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Editorial

Group Interest Tax Regimes and State Aid: EC on the Wrong Track

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1. Introduction

It seems to be that the European Commission (EC) had hard time to decide on the Dutch and Hungarian group interest tax regimes.[1] At least, it took a considerable amount of time to come to final conclusions. Furthermore, it may be questioned whether the final conclusions are consistent with the EC's earlier policy and the European Court of Justice (ECJ)'s case law, at least as far as it concerns the final decision in respect with the Dutch group interest box scheme, and whether the outcome is desirable for the development of the internal market on the long run. In any case, the EC initially had concerns that both group interest regimes were liable to distort competition in the internal market, as both regimes were not open to all companies in the Netherlands, respectively, Hungary.

2. Hungarian Group Interest Regime: Saved by the Bell

In respect of the Hungarian regime, the EC had time on its side, because at the moment of the final decision Hungary had adopted a law repealing the regime as of 1 January 2010. The Hungarian regime was introduced in 2003, thus before the accession of Hungary to the European Union (EU) in 2004. Furthermore, at the time of the introduction, it was uncertain, according to the EC, whether the regime could be qualified as aid. Therefore, the regime was classified as existing State aid.[2] As a consequence, recovery of aid granted was not necessary. In a nutshell, the regime favoured the taxation of net interest income received from affiliated companies belonging to one corporate group. The regime allowed a tax deduction of 50% of the balance of interest received from affiliated companies less interest paid to affiliated companies (majority interest) with the result that only half of the net interest received was taxed. Conversely, at the level of the affiliated company paying the interest, 50% of the amount of the net interest paid was added to the tax base, therefore leading to higher taxation for this company. However, as a consequence of a yearly opt-out possibility, higher taxation was rather a theoretical case. The regime was beneficial in cross-border group financing with the net interest-receiving company situated in Hungary. Insurance companies, financial institutions, investment enterprises, and micro- and small-sized enterprises were excluded from this beneficial regime. Next to these two elements, the regime was also considered to be selective, because only companies being part of a group could benefit from the regime. The opt-out possibility:

> was an *additional* factor to consider that the measure is an exception from the tax system in Hungary [italics added].[3]

One of the lines of the Hungarian defence was that the regime decreased the difference between equity and intra-group loan financing.[4] The EC did not accept this argument as justification, because the scheme had the effect of excluding several sectors from the benefit and that it did not qualify as a simple technical measure aiming to shift part of the tax burden from the net interest-receiving company to the net interest-paying company.[5] With the conclusion of existing aid and the withdrawal of the scheme, the EC could run with the hare and hunt with the hounds.

3. Dutch Group Interest Box: Incomplete and Inconsistent Assessment

In respect of the Dutch regime, the EC did not have chance to such an escape, since the Netherlands did not have the intention to withdraw the bill by virtue of which the group interest box were to be introduced. In tax literature, different opinions were expressed of whether the group interest box, as originally notified to the EC, constituted forbidden

1 See Commission Decision of 8 Jul. 2009, COM (2009) 4511 final (on Dutch group interest box (*groepsrentebox*) scheme, No. C4/2007 (ex N 655/2006)) and Commission Decision of 28 Oct. 2009, COM (2009) 8130 final (on Hungarian tax deductions for intra-group interest, No. C10/2007 (ex No. 13/2007)).

2 See Commission Decision of 28 Oct. 2009, COM (2009) 8130, *supra* n. 1, paras 142–143 and 147–154.

3 See *ibid.*, paras 23, 108–109, and 124.

4 See *ibid.*, para. 29.

5 See *ibid.*, para. 125.

State aid.[6] In a nutshell, the original regime was effectively a tax rate reduction from 25.5% to 5% as far as the intra-group interest received exceeded the intra-group interest paid. Only interest on money loans and comparable agreements could benefit from this low rate. A group company was defined as one company holding an interest of more than 50% in another company. As a result, banks and similar financial institutions established in the Netherlands and which would supply loans to third parties, for example, non-resident subsidiaries of multinational companies, could not benefit from the low tax rate. Their profits would still be taxed at a rate of 25.5%, whereas a head office established in the Netherlands supplying intra-group loans would be taxed on the profit of such loans at a rate of 5%. Head offices would be granted a competitive benefit not available for banks, although, in my opinion, both can fulfil a comparable transnational finance function. In the past, restricting tax benefits to *group financing activities* led to the conclusion that 'certain undertakings' were favoured and that the selectivity criterion was met.[7] In the Dutch case, the financial position of head offices would be improved compared to other taxpayers like banks.[8] An upper limit of a fixed percentage of the average equity would be part of the regime. It would be an optional system for a period of at least three years. The original regime aimed essentially at improving the attractiveness of the Netherlands as place of business for group finance activities.[9] This constitutes normally operational aid. However, the reduction of different tax treatment between debt and equity financing was also mentioned in legislative history.[10] In my opinion, this aim cannot be considered an essential aim of the proposed regime, because tax arbitrage would only be reduced within a group and only if the group were a Dutch resident group, whereas the regime would increase tax arbitrage in transnational group financing. Therefore, the regime would only be advantageous in an international context.[11] This element was also always relevant in the EC's assessment.[12]

In the course of the proceedings, the Netherlands offered to amend the originally notified regime.[13] The regime would become compulsory, that is, the regime would apply to all entities subject to Dutch corporate income tax with respect to interest paid to *group* companies and interest received from *group* companies. Furthermore, the definition of a group company would be amended to cover all arrangements whereby one entity has, directly or indirectly, the effective control on financing of the other entity, or whereby a third individual or entity has the effective control on financing of the two entities involved in the loan arrangement. Finally, the statutory minimum capital of EUR 18,000 for a limited liability company (i.e., a Dutch *Besloten Vennootschap* (*BV*)) would be abolished. As a result, the EC concluded that, after the amendments, the group interest box did not constitute aid within the meaning of Article 87(1) EC (now Article 107(1) The Treaty on the Functioning of the European Union (TFEU)).

