2003 it requested three times for the repayment of the tax paid in the previous financial years. The Agenzia delle Entrate, Ufficio Genova 1. implicitly rejected the Unicredito's requests. The Unicredito contested these decisions by the Commissione Tributaria Provinciale di Genova, inter alia, referring to their irregularity. The Court that referred the question had the opinion that the request for preliminary ruling is justified in the aspects of the

⁹ Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty (OJ L 83, 27.3.1999, p. 1)

¹⁰ Presently: Article 108 (3) of the TFEU

compatibility of the protection of legitimate confidence, legal certainty and proportionality.

The Commissione Tributaria Provinciale di Genova put the following questions to the Court in the preliminary ruling:

1.) Is the rejected decision invalid or contrary to the Community law, if the provisions of the Act 461/98 and the Regulation 153/99 related to the banks, - despite the Commission's opinion – are compatible with the common market, or they belong to the exceptions described in the b.) and c.) points of the Article 87 (3) of EC Treaty?

The other two questions were in relation to the principle of protection of legitimate confidence and proportionality.

Observations: The Unicredito claimed that the Act 461/98 and the Regulation 153/99 ensure the continuing and the ending of the reconstruction and the privatisation of the Italian bank system, that was started in 1990 through the Act 218/90.

It maintained that the rejected decision harmed the (1) and the b.), c.) points of the (3) of the Article 87 of the EC Treaty, because the tax reduction:

- isn't selective, but general provision, and the discrimination that it realized is justified by the nature and the internal structure of the tax system,
- doesn't respect the trade between the member states, and doesn't disfigure the competition, and doesn't menace to disfigure it,
- should be examined in the respect of the „de minimis” aid, which was excluded by the Commission, without any examination,
- is compatible with the common market, if it can be considered as the aid conducive for projects of the common European interest, because it is a part of the privatisation of the Italian bank system, respectively it can be considered as the aid that furthers the development of several economic activities.

The Italian government thought too that the rejected decision was invalid.

In its opinion the tax allowance did not realize irregular state aid, it fits in the continuity and extension performed by the former practice of the Act 218/90, which disposed of significant allowances, essentially with similar terms. Its aim was to establish the privatisation of the Italian state banks through annulment of the inordinate segmentation of the Italian bank system, which was the result of the original state banks' institutional status, and which was partly abolished in the Act 218/90.

4. THE OPINION OF THE COURT OF JUSTICE OF THE EUROPEAN UNION IN RELATION TO THE CRITERIAS OF THE STATE AIDS

The conceptual criterions of the state aids were interpreted by the Court of Justice of the European Union (in time of the decision making in this case) through the following aspects:

4.1. The selectivity of the tax reduction:

The Court said that the Article 87(1) of the EC Treaty prohibits the aids which favour certain enterprises, or the production of certain goods, namely the selective aids. In its opinion according the provision some state aids can be selective even if they affect all of the economic sectors¹¹. In the present case the tax reduction refers to the bank

¹¹ See the other decision according this in another case: C-75/97.sz Belgium v. Commission ECR.1999.,I-3671.

sector, it doesn't favour other economic sectors' enterprises through allowances. Furthermore the enterprises managing the cases of the bank sectors are favoured. Without so much as the Court evaluated the Commission's claim that the tax reduction maintains the large-sized enterprises in large measure, it said that this provision is selective compared to other economic sectors, and it is selective in the bank sector too, because it is not applicable for all the economic operators, so it can't be considered as a general financial or economic provision. It establishes an exception in the general tax system, namely the favoured enterprises partake such an tax allowance, in case of which they aren't entitled in the course of the general application of the tax system, and which the enterprises with similar activity in other sector, or the enterprises that in bank sector but with other activity cannot resort to.

In the opinion of the Court the tax system isn't justified by the nature or the internal structure of the vexed tax system¹². The general system isn't adjusted to the special proprs of the bank enterprises. It is known from the files that the national authorities described the tax allowance decidedly, that amended the effectiveness of several enterprises in a certain point of the sector's development. *So the objection based on the lack of selectivity of the tax allowance is not founded.*

4.2 The vexed tax reducing provision between the trade and the disfiguring effect of the member states the Court decided the followings:

The Article 87(1) of the EC Treaty prohibits the state aids, which disfigure the competition, or which menace to disfigure, if they affect the trade between the member states. In respect of these two terms in the opinion of the Court: the Commission doesn't have to decide if the aids have a real effect on the trade between the member states, it must examine only if these aids are able to affect the trade between the member states and if they are able to disfigure the competition¹³.

The Commission must decide about the incompatibility with the common market, if it is able to affect the trade in the EU, together with the disfiguring effect on the competition or the possibility of that.

If the aid provided by state reinforced the trade situation of several enterprises opposite their rivals, than the aid must be regarded as it affects the trade¹⁴. According this fact; the circumstance that some economic sectors are liberalized at community level, does justice to the term that the aid must have a real or potential effect on the trade, together with the trade between the member states¹⁵. Otherwise to the condition it isn't needed that the favoured enterprise participate the trade in the Community, because if the member state grants aid to enterprises, the internal activity can stay on the same level, or can increase, and through these facts the market joining chances into this member state of these enterprises from other member state are lowering¹⁶. From the

¹² See under the decision of the Court on 2 July in the case C-173/73. Italy v. Commission, ECR. 1974. Page 709.

