

# **Fiscal State Aid Reloaded: Boxes & Rulings Under Review**

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# Patent Boxes: EU Law Compatibility

- Distinction between “input” (back-end e.g. tax credits) and “output” (front-end e.g. Patent Boxes) incentives
- Distinction is relevant to examine compatibility with EU rules
  - Input incentives are limited by budget (tax expenditures)
  - Output incentives are unlimited (because harmful)
- For purposes of possible restriction of freedoms
  - Input incentives are territorial (restrictive?)
  - Output incentives are 'open to all economic agents', but nexus creates restriction
- For SA purposes
  - Input incentives are transparent, targeted and measurable
  - Output incentives are operating aid = unlimited & opaque

# A Nexus Approach for Boxes

- Discussion within the Code of Conduct Group to define Nexus (a genuine link) in Host State – 3 issues:
  1. Definition of qualifying IP rights – trademarks?
  2. Pre-existing IP – can IP be purchased?
  3. Link with R&D activity – can R&D be outsourced?
- Is nexus a restriction? Territoriality of tax incentive
  - Laboratories Fournier Judgment, Case C-39/04, effectiveness of fiscal supervision does not justify a territorial restriction
- Is nexus SA? Correspondence SA/restriction The Iannelli & Volpi judgment, Case 74/76: Distinct fields of application = procedures stay separate
  - AG Kokott Opinion in Case C-66/14 Linz, point 91: Stricter selectivity (Case C-169/09, Regione Sardegna)

# State Aid Review of Boxes: The applicable rules

1. 2014 State Aid Guidelines for Research Development and Innovation (GU C 198/2014), Balancing assessment - Point 4.5.3.1. (Fiscal measures): If not transparent cannot be approved
2. 1998 Fiscal Aid Notice – Distinction between genuine (general) tax measures and selective aids
  - Points 13-15: State aid v general measures distinction
  - Points 21-22: Tax assessment and discretion
  - Points 23-26: Justification by nature of tax system
3. Com/2006/0728 Final on the use of tax incentives to favor R&D. Section 1.2: Incentives open to all operators are in principle general measures

# Aid N 480/2007 ES R&D Box

- Tax reduction for income derived from intangibles: Notified for reasons of legal certainty
- No aid because not selective (“open to all economic operators”) - However this is ‘bad law’ since it does not reflect the ECJ case law:
  1. Aid is broader than subsidy: It includes unjustified tax reliefs (Case 173/73, Italy v Commission)
  2. A tax benefit is selective not only when discretionary, but also when granted on objective grounds ‘open to all operators’ if not justified by tax system (e.g. export deductions in Case C-501/00, Spain v Com)
  3. Only considerations ‘intrinsic’ in tax system can justify selectivity (Cases C-78/08 a C-80/08, Paint Graphos)

# Patent Boxes: Justification

- The nature and organization of the tax system may constitute a proper justification, if:
  1. Similarly to tax amortization and depreciation rules (which are not selective even if these favor certain undertakings more than others), tax reductions or lower rates on revenues deriving from exploitation of qualifying intangibles can also be not selective
  2. It is in the logic of a profit tax system to tax comparably less heavily certain activities, defined by reference to investments made, which are more profitable
  3. Qualifying intangibles are those having potential to maximize profits and accordingly maximize company tax over the years

# Rulings – FA applied to BEPS?

The discussion

- Rossi-Maccanico, *Fiscal Aid, Tax Competition and BEPS*, Tax Notes International, September 8, 2014, p. 857.
  - Postulates application of SA to BEPS
- Raymond Luija, *EU State Aid Rules and Their Limits*, Tax Notes International, October 28, 2014, p. 453.
  - Objects that there is lack of selectivity in cross border mismatches

# SA and BEPS: Illustration

- State aid assessment of tax measures transactions favouring profit shifting? (e.g.: Tax rulings to influence allocation of tax base to no-tax jurisdictions)
- From the *Gibraltar* case-law (C-106/09P and C-107/09P, Points 106 and 107), it follows that :
  - Designing **mismatches** may equate granting State aid
    - Mismatches may not be the random consequence of tax system, but breach of inherent tax principles
  - Three principles
    - **Non Discrimination (obligation not to permit avoidance or abuse of *facultas agendi*)**
    - **No Double Tax** (Source/Residence distinction)
    - **Benefit Principle** (Active/Passive distinction)



# Double non-taxation

- Belgium's scheme for Belgian establishments of US Foreign Sales Corporations – Decision of 24.6.2003: Scheme for Tax Rulings
  - derogating from normal assessment
  - favoring certain undertakings (only MNEs)
  - deprived of any justification because specifically designed to provide double non-taxation
- Incompatible State aid is probable outcome of assessment for scheme

# APAs

- Once obtained (to provide certainty for transfer pricing purposes) can allow double non-taxation
- Possible SA Analysis
  - Discretionary rulings give rise to **presumption** of Aid if
    - Not transparent/ not public
    - Rulings are not available to all undertakings in comparable situations
    - Procedural rules are derogated
    - Not all elements are considered
    - In contradiction with applicable provisions or standards
- Conclusion: Probable aid if derogate from method

# Recent Proceedings

- Procedural issues
  - Circumvention of selectivity requirement?
  - Narrow scope of SA reviews?
  - Incorrect reference to private investor test
- Misconception of TP system as substantive instead of administrative rule
  - Undue reliance on OECD standards
  - Regulatory role of Commission?
- Procedural issues
  - Retrospective effect
  - Mass notification of APA applications?

# Procedure: A Way Forward

- The retrospective effects of Art. 108(2) Decisions (New Aids)
  - Repeal of ruling
  - Recovery of unlawful aid granted
  - Except if legitimate expectation rise
- Art. 107 + 108 TFEU: Limited direct applicability
- Possible solutions:
  - Hard Law v Guidelines
  - Art. 106(1) TFEU: Public undertakings and undertakings with special rights
  - Art. 106(3) TFEU
    - Decisions to sanction competition infringements
    - Directives to provide rules (forward looking)  
Define conditions to prevent granting State aid