Taxpayers will benefit from an early awareness of risks, and tax advisers should also be careful to advise fully on state aid risks when looking at tax issues.

**Fiscal state aid demystified**

EU law on state aid applies to tax, as it does to other areas of commercial life. Recent developments suggest an increased interest in fiscal state aid on the part of the European Commission. Money which is considered to be state aid must be recovered by the government from taxpayers; only a small number of defences to recovery are available to taxpayers. There is a period of ten years for the recovery of amounts considered to be fiscal state aid; this includes interest, which may be compound. Taxpayers will benefit from an early awareness of risks, and tax advisers should also be careful to advise fully on state aid risks when looking at tax issues.

Fiscal state aid is clearly of increasing interest to the European Commission. Just last week, we saw the release of the Commission’s letters to Ireland and Luxembourg as to Apple’s and Fiat’s respective transfer pricing arrangements possibly being in breach of fiscal state aid rules. We have also heard that the Commission’s previous investigation into Gibraltar’s tax rulings has been extended. At the time of writing, reports indicate that Amazon’s transfer pricing ruling in Luxembourg may also be under imminent investigation. The consequences of being held to have received state aid are severe – with more stringent remedies than are applied in domestic cases – and there are few defences. The remedies are required as a matter of EU law. The UK government is required to implement those remedies, regardless of whether it wishes to do so, and it can be subject to consequences itself if it does not. English courts are expressly not entitled to give judgment on the substance of a state aid matter, and may only quantify the amount recoverable. Therefore, the question of whether a recipient is liable to repay fiscal state aid rests in the hands of the EU institutions. This article outlines the state aid rules and key concerns for taxpayers.

**State aid**

The Treaty on the Functioning of the European Union (TFEU) provides that ‘any aid granted by a member state or through state resources in any form … 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).

These four criteria – an advantage; selectivity in granting the advantage; an effect on cross-border trade; and the use of state resources – are the elements of state aid, all four of which need to be present for a measure to be classified as state aid. To counter the breadth of this definition, the TFEU carves out certain areas as aid which is compatible with the internal market. These include aid with a social character, provided there is no discrimination in the execution of the aid, and making good damage from natural disasters. Some additional areas ‘may’ be compatible with the internal market, and these focus on low standards of living, serious underemployment or serious economic disturbance.

**How does this apply to taxpayers?**

Looking again at the four factors for state aid in the context of taxation, one can see that it is surprisingly easy for a tax measure to fall within the criteria. Clearly, as a result of tax being administered by the revenue authorities, any advantage obtained through the operation of the tax system could be considered a use of state resources. The very broad wording ‘any aid’ from state resources means that many aspects of tax regimes may fall within this part of the definition; for example, a relief could amount to an advantage, as could a deduction. Likewise, applying a lower rate of tax could, in some circumstances, amount to an advantage given by the state, if it was selective. Other aspects of the tax system could also be provided in a way that is advantageous, such as lower administrative burdens or lesser reporting requirements. Similarly, the terms of rulings or settlements could be considered an advantage, depending on the particular circumstances. The use of HMRC’s discretion is a particularly ripe area for state aid challenge since the use of such discretion could allow for more generous treatment for some than the law requires.

The other two criteria narrow the definition considerably, however. There must be selectivity in the measure and, although there need only be a threat to distort competition, there must be an effect on cross-border trade within the internal market. The question of effect on cross-border trade is an evidential one. The question of selectivity in the context of a tax system is rather more interesting. The items identified above as features of a tax system which could be advantageous would need to be granted in a selective way in order for them to constitute state aid. A measure which applies generally (such as a tax rate) will not be state aid. However, if a benefit were to be given, for example, to a particular sector of industry (sectoral aid) or to a particular region of the country (regional aid), then this might well be sufficiently selective that the advantage is state aid.

Tax measures have certainly been found to breach state aid rules. In respect of sectoral aid, for example, *Adria-Wien Pipeline* (C-143/99) dealt with energy tax law in Austria, whereby tax was due (and passed on to the consumer) in respect of certain supplies and consumption of electricity and gas. The law granted a rebate, formally where the taxes exceed 0.35% of net production value but, de facto, this applied primarily where undertakings produced goods. This was held to be fiscal state aid.
Consequences of being in breach
The Commission has extensive powers to investigate, obtain information and come to a conclusion as to whether a member state is in breach of state aid rules. In fact, almost all powers in relation to state aid sit with EU institutions.

The key concern for taxpayers is that being in breach of state aid rules results in the recipients of aid being required to repay any amounts which were obtained as a result of the advantage granted. The obligation on the member state is to take 'all measures necessary to recover the aid.' It does not matter if such a measure results in the recipient of the aid going out of business. In fact, since the purpose of state aid recovery is to level the market, this can be an outcome required by the rules. Recovery must be effected without delay. If a member state's provisions do not allow for the 'immediate and effective execution of the Commission's decision', then member states are required to put in place legislation – provisional or otherwise – to effect recovery.

The period for which aid is recoverable goes back ten years. In addition, the aid must be recovered, including interest, from the date of the receipt of the benefit until the recovery at a rate fixed by the European Commission. Compound interest is certainly not precluded by the regulations. In cases where the benefit to a business has been substantial, the figure recoverable can be very large indeed.

Defences to state aid recovery
There are some defences to state aid recovery and there are some mitigating steps which could be taken.

There is a de minimis threshold of recovery, which spans three years. Smaller businesses may fall within the threshold. Other defences to state aid are that recovery is 'absolutely impossible' or that recovery would be contrary to a general principle of Community law. The principle most invoked is that a member state has a legitimate expectation that a measure is not state aid, although there is nothing to say that other principles may not be successfully invoked.

Absolute impossibility is a high test. Procedural difficulties are not generally accepted and financial difficulties for the aid recipients are also largely irrelevant. Evidently, if the entity which received the aid is no longer in the member state, that will make its recovery irrelevant. Evidently, if the entity which received the aid is no longer in the member state, that will make its recovery irrelevant. Evidently, if the entity which received the aid is no longer in the member state, that will make its recovery irrelevant. Evidently, if the entity which received the aid is no longer in the member state, that will make its recovery irrelevant.

Outside of these investigations, those who have had decisions or have agreed a position with HMRC – in which HMRC has used its discretion in such a way that it amounts to anything less than the payment of the full amount required by law – may well be vulnerable to a state aid challenge. In particular, settlement agreements and rulings are likely to be vulnerable, and these should be reviewed carefully at this stage in order to assess exposure to challenge.

Where does this leave us?
There is undoubtedly the potential for state aid to affect other areas of tax law. As we have seen, a relief or other tax advantage need only be selective in nature and affect cross-border trade to be vulnerable to potential challenge. Given that competitors may complain to the European Commission about favourable treatment, and that the Commission must act on such complaints, the possibility of state aid action is very real where a company has received such treatment and a competitor seeks to make such a complaint. Some companies have managed to use this as an effective tool to deal with market imbalances.

Given the long reach of state aid recovery and the fact specific nature of defences, it is very important to take advice as early as possible and for advisers to make their clients aware of possible state aid risks.