¹³ See under: the decision in the case a C-372/97 Italy v. Commission

¹⁴ See under: the case C-730/79.; Philip Morris contra Commission Case, the point 11. of the decision made on 17 September 1980, ECR. 1980. Page 2671., and the point 21 of decision of 22 November 2001 in the case C-53/00 Ferring Case, ECR. 2001. Page I-9067.

¹⁵ See under: the point 75 of the decision in the case C-409/00, Spain contra Commission, on 13 February 2003, ECR. 2003. Page I-1487.

¹⁶ See more under the point 84 of the decision in case C-310/99, ECR. 2002. Page I-2289.

other side this is a strengthening of such an enterprise which didn't join the market at community level before, can strengthen it that it can join other member state's market later.

In the present case the Court decided that the tax reduction can reinforce the situation of the favoured enterprise opposite the other, not favoured enterprises in the EU trade. It must be ascertained that in the sector of financial services at community level a relevant liberalization process came off, which enhanced the competition originated from the free movement of the capital. The aim of the tax reduction – known from the files – was to interfere that the Italian bank system decomposes because of its significant time-lag compared to its European rivals and for the goods of the strongest European banks. The competitive advantage given by the tax reduction for the market operators settled down in Italy is able to encumber the accession into the Italian market for the market operators of other member states, and to unburden the accession into other markets for the enterprises settled down in Italy. Such a circumstance, to which the Italian government referred, that the tax reduction was available in Italy for the branch of banks of other member states, doesn't hinder these harmful effects. Consequently the Court decided that the objections based on the lack of the affect on the trade between the member states and the distortion of the competition are not founded.

4.3. *In the following point the Court mentioned the leeway of the examination of the executed provisions.* It decided that in case of the supporting points the Commission can confine to examine the attributes of the vexed system, without that it is obligated to examine all of the cases to decide if the system contains supporting elements.

4.4. *The examination of the tax reduction in respect of the definition of the „de minimis” aid.* The Court laid down that because the Commission examined the supporting program, and not the individual supporting programs, so it was not obligated to examine all of the individual cases of the applications of the system if they did not exceed the highest sum of the „de minimis” aids.

4.5. *The application of the c.,d.) points of the Article 87 (3) of the EC Treaty*

The Commission has a wide discretionary power through the application of the Article 87 (3), which practice assumes the evaluation of the economic and social aspects. The Court – examining the legality of its decision freedom – can't replace the evaluation of the competent authority(Commission), but it can confine itself only to examine that through the former evaluation obvious error or absence of abuse of power happened or not¹⁷.

4.6. *About the definition of aid supporting projects for the common European interest:*

The b.) point of the Article 87 (3) of the EC Treaty gives scope for the Commission to pronounce compatible an aid supporting projects for the common European interest. In the vexed decision's justification the Commission laid down that the aim of the provision concerned was to reinforce the Italian bank system, and favoured mainly the economic operators of some member states, but not the whole Community. It is sufficient to refer that from the justification of the vexed Act 461/98 it lightened that the tax reduction's aim was essentially to improve the competitiveness of the market

¹⁷See under the point 41. of the decision made on 12 December 2002 in the case French contra Commission Case, ECR. 2002. Page I-11949.

operators settled down in Italy for reinforcing their competitive position in the national market. Consequently the Court laid down that it didn't make a disciplinary mistake when it excluded the provision's „aid supporting projects for the common European interest” qualification.

The Unicredito and the Italian government can't refer in an effective way to that the vexed provision happened in the framework of the privatisation, which can realize a project for the common European interest, because a privatisation started by only one member state cannot be a project for the common European interest.

4.7. About the definition of the aids supporting several economic activities:

The c.) point of the Article 87 (3) of the EC Treaty gives scope for the Commission to pronounce compatible an aid supporting several economic activities. In the vexed decision's justification the Commission laid down that none of the attributes of the supporting program can be regarded as compatible with the common market based on the c.) point of the Article 87 (3) of the EC Treaty. As the Court laid down the Commission had described that in connection of the recent point the tax reduction essentially resulted to improve the competitiveness of the favoured ones in such a sector which is a field of a really strong international competition, and because it emphasized that the aid reinforced the position of the favoured ones against their rivals that couldn't have chance for the aid, the Commission tacitly excluded that the aim of the tax reduction would be generally the improvement of the bank activities. Taking into account the legal basis of the examination of the objections, it must be recognized in connection with the attributes of the tax reduction that this analysis of the Commission issued from disciplinary error. Consequently the Court laid down that the objection based on the harm of the c.) point of the Article 87 (3) of the EC Treaty wasn't founded.

We can delineate, that in the above mentioned C-148/04 Unicredito-Case the Court interpreted almost every term of the state aids, it showed that when and how it is possible to qualify a tax allowance (state aids) incompatible with a common internal market. The case interpreted the following definition elements in connection with the incompatible state aids described in the Article 87 (1) of the EC Treaty¹⁸: selectivity, the effect on the trade between member states, the competition's distortion, or the menace of that, together with the aids against the definition of the aid supporting projects for the common European interest defined in the b.) and c.) points of the Article 87 (3) of the EC Treaty¹⁹, as a definition of an exculpation element, as well as, aids supporting several economic activities, as a definition of an exculpation element.

It can be laid down from the analysis and the interpretation that this case is an excellent example for the interpretation problems of the definition elements of the state aids which are incompatible with the common and European internal community market, and its separation from the allowed state aids.

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¹⁸ Presently: Article 107 (1) of the TFEU

¹⁹ The b.) and c.) points of the Article 107 (3) of the TFEU