Tax benefits and EU state aid control:

The problem of and approaches to resolving the conflict of jurisdiction with fiscal autonomy
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Report of the Advisory Board to the Federal Ministry of Finance

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EU state aid control has increasingly targeted fiscal measures in recent years. The stricter control is aimed at both tax legislation and in the meantime also case-by-case measures – mostly rulings and advance pricing agreements (APAs). State aid control long moved beyond conventional tax benefits – such as special depreciation allowances for specific sectors like ship or aircraft building – to take in all fiscal measures that reduce the tax burden.

This widening of state aid control creates great legal uncertainty both for national fiscal legislators and for affected undertakings. A central problem of state aid control is that there is no way of predicting whether fiscal measures will be deemed state aid, combined with the fact that beneficiary undertakings bear all the risk. Regardless whether a measure visibly amounted to state aid from the outset, the aid has to be paid back retrospectively for a period of 10 years, plus interest. No provision is made for the protection of legitimate expectations.

The EU is working to clarify the situation. This was the aim of the Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, published on 19 July 2016. Yet far from defining criteria to create legal certainty, the Notice merely confirms the trend towards widening fiscal state aid control.

The uncertainty about whether rules will be considered state aid and the broader definition of state aid severely undermine the fiscal autonomy of EU Member States. If every measure that reduces the tax burden can ultimately be seen as prohibited state aid, a fundamental conflict of jurisdiction arises between the continued autonomy of Member States in the area of direct taxation and the prohibition of state aid. To resolve this conflict, and also to create legal certainty, state aid control needs to be more clearly aligned with the reason for prohibiting state aid, which is to avoid distortions in cross-border trade. It can be restricted both at the level of criteria for the definition of fiscal state aid and regarding the legal consequences of prohibited state aid.

The Advisory Board is against general control of subsidies by the European Commission. The prohibition of state aid comes within the context of the prohibition of customs duties. It must be restricted to distortions in cross-border trade. State aid must be differentiated according to whether its effects are only local or concern cross-border trade. Restricting the analysis to cross-border trade is also in line with the subsidiarity principle.
The remaining legal uncertainty around the classification of fiscal measures must not solely come at the expense of Member States and taxpayers. Until now, wherever selectivity is established – meaning any deviation from the normal regime – it has always been presumed that there must also be a distortion of competition and an impact on cross-border trade. This presumptive effect should be restricted in the future to cases where rules deliberately benefit undertakings in a specific sector (as with special rules for mercantile shipping or aircraft building). In all other cases, the burden of proof for any (potential) distortion of trade must lie with the Commission. A further possibility for involving the Member States consists of unanimously adopting directives for areas that are frequently subject to fiscal incentive policies. Finally, from the perspective of the affected undertakings, provision should be made for the protection of legitimate expectations by not requiring the recovery of past tax benefits provided for in general tax legislation.
I. Introduction: Recent developments

EU state aid control has increasingly targeted fiscal arrangements in recent years. The stricter control is aimed at both tax legislation and in the meantime also case-by-case measures – mostly rulings and advance pricing agreements (APAs). In December 2014, the European Commission launched an enquiry covering all 28 EU Member States with a view to systematically identifying arrangements relevant to state aid. The sums that can be involved when fiscal measures are held to be state aid are shown by the European Commission decision announced in August 2016 ordering Ireland to recover €13 billion in tax benefits that Apple is said to have profited from in the years 2003 to 2014.

General provisions of German tax law, such as a tax exemption of restructuring gains to avert insolvency or tax relief on real property transfer tax for intra-group restructurings, likewise come under suspicion of being prohibited state aid and thus have to be notified to the European Commission and/or brought before the European Court of Justice (ECJ) for review.

In 2012, a process was launched for the reform of EU state aid control.\(^1\) Its aim is to increase the administrative efficiency and predictability of state aid control. A Commission notice published as part of the process on 19 July 2016 on the notion of state aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (TFEU)\(^2\) also contains clarifications on fiscal state aid. Despite this initiative, it is still not clearly defined which tax measures count as tax benefits.

As the practice of state aid control makes no provision for the protection of legitimate expectations and always leads to recovery of benefits retrospectively held to be state aid, undertakings face great legal uncertainty that, worst of all, they have no means of resolving. They can neither procure clarification directly from the Commission nor, for example, cover themselves by obtaining binding reassurance from the revenue

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administration. The risk of the European Commission classifying national measures as prohibited state aid also curbs the fiscal autonomy of EU Member States. Combined with the notification requirement for legislative initiatives under EU state aid law, this uncertainty is also carried over into the legislative process, thus severely encroaching on EU Member States’ fiscal autonomy.

The Advisory Board considers the problems surrounding the practice of state aid control to be the outcome of a fundamental conflict of jurisdiction between fiscal autonomy and the mutual understanding among Member States to do without unilateral measures that distort trade. The Board therefore makes specific recommendations in order to restrict state aid control in the area of fiscal measures.
II. The practice of European state aid control with regard to tax benefits

Article 107(1) TFEU contains a prohibition of state aid directed at the EU Member States:

“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 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.”

The prohibition of state aid is not absolute. Instead, state aid by Member States is subject to authorisation by the European Commission. Article 107(2) and (3) TFEU set forth criteria for authorisation. Paragraph (2) lists cases that are normally to be authorised (aid having a social character, aid in the event of natural disasters or exceptional occurrences, and aid to overcome the economic consequences of the division of Germany).

Under paragraph (3), the Commission has discretionary power to authorise aid to promote regional or structural/sectoral development, projects of common European interest, and/or culture. A requirement is that Member States must always notify the European Commission of new state aid before its first-time application. Failure to notify results in state aid being prohibited under EU law and triggers a recovery requirement, even if the aid is capable of being authorised.

According to the ECJ, the definition of state aid is broader than a subsidy. It also includes measures that “mitigate the charges which are normally included in the budget of an undertaking and which thus, without being subsidies in the strict sense of the word, are similar in character and have the same effect”. The prohibition of state aid therefore applies not only to direct subsidies, but also to fiscal measures (“aid ... in any form”).

3 ECJ 8 September 2011, Joined Cases C 78/08 to C 80/08 – Point Graphos, ECLI:EU:C:2011:550, para 45; likewise far earlier ECJ 23 February 1961, Case 30/59 – Steenkolenmijnen, ECLI:EU:C:1961:2; thereafter settled case law, see e.g. ECJ 15 March 1994, Case C-387/92 – Banco Exterior de España, ECLI:EU:C:1994:100, paras 13 f.
2.1 Tax benefits as state aid

Identifying state aid in the form of tax benefits causes considerable difficulty simply because – unlike direct aid by way of financial assistance – rather than the granting of an advantage in the shape of a state benefit, it consists of a dispensation from the disadvantage of taxation. The market economy operator test or private investor test applied to direct subsidies – where there is no subsidy if the state acts as would a private investor – does not normally work here.4

The delimitation problems are plain to see in recent decisions on state aid (see boxes, p. 13 f.). Cases of what is called de facto selectivity are particularly difficult – measures that apply to all but whose effects only benefit certain groups of undertakings. For example, the new corporate tax regime for Gibraltar that was the subject of the ECJ’s Gibraltar decision5 was formulated to apply for all companies, but as the tax base partly depended on the size of business premises and the workforce, foreign holding companies hardly paid any tax. In addition, the European Commission and the ECJ show a recent tendency towards massively extending state aid control. Article 107 TFEU is no longer used solely against distortions of competition, but also as a means to fight suspected wastage of taxpayers’ money. Another increasing focus is on general differences in the treatment of economic operators.6

The lack of stringency in ECJ decisional practice and the tendency to continuously widen the scope of control mean that there is no visible pattern to the European Commission’s initiation of state aid proceedings. In the wake of the so-called LuxLeaks affair, a systematic enquiry – the first of its kind – has now been launched into arrangements between undertakings and the revenue authorities of relevance to state aid. Tax law measures, by contrast, seem to be targeted at random; this is presumably due to limited resources, as the European Commission cannot fully monitor the tax systems of all 28 EU Member States at all times.

