What is State Aid and why corporations should be worried about it?

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José-Manuel Martin Coronado
jm@emecep-consultoria.com
Head of Tax Research
EMAE Lawyers & Economists
Lima, Perú

Introduction

The State Aid is a public policy that European State Members have in order to control or regulate country policies that artificially stimulate growth in a specific economic sector or group of corporations within a specific country.

Since its creation in 1985, it was a sort of dormant policy. But given the recent events of tax avoidance of multinationals, the European Union (EU) has used this public policy to prevent the abuse of tax laws, given the great loopholes that those pieces of legislation have.

That's why in 2014, the EU issued a draft notice aiming to review the concept of state aid and update its application within the Member States. The impact of that review is being seen nowadays with the current accusations of state aid towards Apple, Amazon or Google, among others.

So, that document is considered to be a "break point" in the history of State Aid, which directly affects corporations because it generates a liability to compensate a country or the EU for the illegal benefits obtained from a unlawful state aid.

What is article 107(1) TFEU about? The article 107(1) TFEU is included in section 2 (Aid granted by states) of Chapter 1 (Rules of Competition) of Title VIII (Common rules of competition, taxation and approximation of laws), which suggests that the main goal is not taxation (because that topic is regulated in chapter 2) but competition between members states.
One aspect of competition is that a State can help the private business of residents and/or nationals of that State to become more competitive in respect of another State, to sell products or services inside the Union (“internal”) or even outside it.

Thus, this type of competitiveness policy should be help by states but with the help of a “central planner” of the union, as it can create distortions in the allocation of resources and trade of goods and services. And that distortion, not the improvement of competitiveness itself, represents a competition policy problem within the Union’s Internal Market.

In specific, the section 2 deals with the already known state aid and it gives the following basic rule:

“Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring 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.”

Therefore, the general rule is that all state aid is forbidden for any member state, unless the Treaty provides and exemption to it or a validation of that practices. Otherwise, it shall be considered unlawful.

On the other hand, article 107(2) present many cases where a State Aid shall be allowed, for example, in special cases such as natural disasters. But also, in other cases where it may be allowed, it’s not clear what will be the criteria to decide the legality of that state aid, for example when there is serious underemployment or the standard of living is abnormally low, among others.

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In addition, article 108 provides the mechanism that the Commission should use in order to address this issue, for example a constant monitoring duty, the proposal of specific and appropriate measures and the procedure to notify the States about a possible distortion cause by a state aid.

It seems clear that the TFEU has given the Commission many duties and activities on this matter, so it’s not surprising that the draft notice subject to analysis represents a very important document to fight against unlawful state aid, especially if it’s related to tax issues.

What was included in the Draft Notice?

The Draft Notice is very wide, because it includes general topics as well as specific issues related to state aid. The general overview contains the “notion of undertaking and economic activity”, the state origin, the concept of “advantage” and the “selectivity” criteria.

Secondly, a special part includes an interesting analysis about “public powers” related to state aid, the “effects on trade and competition”, “regional selectivity”, as well as many tax issues related to fiscal state aid.

As expected this last part is the most relevant for corporate taxation, as it includes the following topics: “Cooperative societies”, “Undertakings for collective investment”, “Tax amnesties”, “Tax settlements and rulings”, “Depreciation and amortization rules”, “Flat-rate tax regime for specific activities”, “Anti-abuse rules” and “Excise duties”.

While, in general, all kinds of tax exemptions are included in this section, a specific analysis of the causes, a taxonomy and the impact of those aids haven’t been shown in this document, so it remains unclear what the treatment should be.
Hopefully, some comments are found in page 15 of the Draft Notice, where the Commission states that Tax Exemptions are also considered a transfer of state resources, and thus included in the state aid regulations.

This can be obvious for some scholars, but not for many entrepreneurs and corporations which consider an exemption a good relief on tax obligations.

**How selective should a tax exemption be?**

Those tax exemptions, given by member states, can also be called “tax expenditures”, which represent the amount of taxes lost by governments, and that may be considered as an opportunity cost for them.

Whatever the name, a tax exemption should be, by economic definition, selective, to reduce the negative distortion created, while helping the specific sector or agents subject to it.

Thus, asking for a tax exemption not to be selective is a very complex issue. So, a greater economic and legal benefit should be achieved in order to admit it as a lawful measure within the Union.

Notwithstanding, a systemic interpretation of the law suggests that this tax exemptions should be clearly general, not only potentially or optional, but enforceable in specific cases.

As consequence, member States hold a dilemma: To create a selective tax exemption to promote growth in a specific sector hoping to fulfill the requirements of article 107(2) but probably be subject to a fine or to not offer that exemption and risk a crisis or a recession.

This is obviously a simplified decision making, but the main idea stands still: how general can really a tax exemption be?
How does Draft Notice address this issue?

The Draft notice presents (in foot note 79, page 15), the case of “Banco de España” where the Spanish government applied some tax exemptions during the process of insolvency. Another interesting case is presented in page 33 (footnote 177) which confronted the state of Italy and the Commission, about a partial tax exemption from the excise duty on diesel used for heating green houses.

In fact, not only the Commission, but the Court of Justice itself argued that selectivity still exists even if the “exemption could benefit all undertakings choosing greenhouse production”, because it considered that such a possibility “was not sufficient to establish a general character of the measure”, thus a selective one. This issue is also treated in page 34 of the Draft Notice with the following statements of the Commission:

“When Member States adopt ad hoc positive measures benefiting one or more well identified undertaking (for instance, granting money or assets to certain undertakings), it is normally easy to conclude that such measures have a selective character, as they reserve favorable treatment for one or a few undertakings.

The situation is usually less clear when Member States adopt broader measures, applicable to all undertakings fulfilling certain criteria, which mitigate the charges that those undertakings would normally have to bear (for instance, tax or social security exemptions for undertakings fulfilling certain criteria).”

Conclusion

Finally, there are many cases and arguments related to this issue, but none of them are clear enough to finally determine how to overcome the so-called selectivity dilemma.
However, many improvements have been implemented, especially on transparency, procedure and evaluation. In fact, the draft notice helped to amend and modernize many of the different provisions of state aid in EU legislation.

This is highly recommended for corporations to read and understand. As times passes, the scandal cases are left behind and regular cases appear, such as Belgian tax measures for maritime transport or UK tax scheme for multinationals.

Notwithstanding, with a sound understanding of the law a specific state aid may be approved, such as the measures in petrochemical sector in Hungary, the Portuguese aid to the sale of Novo Banco or the special deployment of renewable energy in France.