In the following, a distinction is made between tax benefits at the level of tax enforcement and tax benefits at the level of tax law.

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4 See Schön (2015), Tax Legislation and the Notion of Fiscal Aid, p. 3; meaningfully applicable at best to fiscal measures relating to public enterprises or private-sector enterprises with state owners.
Tax benefits at the level of tax enforcement

It is relatively undisputed that waiving enforcement of a legally assessed tax debt is state aid. General measures where the authorities can exercise discretionary powers on a case-by-case basis when levying tax also count as state aid according to European judicial practice. Less clear is the treatment of advantages in connection with tax assessment, whether due to the lawful exercise of official discretionary powers to interpret taxable events in the taxpayer’s favour, or whether due to (intended or unintended) unlawful assessment in the taxpayer’s favour. As a rule, whether there is an intention to grant an advantage is immaterial to the classification as state aid; what matters in practice is solely the potential effect. This creates a risk that virtually any ruling that gives an advantage can potentially become prohibited state aid under EU law. There is thus no provision whatsoever for protecting the legitimate expectations of undertakings.

State aid control of measures at the level of tax enforcement is of increasing importance in the context of the base erosion and profit shifting (BEPS) process, in which the European Commission checks transfer prices agreed with international corporations for conformity with OECD standards, because in some points the EU applies criteria of its own that differ from OECD transfer pricing principles.

Fundamentally, however, the EU’s objective – as with the OECD with the BEPS project – is to ensure, by means of state aid law, that tax is charged where value creation takes place.

Tax benefits at the level of tax law

For tax law measures to be classified as state aid, it is first necessary to identify an advantage and then to determine that the advantage is granted selectively. The question of state aid can also arise in the context of a selective special charge that is not imposed on other undertakings. For example, Hungary introduced a progressive tax for undertakings with advertising revenue. The measure was intended to affect large (mostly foreign) media undertakings. Instead of targeting the measure as indirect discrimination against foreign undertakings, the Commission applied state aid law in light of the fact that companies with lower advertising revenue were not affected and thus had a competitive advantage.

In the opinion of the ECJ, the identification of an advantage for the purposes of state aid law depends on the “normal taxation regime” applicable to comparable undertakings. Any derogation from that regime is a “selective measure” and is classified as state aid.

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8 Risse, Global Taxes, TLE-08-2017 in relation to the cases of Amazon, Starbucks and Fiat.
9 On the distinction between the two tests, which are sometimes conflated in European judicial practice, see most recently Schön (2015), Tax Legislation and the Notion of Fiscal Aid, p. 3 ff.
10 European Commission, State aid: Commission finds Hungarian advertisement tax in breach of EU rules (available at: http://europa.eu/rapid/press-release_IP-16-3606_en.htm). The same question was the subject of the ECJ case against the German nuclear fuel duty in Kernkraftwerke Lippe-Ems, where the ECJ held that the non-taxation of undertakings using other fuels was not an exception and thus not state aid because such other undertakings were not comparable with nuclear power undertakings with a view to the specific objectives of the nuclear fuel duty and how it was implemented; see ECJ 4 June 2015, Case C-5/14 – Kernkraftwerke Lippe-Ems, ECLI:EU:C:2015:354, paras. 78 ff.
11 ECJ 8 December 2011, Case C-81/10 P – France Télécom, ECLI:EU:C:2011:811, paras 16–18.
The test is generally applied in three stages:

1. Identification of the reference system (normal taxation regime)
2. Departure from the reference system
3. No justification as a generally applicable element of the reference system.

The central problem in identifying an advantage lies in determining the normal or baseline tax burden. This cannot be done objectively and, with a view to continued national sovereignty, depends on the legislative stipulations of each Member State and the underlying tax regime. For example, a Member State’s decision to forgo corporate tax or to charge 0% as the standard rate would not constitute state aid, even though it would be exceptional by EU standards.

Yet deciding what is normal and what is an exception is not left to the free choice of national legislators either. While the objectives pursued by measures have no bearing, the yardstick that applies to the national legislature is its own taxation decisions, such as the choice of a synthetic income tax system. However, the less systematic the national tax system, the harder the delineation problem.

The ECJ pays little heed to the argument that reducing the tax burden helps make the tax system more efficient. In principle, tax benefits still come under Article 107 TFEU even if they are meant to make up for a burden elsewhere. For example, a VAT exemption for self-employed doctors could not be justified by arguing that it merely offset the disadvantage relative to employed doctors who are not subject to VAT because they are not business owners.

What should matter with regard to selectivity is, firstly, not the legislative choice of method but solely the economic effect. This is why rules are also captured that are formulated to be generally applicable but in actual fact cannot be made use of by all undertakings. Secondly, it should not be decisive whether a group of undertakings that benefit can be identified or whether undertakings that do not benefit are in direct competition with ones that do. Thirdly, it should also not be a question of whether an advantage can theoretically be used by all undertakings in a similar situation – which is essentially true of almost all abstractly formulated benefits under tax law – but solely whether the rule can be used by all economically active undertakings. In the World Duty Free Group case, the ECJ Grand Chamber held it not to be decisive for a measure to be fundamentally open to all undertakings. No weight is given to the criterion of “favouring certain undertakings or the production of certain goods” if there is unequal treat-

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12 A.A. Ismer/Piotrowski, Intertax 2015, 559 (569 ff.), arguing that generally applicable rules should be measured against international standards to be determined by the European Commission. State aid control then effectively results in harmonisation.


14 See Luja (2014), Defining the Scope of State Aid, section 6.

15 ECJ 3 March 2005, Case C-172/03 – Heiser, ECLI:EU:C:2005:130, paras 52–54; similarly ECJ 29 April 2004, Case C 372/97 – Italy v Commission, ECLI:EU:2004:234, para 67. More narrowly, see opinion of Advocate General Kokott delivered on 16 April 2015, Case C-66/14 – Finanzamt Linz, ECLI:EU:C:2015:242, para 83: “Thus, it is only where a Member State also uses its existing tax system as a means of distributing cash benefits for purposes other than those of that tax system that there are sufficient grounds for treating such tax advantages as subsidies in the narrow sense.” See also the non-tax judgment ECJ 14 January 2015, Case C-518/13 – Eventech, ECLI:EU:C:2015:59, paras 58 ff., in which far stricter requirements for London black cabs than for minicabs were cited in negation of comparability between the two, with the outcome that the rule allowing only black cabs to use bus lanes was not deemed to be selective.

16 ECJ 21 December 2016, Joined Cases C-20/15 P and C-21/15 P – World Duty Free Group, ECLI:EU:C:2016:981, paras 70 and 82.
ment of undertakings in a similar factual and legal situation. A measure that differentiates between undertakings performing “similar operations” is thus found to suffice for the criterion of selectivity. On the other hand, not every tax base benefit (such as accelerated tax depreciation or the investment allowance for SMEs under section 7g of Germany’s Income Tax Act (Einkommensteuergesetz) is considered to be selective. This is to avoid excessively constraining national legislators. However, it remains unclear where the line is to be drawn.

The problems are not resolved, however, by redefining the criterion of a tax benefit for certain groups of companies as a general discrimination test. Granted, there is then no longer the need to first identify the normal regime, but only to establish unequal treatment. Nonetheless, the rule in Article 108(3) TFEU that an incompatible measure may not be put into effect makes it necessary to decide what level of tax burden is right within the meaning of the normal taxation regime. The restructuring provision in section 8c subsection 1a of Germany’s Corporation Tax Act (Körperschaftsteuergesetz), for example, treats undertakings differentially with regard to loss carry-forwards and so discriminates against undertakings not under threat of insolvency. Yet it is unclear whether – and in what circumstances – the right rule is for loss carry-forwards to be forfeited on change of ownership or to be retained regardless of any change of ownership.

Another reason why the criterion of selectivity is pivotal is because the remaining requirements in Article 107 TFEU virtually never lead to state aid being turned down. According to settled case law, there is no need to prove that the state aid in question actually distorts competition or has a real effect on trade between Member States. This is noteworthy because Article 107 TFEU addresses not state aid as such, but only state aid that affects cross-border trade. Conversely, in case law, it is only examined whether state aid, with regard to its basic approach, is liable to distort competition and affect trade between Member States.

It is not even necessary for the beneficiary undertakings themselves to be involved in trade between Member States, it being sufficient that they might be so involved in future or that their foreign competitors might try to expand into the domestic market.

Secondary objectives pursued with tax benefits, such as environment protection and protection from disadvantages in international competition, are also immaterial. Whether from an economic viewpoint there is a need for support to remedy market failure is also irrelevant to the classification of a measure as state aid by the European Commission and to the notification requirement, because the purpose of the support does not eliminate the tax benefit. Considerations of this kind can only be taken into account in connection with the criteria in Article 107(2) and (3) TFEU.

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19 See opinion of Advocate General Kokott delivered on 16 April 2015, Case C-66/14 – Finanzamt Linz, ECLI:EU:C:2015:242, para 114.
There are general exceptions from the notification requirement:

> Under the EU “de minimis” Regulation\(^{20}\) for state aid up to €200,000. This exception is not relevant to tax law measures, however, because what matters is the total effect, and this will always exceed the de minimis threshold because tax benefits are formulated in abstract general form and so are not granted in a predefined quantity of individual cases.

> Under the General Block Exemption Regulation,\(^{21}\) subject to certain requirements, small and medium-sized enterprise (SME) aid, research and development aid, environment aid, social aid (for employment and training), and regional aid.


Box 1: Examples from European practice denying selectivity

> Special rules on goodwill amortisation for certain shareholdings

a) For shareholdings in domestic undertakings (ECJ 6 October 2015, Case C-66/14, Finanzamt Linz; detailed in the opinion of Advocate General Kokott delivered on 16 April 2015, paras 74 ff.)

b) Conversely, selectivity was affirmed for special rules on goodwill amortisation of foreign shareholdings of at least 5% in ECJ 21 December 2016, Joint Cases C-20/15 P and C-21/15 P, Commission v World Duty Free Group (see also Box 2).

> Reduced taxation on IP income

The classification of patent boxes as state aid within the meaning of Article 107 TFEU has not yet been judicially decided but is rejected by the European Commission as any undertaking can generate qualifying income (see European Commission, IP/08/216).

> Nuclear fuel duty

No selective advantage found for energy utilities which were not taxed as they were not in a similar factual and legal situation because they do not incur any of the costs specific to nuclear energy (ECJ 4 April 2015, Case C-5/14, Kernkraftwerke Lippe-Ems).

> Rule allowing London black cabs but not minicabs to use bus lanes (ECJ 14 January 2015, Case C 518/13, Eventech)

Not selective, as black cabs and minicabs, due to various special requirements applying to black cabs, were found to be legally and factually in such a different situation that they were not comparable and the bus lane rule therefore did not constitute a selective economic advantage.
Box 2: Examples from European practice affirming selectivity

> Tax benefits on foreign shareholdings

Special rules on goodwill amortisation of foreign shareholdings of at least 5%; it was immaterial that essentially any undertaking can hold such shareholdings (ECJ 21 December 2016, Joint Cases C-20/15 P and C-21/15 P, Commission v World Duty Free Group).

> Tax benefits for manufacturing industry

Energy tax rebates for natural gas and electricity solely for undertakings whose activity consists primarily in the production of goods; the size of the group of beneficiary undertakings does not eliminate the selectivity (ECJ 8 November 2001, Case C-143/99, Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke, para 48).

> Tax concession for investment in a specific region

Concerned a tax concession under section 6b of Germany’s Income Tax Act for reinvestment in shareholdings in undertakings located in eastern Germany. Argument: The tax concession for reinvestment in certain shareholdings was not selective because it was open to all undertakings. However, selectivity was affirmed because it indirectly favoured eastern German undertakings in which the beneficiary investor held a shareholding (ECJ 19 September 2000, Case C-156/98, Germany v Commission).

> Rules predominantly advantageous to foreign (holding) companies

Gibraltar corporate taxation reform: Corporate tax on profits was to be replaced with three taxes: Payroll tax, business property occupation tax (BPOT) and a registration fee, with the liability for payroll tax and BPOT capped at 15% of profits. Due to their small space needs and small workforce, (foreign) holding companies benefited particularly from the planned regime (as was also intended), which is why the ECJ affirmed selectivity despite the general scope of the measure (ECJ 15 November 2011, Case C-106/09 P, Gibraltar).

> Special rule on loss carry-forwards for insolvent or over-indebted undertakings

Concerns the restructuring provision in section 8c subsection 1a of Germany’s Corporation Tax Act. That the possibility of retaining loss carry-forwards was open to all undertakings in a restructuring situation was irrelevant because what mattered was solely the actual utilisation by insolvent undertakings as a group and not the possibility of utilisation by all undertakings in the event of insolvency. Insolvent undertakings that avail themselves of the restructuring provision were held to be comparable with other companies that had loss carry-forwards and were subject to a change of ownership but only the former benefited from the provision (EGC 4 April 2016, Case T-620/11, GFKL v Commission).

> Reduction of social insurance contributions for female employees only

A reduction effectively favouring sectors that employed a largely female workforce (ECJ 14 July 1983, Case C-203/82, Commission v Italy).
2.2 Consequences of classification as state aid to Member States and taxpayers

The European Commission and the ECJ tend to apply a very broad definition of state aid. The resulting legal uncertainty as to the classification of national measures creates problems not only for undertakings, but also for Member States.

In the process of creating legislation, any special tax rules must be checked to see if there is a notification requirement. Current examples of rules discussed in litigation or the literature or where approval proceedings have been sought include:

- Federal Ministry of Finance restructuring decree (Sanierungserlass) and tax exemption for restructuring gains (section 3a of the Income Tax Act and section 7b of the Trade Tax Act (Gewerbesteuergesetz)\(^{22}\)

- Tax incentives for electric cars\(^{23}\)

- Special depreciation allowance for new housing\(^{24}\)

- Special rules on real property transfer tax in the event of restructuring within a corporate group\(^{25}\)

- Inheritance tax exemptions for business assets.\(^{26}\)

Even where there is no explicit classification as state aid, European state aid law significantly constrains legislative freedom in instances where the burden of fiscal measures is to be partially eased because they cause unwarranted hardship in specific circumstances.\(^{27}\)

For the revenue administration, the question presents itself of whether and when actual rulings and APAs fall within the scope of the prohibition of state aid. Individual concessions,\(^{28}\) where the authorities have discretionary power in the taxpayer’s favour, can also meet the criteria under Article 107 TFEU.\(^{29}\)

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\(^{22}\) See BFH, 25 March 2016 – X R 23/13, BStBl. II 2016, 696 (702) and, e.g., de Weerth, DStR 2014, 2485. On the problems associated with the legal uncertainty in European law after the Grand Senate of the Federal Fiscal Court (BFH, 28 November 2016 – GrS 1/15, BStBl. II 2017, 393) held the restructuring decree to be incompatible with the rule of law; see Hey, FR 2017, 453. Notification proceedings have thus rightly been set in motion for the new rules superseding the restructuring decree (on the success prospects of the notification proceedings see Kofsmal/Licht, DB 2017, 1797), although this will not affect past cases.

\(^{23}\) European Commission, notification number 2016/275/D concerning a Draft Act on fiscal support for electromobility in road transport.

\(^{24}\) Bundestags-Drucksache 18/7736, 11.

\(^{25}\) Reference to the ECJ for a preliminary ruling from the Federal Fiscal Court (BFH), 30 May 2017 – II R 62/14, BFHE 257, 381; Schmid, DStR 2016, 125 (127).

\(^{26}\) Wachter, DB 2016, 1273; Bäuml/Vogel, BB 2015, 736.

\(^{27}\) Thus, for example, there remains an unmet need for legislative clarification concerning a rule on rental and lease payments being added back to profit in the assessment of trade tax (section 8 number 1 letter e of the Trade Tax Act) for travel agents, even though application of the rule to the services of travel agents is considered inappropriate, because a sectoral rule would be very likely be classified as prohibited state aid.

\(^{28}\) For example under the Federal Ministry of Finance restructuring decree (BMF communication dated 27 March 2003 – IV A 6-S 2140-8/03, BStBl. I 2003, 240; on the classification as state aid see de Weerth, DStR 2014, 2485).

\(^{29}\) Para 171 of the 2014 draft communication (see Footnote 3) and, somewhat more narrowly, para 180 of the 2016 communication (see Footnote 2).
Finally, the judiciary, too, is required to observe EU state aid law because notified state aid has to be referred in case of doubt to the ECJ.\textsuperscript{30} It lies with the ECJ alone to decide, in the interest of uniform development of European law, on the classification of a measure as state aid within the meaning of Article 107 TFEU.\textsuperscript{32}

The financial risk is carried not by the state, however, but by the taxpayer, as state aid prohibited under EU law must be paid back retrospectively for ten years. Attempts to invoke the protection of legitimate expectations have so far had no success. The Commission could indeed, in principle, refrain from requiring state aid to be recovered if this contradicted a general principle of Union law. The protection of legitimate expectations is such a principle. It is settled case law, however, that the conduct of a national authority responsible for applying EU law where the authority acts in breach of that law cannot give rise to a legitimate expectation, on the part of a trader, of favourable treatment contrary to EU law.\textsuperscript{31} Similarly, in the opinion of the ECJ, difficulties regarding classification as state aid do nothing to alter the obligation for recipients to satisfy themselves that the state aid procedure (Article 108(3) TFEU) has been observed. Irrespective of this, it is not possible to invoke good faith because, as a rule, responsibility for the nonconformity with Union law lies not with the taxpayer but with the legislature or administration. Effectively, this creates strict liability for taxpayers in respect of wrongdoing by the legislature or the administration – an effect that squares very poorly with the rule of law but nonetheless remains prevailing state aid practice. To ensure that the recovery obligation is put into effect, Member States are threatened with substantial penalty payments to the EU if they fail to recover contested state aid after it is found to violate Article 107 TFEU.\textsuperscript{32}

2.3 Interim conclusion: Lack of clear delineation capable of providing legal certainty

Juridically, state aid control raises a host of procedural and substantive questions, while the objectives of European state aid control lack precise definition. Yet clarity about how the prohibition of state aid operates is vital to the formulation of rules that are fit for purpose. The de jure delineation applied so far between the normal taxation regime and exceptions (which are subject to authorisation) is not convincing and leads to arbitrary outcomes.

The debate in the literature mainly seeks to strike a balance between the prohibition of state aid and national sovereignty. As a rule, the antecedent question as to the objectives of the prohibition of state aid is posed only peripherally. The criterion of selectivity which is used to differentiate between the normal taxation regime and the exception captures the letter and purpose of

\begin{itemize}
\item See, concerning section 6a of the Real Property Transfer Tax Act (Grunderwerbsteuergesetz), BFH, 30 May 2017 – II R 62/14, BFHE 257, 381: reference to the ECJ for a preliminary ruling.
\item ECJ, 13 May 2014, Case C-184/11 P – Commission v Spain, ECLI:EU:C:2014:316.
\end{itemize}
the European prohibition of state aid at best indirectly. Conversely, the criteria of distorting competition or threatening to distort competition and of affecting cross-border trade have been interpreted so broadly in application of the law that they effectively fail to have any delineating effect of their own.33 Any effect on competition features only indirectly in the assessment, as selectivity presupposes that beneficiary and non-beneficiary undertakings are in a comparable factual and legal situation.34

33 Only very tentatively in ECJ 7 September 2006, Case C-526/04 – Laboratoires Boiron, ECLI:EU:C:2006:528, para 34.

3. **Purpose of the European prohibition of state aid**

The prohibition of state aid comes within the context of the prohibition of customs duties. Customs duties between European Union Member States would obstruct the free movement of goods and services within the EU and distort cross-border trade. They have been abolished between EU Member States. From an economic perspective, the logic behind the prohibition of customs duties is that individual Member States could be tempted to gain advantages in trade at the expense of others. But if all Member States practise protectionism, no one gains and trade is obstructed to the detriment of all.

Protectionism is not limited to customs duties. It must first be noted that trade can be distorted both by affecting imports and by affecting exports. For simplicity’s sake, an obstruction of imports is considered in the following. It is necessary to bear in mind here that, quantitatively speaking, imports of a given good equal the difference between domestic demand and domestic supply. An import duty thus has the effect of a tax on the excess of demand over supply. But because a tax on this excess is equivalent to a matching combination of a tax on demand and a subsidy for supply, taxing demand while providing state aid for production would have the effect of a customs duty. Without a prohibition of state aid, Member States could circumvent the prohibition of customs duties in an area such as consumer goods by combining a special excise duty with state aid for production. The same applies to durables and capital goods.

Protectionist measures can delay desirable sectoral adjustment or have a distorting effect on the outcome of competition between undertakings. Anecdote has it that there was a subsidy race in steel-making in the early years of the European Community, where individual states propped up their domestic producers with subsidies at the expense of competitors operating far more cost-effectively elsewhere. Such competition in state aid is costly; in actual fact, state aid is against genuine Member State interests, but it evidently belongs to the repertoire of policies that EU Member States would exercise in the absence of state aid control.

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36 In the special case where a specific good is not produced domestically, a tax on demand operates like a customs duty even without being combined with state aid for production.

37 On the prevention of subsidy races as an objective of the prohibition of state aid, see ECJ 17
If the goal is accepted to be promoting global efficiency, then an understanding is to be welcomed that commits all party states to dispense not only with customs duties, but also with subsidies for individual undertakings or sectors. By this argument, the logic of the EU state aid scheme lies in a voluntary commitment by the EU Member States. In the state aid scheme, they have undertaken, in ways that go beyond customs duties, to refrain from deliberately exerting influence on cross-border trade. By establishing state aid control at European level, the Member States have safeguarded themselves against the use of such collectively damaging practices.

With regard to its enshrinement in law, the prohibition of state aid was already part of the EEC Treaty of 1957. Except for the criterion of the common market, which was superseded in Article 107 by the internal market, the wording has remained unchanged. From the very outset the wording thus contained the qualification that state aid is only prohibited if it

- distorts or threatens to distort competition – and even then only

- in so far as it affects trade between Member States.

It follows that state aid is not prohibited as such under the TFEU – not even if it distorts competition. Instead, it must also affect trade between Member States.

Appropriately, Article 107(1) refers to “aid [...] in any form whatsoever”. This is because it is known both from public finance theory and economic policy practice that state aid for specific beneficiary groups does not always take the form of direct payments. Rather, trade can also be affected by quantitative or technical import restrictions, or indeed by tax benefits.

Regarding the definition of “trade”, there are pointers towards a narrow interpretation. Article 3 of the EEC Treaty thus lists a range of activities for the attainment of the Treaty objectives named in Article 2 (“establishing a common market and progressively approximating the economic policies of Member States”). Indent a) of, in all, eleven indents sets forth “the elimination, as between Member States, of customs duties and of quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect”. Although the word “trade” is not used here, the term is precisely captured by the formula “import and export of goods”. One might next ask if trade in services is excluded. A point in favour of this is that freedom of movement for services is only addressed in indent c), meaning only after the introduction of a common commercial policy in indent b) (“the establishment of a common customs tariff and of a common commercial policy towards third countries”). The sequence and the wording suggest a conclusion that in the EEC Treaty, “trade” solely means trade in goods and not trade in services. Against this very narrow interpretation of the prohibition of state aid, however, stands the fact that the European Union has changed in character since its early days. While it is true that the European Union evolved from a customs union, politically it has grown into something more. This is already visible from the way in which the prohibition of internal customs duties has been demoted in the treaties. In the EEC Treaty, the abolition of customs duties is enshrined right at the start in Article 2. In the TFEU, on the other hand, the prohibition does not appear until article 28. Thus trade in services is largely placed on an equal footing with trade in goods in the EU.

38 Catalán, in von der Groeben/Schwarze/Hatje, Europäisches Unionsrecht, 7th ed. 2015, Art. 107, at 66. This accords with the understanding of the internal market that follows from the basic freedoms, which also encompasses the freedom to provide
At the same time, the prohibition of state aid is clearly restricted to cross-border trade. What that means in concrete terms can be illustrated by the example of a special depreciation allowance for new housing. Construction itself is a place-bound production activity. Goods used in residential construction, however, such as building materials, are traded between Member States. State aid for domestic production of building materials such as cement or tiles would thus be prohibited because it would distort competition with building materials from elsewhere and affect trade in such materials. An example of a tradable service in residential construction is the erection of housing on contract to a property owner. If all domestic building contractors were to be given state aid, it would affect cross-border trade in services. In consequence, foreign contractors could go empty-handed, even if they may be able to offer construction work at a lower price. A special depreciation allowance constitutes a subsidy for residential construction and, presumably, largely benefits domestic building contractors. Nonetheless, it does not affect cross-border trade if it is granted independently of whether construction is performed by domestic or foreign building contractors.

services; see Bartosch, EU-Beihilfenrecht, 2nd ed. 2016, Einleitung at 1 and Art. 107 Abs. 1 at 160: “gesamter Waren- und Dienstleistungsverkehr zwischen den Mitgliedstaaten” [“entire trade in goods and services between the Member States”].
4. Conflict between fiscal sovereignty and state aid control

In principle, it is possible to simulate any desired system of state subsidies by remodelling tax laws. By providing tax breaks, reduced tax rates, etc., for example, a situation can be created where state aid beneficiaries are placed in the same position after tax – in terms of both their ultimate net tax burden and behavioural incentives from the modifications to the tax system – as they would have been with direct state aid.

The form in which subsidies are granted is therefore initially immaterial to the economic analysis. However, it is hard to tell between tax subsidies and measures aimed at keeping down the efficiency costs of taxation. A central demand of optimal tax theory, for example, consists of adjusting the tax burden according to the size of evasive responses in order to minimize efficiency losses through taxation. Depending on the type of tax and what it is levied on, it can make economic sense to differentiate the tax burden using specific measures. Such measures serve to reduce distortion costs rather than to create distortions in the first place. Such measures directed at improving the tax system are nonetheless hard to distinguish from tax subsidies that, in the final analysis, merely replicate financial aid. A similar situation applies in the context of the distributional equity of the tax system. The legislature’s objective with a specific measure may thus not be to give an advantage in trade, but merely to attain a certain distributional outcome.

Just how difficult it is to distinguish between tax subsidies and measures to improve efficiency and distributional equity is clearly demonstrated by the practice of EU state aid control. This makes classification as state aid conditional on tax benefits being selective, as determined against a reference system. Any departure from the reference system prompts closer examination for whether a benefit is selective. Now, every tax system features a certain systematic classification of the taxable events to be captured by a given tax. In areas such as corporate taxation, however, identifying a reference system is notoriously difficult.\textsuperscript{39} The corporate tax systems established by the

\textsuperscript{39} On this point, see Bond (2014), Business tax incentives.
EU Member States are consequently all – to varying degrees – characterised by numerous inefficiencies. These include distortion of the financing structure, absence of investment neutrality and restrictions on loss carry-forwards. One potential means of eliminating or at least limiting such inefficiencies – aside from radical reform – consists of tax benefits for specific purposes. Examples include accelerated depreciation, a deductible notional return on equity, and deductibility for R&D expenditure. There are many more. Such measures, however, constitute tax benefits that potentially benefit certain sectors more than others. There is thus an immediate suspicion of selective state aid. For most such tax benefits, it will be difficult or impossible to determine whether a measure primarily bestows an advantage on specific sectors or undertakings, or whether it is more an efficiency-enhancing measure – especially considering that what matters in state aid practice is not the legislative intent but solely the effects of a measure. When effects are appraised, however – as discussed above – no effort is made to establish whether there is an actual effect on cross-border trade. The fact that state aid control in practice defines tax benefits against a reference system as presented above therefore inevitably creates considerable legal uncertainty and thus lessens the possibility of improving the tax system with regard to efficiency. There is a considerable margin of discretion regarding the classification of specific measures. Critical importance thus accrues to the question of who does the classifying.

The practice of state aid control in the area of tax law manifests a fundamental conflict of jurisdiction between the EU level and the Member States. There is no political balancing of interests between the two levels by a higher authority; the interests of the Member States risk being sidelined. It is true that the ECJ can review state aid decisions. This does not comprise any balancing of the policy objectives of a given fiscal measure, however. The ECJ is restricted in any event to retrospective judgment of individual cases.

Under the European Treaties, for the purpose of safeguarding the Common Market and in particular free movement of goods, responsibility for state aid control is assigned to the European Commission. In contrast to the assignment of state aid control to the EU level, the power of Member States to decide on national fiscal policies has remained untouched by the European Treaties. The background to this is that the EU Member States differ in their basic understanding of the duties and objectives of the state – for example with regard to the size and form of state benefits or to distributational equity – leading to differing financing needs and differences in the goal-oriented implementation of tax policy. Powers to generate tax revenue are correspondingly assigned to the Member States. Even in the area of harmonised indirect taxes, Member States have retained their autonomy to set tax rates. Exceptions permit national fiscal legislatures to continue exercising tax policy, including with regard to the harmonised value added tax. Moreover, every step towards harmonisation requires and has always required a unanimous vote in order to safeguard the national interests of Member

40 The ECJ, which could strike a balance between state aid control and national fiscal sovereignty, has largely tended in recent times to give the European Commission free rein. See in particular judgment ECJ 21 December 2016, Joined Cases C-20/15 P and C-21/15 P – World Duty Free Group, EU:C:2016:981.
States. In the area of unharmonised direct taxes, the Member States, with due regard to primary law, and in particular the basic freedoms, are at liberty to decide on their tax systems; only in isolated instances have they agreed uniform rules.

Direct state aid can be unilaterally prohibited by the European Commission. However, as the Member States have sole authority in almost all areas of taxation, they have at their disposal a versatile toolkit that can be put to use, almost equivalently to direct state aid, for the establishment of indirect aid via tax benefits. It is therefore understandable that state aid control should extend to fiscal measures ("aid [...] in any form whatsoever"), with increasing tax competition in the 1990s having contributed most of all to the wider understanding of fiscal state aid. This trend has been taken even further by the recent debate on tax competition as a result of the BEPS initiatives by the G20, the OECD and the EU. Ultimately, as the examples in section 2 demonstrate, EU state aid control can examine and potentially prohibit any fiscal policy measure from the perspective of whether it has an effect, whether more or less hidden, that resembles (prohibited) state aid.

The desire to extend the powers of state aid control is aimed at preserving the effectiveness of the instruments of state aid control and is therefore understandable. If control did not extend to fiscal measures, direct state aid could be systematically substituted with indirect aid under tax law, thus circumventing the prohibition of state aid. However, this extension also results in state aid control encroaching on the domain of national tax policy. It decides on the lawfulness of tax policy decisions that shape national tax law. Even if state aid control strictly limited itself to state aid aspects in its examination of national tax policies, an authority with a very narrow remit has nonetheless acquired considerable powers in general tax policy and uses them to align tax policy to a very specific policy objective. Tax policy, however, must serve many legitimate policy objectives, many of which should be considered more important than the problem of subsidies. National tax systems are, after all, also fundamental to Member States’ autonomy and also a central policy area for the attainment of state objectives. If, however, compatibility with state aid law takes first place, one of the most important tools for shaping national policy is geared solely to a very narrow goal. However, the outcome will then never be a tax system focused on efficiency and equitable distribution.

It may be argued that the extension of control is limited to the possibility of prohibiting or authorising tax policy measures and hence that the European Commission does not play an active role in shaping tax legislation. However, virtually any tax law or tax practice can be made out to be state aid if the “normal” tax regime (the situation without state aid) is merely defined in a suitable way. To the extent that the Commission or the ECJ ascribes itself the authority to define the normal tax regime, the Commission, through state aid control, can in principle use its state aid control powers to prohibit any tax measure that does not correspond to the normal situation as the Commission chooses to define it. The ECJ highlights in its case law that this is merely a matter of consistently applying the rules laid down by Member State legislatures themselves.

41 Commission notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384/3.

42 This also speaks against construing the selectivity test as a general discrimination test, Hey, StuW 2015, 331 (334).

43 On this conflict between the Commission and national fiscal legislatures see Schön, in Hancher/Ottervanger/Slot, EU State Aids, 5th ed. 2016, at 13-052 ff.

44 What matters is the “general scheme of the system”, see ECJ 2 July 1974, Case C-173/73 –
In the final analysis, however, it is not the Member States, but the European Commission and the ECJ which decide what is the exception and what is the rule,\textsuperscript{45} justification on the basis of the nature or the general scheme of the tax system usually fails.\textsuperscript{46} In this instance, the fiscal policy powers initially characterised as seemingly purely negative can no longer be separated in material terms from positive policy making powers. Expressed formally, whoever has the right to prohibit n-1 out of n alternatives ultimately has the right to elect the sole alternative that can then be implemented.

A compounding factor in this context is that state aid control decisions have substantial retrospective effect. Not only does a tax law that is found to be a prohibited hidden subsidy from the perspective of state aid control become ineffective from the time of the decision, but the hidden subsidies caused by that law over the past ten years also have to be paid back by the beneficiaries of the fiscal measure. This creates considerable uncertainty for the private sector. A fiscal legislature wishing to reduce this uncertainty must either divine the logic behind state aid control decisions and incorporate that in fiscal policy as a side factor in the legislative process, or it must be willing, for every new tax law, to enquire in Brussels formally or informally whether the new law is acceptable from a state aid point of view. If a Member State is left no longer capable of drafting legislation without visible defects, its fiscal sovereignty is severely impaired.

By shaping state aid control, the European Commission can also pursue other goals in fiscal policy. Ultimately, state aid control gives Brussels the option to take control of national fiscal policy. The mechanisms discussed in bureaucracy theory and in the economic theory of politics suggest that a bureaucracy, an authority or a governmental agency that intentionally or unintentionally gains the benefit of a policy instrument will sooner or later make use of that instrument. In view of the situation described, it is therefore to be expected that the EU level will exert a growing and increasingly dominant influence on national fiscal policy through the instrument of state aid control.

It is true that fiscal legislative powers are also limited by the basic freedoms. The ECJ has consistently ruled that the Member States may only exercise their remaining powers in compliance with Community law. However, the scope of the fundamental freedoms is clearly limited to cross-border matters and has also been developed in ECJ case law on tax legislation. In connexion with the justification test, the ECJ also increasingly seeks to achieve a balance of interests between the objectives of the EU and Member States’ needs for autonomy. The basic freedoms, as power delimiters, are thus far less susceptible to political intervention by the European Commission, especially since the latter is always in need of the ECJ for enforcement because in cases of violations of basic freedoms it is dependent on infringement proceedings before the ECJ.\textsuperscript{47}

\textsuperscript{45} By way of example, EGC 4 February 2016, para T-287/11 – Heitkamp Bauholding, ECLI:EU:T:2016:60, para 163, on the restructuring clause (\textit{Sanierungsklausel}) under section 8c subsection 1a of the Corporation Tax Act.

\textsuperscript{46} In EGC 4 February 2016, Case T-287/11 – Heitkamp Bauholding, ECLI:EU:T:2016:60, paras 168 ff, the Court thus did not accept the argument that the restructuring clause restored the application of loss carry-forwards as an expression of the principle of taxation according to ability to pay.

\textsuperscript{47} However, the basic freedoms and the prohibition of state aid parallel each other as control standards – settled case law, e.g. ECJ 7 May 1985, Case C-18/84 – Commission v France, ECLI:EU:C:1985:175, para 13; ECJ 19 September 2000, Case C-156/98 – Germany v Commission, ECLI:EU:C:2000:467, paras 72 ff.
State aid control, by contrast, permits the European Commission to impose obligations on Member States without involving an independent judicial body. The determination that state aid is prohibited is made in an aid decision issued by the European Commission; while such a decision can be contested by affected undertakings and Member States before the European courts, it is initially enforceable without requiring judicial endorsement. This area is consequently highly susceptible to political influence. The limits to European Commission policies here are less of a legal than of a practical nature, as it is simply impossible for DG Competition to keep a constant watch on the tax regimes of all 28 Member States for state aid conformity. However, it is also impossible to predict how the limited resources will be deployed. This adds an extra, very arbitrary facet to state aid control. It is not even guaranteed that Member States will be treated in the same way with regard to similar tax rules, which is partly but not only due to the fact that the appraisal may differ in the context of different tax systems.
One initial possibility for resolving the conflict of jurisdiction between EU state aid control and fiscal autonomy might be tacit acceptance of the fiscal policy power shift to EU state aid control. In effect, however, this would be the same as surrendering most national fiscal policy autonomy.

A second possibility, which in its consequences is similarly far-reaching as the first, consists of amending European law in order to fully exclude fiscal measures from European state aid control. This solution eliminates the conflict of jurisdiction. A point in its favour is that state aid control carries relatively little importance compared with the objectives of good fiscal policy. The solution would also have a positive signalling effect for other policy areas where use is made of existing powers at Union level in order to extend them to additional policy areas. However, in effect, such an exclusion for tax law would be tantamount to incapacitating European state aid control almost in its entirety, as any direct subsidy can be converted into a tax benefit (such as a tax credit). This interchangeability of direct and indirect support measures is the reason why the ECJ decided as long ago as the early 1960s that state aid control applies to tax benefits.48

A third possibility might consist of trying to defuse the conflict of jurisdiction by clearly delineating powers without actually dethroning either of the two decision makers. The TFEU indeed provides the means to this end, in various forms. Possibilities include secondary-law stipulations in the form of directives or clarifications in exemption or implementing regulations on the basis of Article 109 TFEU.

Before exploring further options for resolving the conflict of jurisdiction, the sections that follow first discuss points of departure for a delineation of powers that are already to be found in the TFEU.

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48 See references in Footnote 3.
The notion of state aid is an open-ended concept that can be interpreted in a restrictive way, especially since a broad interpretation in relation to fiscal state aid has led to undesirable developments that need to be rolled back to prevent investment-damaging legal uncertainty.

It is consequently necessary to distinguish between state aid of only local effect and state aid that affects cross-border trade. The case of a special depreciation allowance for new housing can serve as an example of restricting state aid control to where there is an effect on cross-border trade. Residential construction is a place-bound, non-tradable production activity. A measure favouring construction does not affect cross-border trade provided that it also applies when construction work is done by foreign building contractors. It should therefore not be a subject of state aid control.

Similarly, no distortion of trade can be seen in the restructuring provision (Sanierungsklausel) of Germany’s Corporation Tax Act. Under section 8c subsection 1a of the Corporation Tax Act, the possibility of retaining loss carry-forwards is open to all undertakings. It is true that such a provision has a positive effect on a region’s attractive-

5.1 Restricting state aid control to distortions of cross-border trade in the strict sense

Current state aid control practice goes far beyond the objective of the prohibition of state aid under Article 107(1) TFEU discussed in the previous section. According to the ECJ, state aid control is intended to cover measures that “mitigate the charges which are normally included in the budget of an undertaking and which thus, without being subsidies in the strict sense of the word, are similar in character and have the same effect”. The wording “aid [...] in any form whatsoever” is taken out of the context of cross-border trade here and given a life of its own.

As with the scope for intervention under Article 116 and 117 TFEU, the sole purpose that state aid control can have is to prevent distortion of trade between Member States. While the cross-border element is missing in the distortion of trade, Article 107(1) TFEU stipulates that state aid is prohibited only “in so far as it affects trade between Member States”. This makes very plain that it is not a matter of general control of subsidies, but of obstructions to cross-border trade. This criterion has not so far been given independent weight in state aid control, but it could be taken as a point of departure for restriction.

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5.2 Provisions on indirect taxes

An example of considerably more restrictive handling of possible trade restrictions can be found in practice surrounding the prohibition of customs duties. With regard to indirect taxes, the prohibition of customs duties is underpinned by Articles 110 and 111 TFEU, which explicitly relate to cross-border trade. According to Article 110 TFEU, “No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products.” Article 111 TFEU prohibits any favouring of imports in like manner. In the past, Article 110 has only been applied to discriminating provisions, thus restricting its scope to cross-border matters. The implication of this for the treatment of an adverse effect on trade via indirect taxes is that any differentiation in indirect taxes capable of adversely affecting cross-border trade is in conformity with EU law if the affected goods from other Member States are not taxed less favourably than equivalent domestic goods. This can be illustrated by a number of examples.

Taxing petroleum products is a globally widespread practice. It is a practice that may be justified with environmental objectives or the wish to conserve fossil fuels. At the same time, it incontrovertibly affects trade between states that extract and export petroleum and states that solely import it. The negative impacts on trade extend to the European Single Market.

It is not only the United Kingdom – whose membership of the EU is currently in question – that produces petroleum and exports it to other EU countries. Denmark and – to a limited extent – Germany also produce petroleum.

56 Federal and state-level powers are similarly arranged in the USA. There, the federal government is authorised to intervene in certain circumstances where there is an impact on interstate commerce.  
The risk of excise duties on petroleum products affecting EU trade may be of minor and diminishing importance, but in principle it does exist. Nevertheless, taxation of petroleum products does not violate Community law provided only that petroleum products from other Member States are not taxed more heavily than domestic petroleum products.

Similarly, there are many countries that do not produce cars and at the same time subject the registration of new cars to a special tax. A typical example is Denmark. There, new car buyers are charged a registration tax of up to 140%. The tax rate is reduced to 105% if the purchase price for a new car does not exceed approximately €11,000 including 25% VAT. Again, such a practice may be justified by specific policy objectives. In Denmark, for example, the measure is referred to as a “luxury tax”. However, there is no denying an adverse effect on trade with countries from which passenger cars are imported. As well as imports of cars being impeded, large cars are also discriminated against relative to small cars. Once again, however, this price-dependent taxation of imported passenger cars is unobjectionable under Community law, on account of Article 110 TFEU.

Foreign new cars are not discriminated against relative to domestic new cars as there is no domestic production. The conflict between national fiscal autonomy and the Community prohibition of trade distortions is thus resolved in favour of fiscal autonomy.

59 http://reimport-dk.de/ZULASSUNGSS-TEUER.194.0.html.

60 http://reimport-dk.de/ZULASSUNGSS-TEUER.194.0.html.

61 ECJ 30 November 1995, Case C-113/94 – Casarin, ECLI:EU:C:1995:413, paras 17 ff. on the progressive road tax in France; the outcome is different if the higher tax rate expressly applies solely to imported new cars, see ECJ 9 May 1985, Case C-112/84 – Humblot, ECLI:EU:C:1985:185.

Other examples could be added almost ad infinitum. The example of value added tax will be taken here to bring out the virulent nature of the potential harm to trade from indirect taxation. Basic foodstuffs typically have a reduced rate of VAT. Under normal conditions, demand for basic foodstuffs ought thus to be higher than for other goods taxed at the standard rate. If the latter are imports, however, there is a negative effect on trade. Differentiated VAT rates nonetheless remain compatible with Article 110 TFEU, irrespective of whether they perhaps have the effect of state aid, as long as goods are taxed equally regardless of origin. As these examples make clear, state aid control largely disregards the area of indirect taxation. If anything is picked up on, it is discrimination, albeit not for reasons of state aid, but for an infringement of the basic freedoms.

With regard to state aid control, there is recognition in case law that it is not meant to be limited to discriminatory provisions that differentiate between domestic and foreign undertakings. However, for consistency with the yardstick applied in Articles 110 and 111 TFEU, general direct tax regimes are only likely to be classified as state aid under Article 107 TFEU in exceptional cases, provided that they are shown to distort cross-border trade.
5.3 Measures to restrict state aid control

At the substantive level, the key to restricting state aid control lies in giving greater weight to the criterion of there being an effect on cross-border trade. Even then, however, not all delineation problems will be resolved, making it necessary to consider additional procedural means of reducing the resulting legal uncertainty.

The following instruments – which could also be deployed cumulatively – should be given closer examination:

1. Additional authorisation criteria

2. Increased burden of proof for the Commission

3. Involvement of Member States by referral of contested state aid decisions to the Council

4. Secondary legislation for specific areas

5. Limiting the legal consequences by altering the allocation of risk between Member States and undertakings: protection of legitimate expectations

(1) Additional authorisation criteria

Adding to the list of authorisation criteria in Article 107(2) and (3) TFEU is not suitable as a means of resolving the conflict of jurisdiction. An example is support for renewable energy under Germany’s Renewable Energy Sources Act (Erneuerbare-Energien-Gesetz). The purpose of this support is to make Germany independent of energy from nuclear power and fossil fuels. There is no doubt that the measure affects trade in energy. Imported electricity from non-renewable sources is intended to be substituted with electricity from renewable sources. With a view to the high-ranking environment policy objective, which is also enshrined in EU law (see Article 191 TFEU), state aid conformity has been brought about in a highly involved process of negotiation with the European Commission. The obtaining of authorisation does not, however, create an exemption from the notification requirement. Such a measure therefore continues to be subject to state aid control, with all related consequences. The specific difficulty with regard to indirect state aid, however, lies precisely in determining whether notification is necessary. As long as the assessment in the state aid control process rests with the European Commission, the beneficiaries are also denied legal certainty, and the effectiveness of the attempt at restricting state aid control is questionable.
(2) Increased burden of proof for the Commission

Until now, wherever selectivity has been established – meaning any deviation from the normal regime – it has always been presumed that there must also be a distortion of competition and an impact on cross-border trade. In diametric opposition to the current trend in case law, this presumptive effect should be restricted in the future to cases where rules deliberately benefit undertakings in a specific sector (as with special rules for mercantile shipping or aircraft building). In this event, too, however, Member States or the beneficiary undertakings should be able to demonstrate that there is no risk of an adverse effect on cross-border trade. Where a measure does not differentiate in this way, meaning that it benefits either individual undertakings or clearly identifiable sectors – as with the case of the restructuring provision in Germany – the European Commission ought to be required to prove that there is a negative impact on cross-border trade, if necessary by means of expert reports, in the manner of the more economic approach already applied in the field of antitrust enforcement.\(^{62}\) If the Commission fails to supply such proof, the measure can be assumed not to conflict with the prohibition of state aid under Article 107(1) TFEU.

A similar procedure should have to be followed in the case of the benefits from individual rulings and advance pricing agreements mentioned earlier. The Apple case, for example, is likely to qualify as state aid if it constitutes a departure from Ireland’s prevailing transfer pricing standards in favour of a specific undertaking. It could perhaps be argued that the Irish profit allocation rules in general depart from the internationally usual OECD standards. Even if substantial tax advantages result in this way, state aid would have to be assumed. If state aid is found to be present, however, it may only be contested on the basis of Article 107 TFEU if there is also an adverse effect on trade in goods or services. This may be the case here, because tax rules in Ireland enable Apple to export at lower cost from Ireland to other EU Member States.

(3) Involvement of Member States by referral of contested state aid decisions to the Council

Alternatively or additionally, there could be the possibility of a Commission decision being overruled in contested cases by a Council decision adopted either unanimously or by qualified majority. This would give Member States a voice in the state aid procedure. A question is whether judicial review would then cease entirely, or if it would still be possible to bring a case before the European courts, at least in the context of competitors’ litigation, by undertakings whose trade activities are affected. In any case, the conflict of jurisdiction with the fiscal autonomy of an individual state would remain unresolved.

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\(^{62}\) On the differential burden of pleading and proof in European antitrust cases see, e.g., Eimansberger in Streinz, EUV/AEU, 2nd ed. 2012, Art. 101, at 84 ff.
(4) Secondary legislation for specific areas

A further possibility for involving the Member States consists of the European Commission, which has the right of initiative in this regard, presenting to the Member States proposals for directives for areas that are frequently subject to fiscal incentive policies. The VAT Directive could serve as a model here. This gives Member States a framework for tax incentive policies without banning them outright. The VAT Directive thus sets a minimum rate and allows tax exemptions or the use of a reduced rate for specific supplies. Although the reduced rate of VAT is also a tax subsidy, the rules here emanate not from state aid control but from an EU tax harmonisation measure in which the Member States were involved. Directives concerning tax benefits for research and development or harmonising European tax law in relation to restructuring could be drafted in a similar way. It would be up to the Member States to decide whether to make such rules mandatory or optional. Since directives (as European secondary legislation) must square with the prohibition of state aid (enshrined in primary legislation) it would also be ensured that the resulting common frameworks are as free of distortion as possible.

Ideas for improving legal certainty can also be found in European antitrust law. While Articles 101 ff. TFEU also leave considerable leeway, block exemption regulations and safe harbour rules provide clearer guardrails. Article 109 TFEU provides for similar possibilities in state aid control.

The intrusion of state aid control into fiscal sovereignty could be curbed even more effectively if an exhaustive list of prohibited fiscal state aid were to be laid down in a unanimously adopted directive so that, by implication, measures not in the list could no longer be targeted under Article 107 TFEU. This approach would have certain similarities with that of the Code of Conduct Group for the prevention of unfair tax competition, which lists certain measures as being unfair in the Primarolo report, but unlike these soft-law recommendations would be legally binding.

(5) Limiting the legal consequences by altering the allocation of risk between Member States and undertakings: protection of legitimate expectations

When state aid control targets general statutory rules on taxation, the conflict with Member States’ fiscal autonomy is particularly pronounced because the standard practice in state aid control is to declare the existing rules invalid with retrospective effect. This means that taxpayers can no longer rely on tax rules being lawful when making economic decisions. The tax law provisions of Member States are consequently undermined and robbed of effectiveness, even if they ultimately prove unobjectionable. To safeguard both fiscal autonomy and the rule of law in taxation from the perspective of affected undertakings, it may be advisable to provide better protection for legitimate expectations by ceasing to give decisions retrospective effect in state aid infringement proceedings against measures contained in general tax legislation. This would also be reasonable because abstractly formulated regulations in tax laws are less likely than individual rulings to involve a risk of collusion between individual taxpayers and national legislators.

63 This is the direction followed by OECD rules on a nexus approach; see OECD (2016), Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5: 2015 Final Report.

64 For a recent account on the Group’s approach see Nouwen, Intertax 2017, 138.
The ten-year retrospective application is questionable in any case as it is incapable of curing the distortion of competition and trade after the event. This is another significant difference between direct and indirect state aid. With the former, a subsidy is usually approved before the incentivised action takes place. Recovery may make sense here, especially when done quickly, as it may still be possible to forestall the effect on trade. The situation is different when it comes to tax law measures that, by definition, only benefit taxpayers when the criteria are found to be met in tax assessment. Here, the recovery requirement – most of all when it reaches so far back in time – chiefly serves to penalise national fiscal policy, albeit at the expense of affected undertakings.
EU state aid rules, in economic terms, amount to an understanding between Member States to do without policies that distort trade, and not only in the field of customs duties. By establishing state aid control at the European level, the Member States have safeguarded themselves against the use of such collectively damaging practices. In light of this objective, it is understandable in principle that direct state aid and fiscal state aid are treated the same. Yet applying state aid law to the domain of tax law leads to a fundamental conflict of jurisdiction with the fiscal autonomy of Member States.

This conflict gives special cause for concern because state aid control does not clearly define prohibited fiscal state aid. It is true that not every beneficial measure under tax law amounts to a subsidy that adversely affects cross-border trade. State aid control has taken on a life of its own, however, and also targets measures where there is little or no effect on cross-border trade.

The great legal uncertainty, along with the practice of declaring fiscal measures classified as state aid to be invalid with retrospective effect and requiring their recovery, destroys the credibility of Member States’ fiscal policies and undermines their fiscal autonomy.

The separation of the normal taxation regime and tax benefits that is applied in state aid control does not make economic sense. Within this approach, the conflict of jurisdiction between state aid control and fiscal policy cannot be resolved either with a more precise economic definition of fiscal state aid. Given the purpose of the prohibition of state aid, state aid control should – as well as testing for state aid – focus most of all on whether there is a distortion of cross-border trade. Moreover, the legal uncertainty can also be countered by changes with regard to procedures and legal consequences.
In summary, the Advisory Board recommends the following adjustments in state aid control:

1) In tax matters, state aid control should concentrate on measures that adversely affect cross-border trade.

2) The Commission must prove a fiscal state aid measure’s putative effect on trade in each case. Member States or the beneficiary undertakings must be able to demonstrate that there is no risk of an adverse effect on cross-border trade.

3) Greater legal certainty can be created by secondary legislation, either by listing requirements for authorised benefits for specific sectors or by taking specific categories of measures out of state aid control.

4) Measures in tax law that are classified as state aid should normally be free from recovery of the aid. National legislators can meet the European Commission’s objections by repealing measures with effect for the future.
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