Amazingly, the EC did only pay attention to the alleged aim of reduction of tax arbitration, ignoring completely the *essential* aim of the group interest box: improving the attractiveness of the Netherlands as a place of business for group financing activities.[14] Therefore, the EC's analysis is incomplete and not convincing. This is even more striking because the EC emphasized in its decision that:

> fiscal measures, which do not constitute an adaptation of the general system to particular characteristics of certain undertakings, but have been conceived as a means to *improve their competitiveness*, fall into the scope of article 87(1) EC [italics added].[15]

Furthermore, the reduction of tax arbitrage would only be reduced in domestic Dutch group situations, so outside domestic group situations and in cross-border situations, tax arbitrage would not be reduced. In its decision, the EC further argues that

6 No state aid: see, e.g., F.A. Engelen & P.C. van der Vegt, 'De Octrooien Rentebox: Dispariteit, Distorsie of Steunmaatregel', *Weekblad Fiscaal Recht (WFR)* 6690 (2006): 1181–1189, Q.W.J.C.H. Kok & J.C.M. van Sonderen, 'Octrooibox, Groepsrentebox en Renteaftrekbeperkingen', *Tijdschrift Fiscaal Ondernemingsrecht (TFO)* 87 (2006): 164, and R.H.C. Luja, 'Boxen, Beleggingsinstellingen en Staatssteun', WFR 6679 (2006): 820–821, although less firmly than the others. State aid: see, e.g., J.A.G. van der Geld, 'Trends in de Vennootschapsbelasting', TFO 100 (2008): 188–191, E.C.C.M. Kemmeren, '(Aangescherpte) Groepsrentebox is naar Huidige Stand van Zaken Verboden Staatssteun', WFR 6805 (2009): 371–380, and R. Szudoczky & J.L. van de Streek, 'Revisiting the Dutch Interest Box under the EU State Aid Rules and the Code of Conduct: When a "Disparity" Is Selective and Harmful', *Intertax* 5 (2010): 263–273.

7 See for a similar comparison, e.g., ECJ 6 Sep. 2006, Case C-88/03, *Portugal (Azores) v. Commission* and Commission Decision of 8 Feb. 2006, 2006/C 78/02/EC, OJ, 31 Mar. 2006, 3. Compare also, e.g., Commission Decision of 22 Jul. 1998 on 'Irish Corporation Tax' (SG(98)D/7209), Commission Decision of 30 Mar. 2004 (2005/77/EG), OJ L29/24, 2 Feb. 2005, paras 65 and 66 ending in ECJ 18 Dec. 2008, Cases T-211/04 and T-215/04, *Gibraltar v. Commission*, OJ C44 of 21 Feb. 2009, 41; Commission Decision of 17 Feb. 2003, No. C (2003) 568, OJ L180/52 of 18 Jul. 2003, 61–63 on Dutch CFA regime, paras 87–88,
Commission Decision of 8 Feb. 2006 (2006/C 78/02), OJ, 31 Mar. 2006, 2 et seq. on Luxemburg exempted 1929 holdings and multimillionaire holdings, Commission Decision of 13 Feb. 2007 COM (2007) 411 final on compatibility of certain Swiss company tax regimes with the Agreement between the European Economic Community and the Swiss Confederation of 22 Jul. 1972, and Carlo Pinto, *Tax Competition and EU Law*, *EUCOTAX Series on European Taxation*, vol. 7 (The Hague: Kluwer Law International, 2003), 119, 135–136, 156–159, and 183–187.

8 Compare, for example, ECJ 15 Mar. 1994, Case C-387/92, *Banco de Crédito Industrial SA nu Banco Exteritor de España SA v. Ayuntamiento de Valencia*, para. 14.

9 See Dutch legislative history: for example, *Memorie van toelichting*, *Kamerstukken* II 2005–2006, 30 572, No. 3, 6 and 11, *Nota naar aanleiding van verslag*, *Kamerstukken* II 2005–2006, 30 572, no. 8, 26 and 30, and *Verslag wetgevingsoverleg*, *Kamerstukken* II 2005–2006, 30 572, No. 13, 16 and 33.

10 See Dutch legislative history: for example, *Memorie van toelichting*, *Kamerstukken* II 2005–2006, 30 572, No. 3, 11, *Nota naar aanleiding van verslag*, *Kamerstukken II* 2005–2006, 30 572, No. 8, 27, and *Verslag wetgevingsoverleg*, *Kamerstukken* II 2005–2006, 30 572, No. 13, 33.

11 See further Kemmeren, *supra* n. 6, 373. Dissenting. Engelen & van der Vegt, *supra* n. 6, 1187.

12 See, e.g., Commission Notice on the Application of the State Aid Rules to Measures Relating to Direct Business Taxation, 11 Nov. 1998, OJ C384, 10 Dec. 1998, 3, paras 16, 18, 20, 26, and 33.

13 See Commission Decision of 8 Jul. 2009, COM (2009) 4511 final, *supra* n. 1, paras 25–26.

14 See *ibid.*, paras 10–18 and 85–106.

15 See *ibid.*, para. 75.

the financing function of banks and financial institutions is not comparable to financing activities of group companies,[16] whereas, as shown above, in earlier policy documents and decisions such activities were considered comparable. The offered extension of the group definition is not sufficient to remove this selective element. The low tax rate is still restricted to *group finance activities*. The selective character is not removed either with the abolition of the statutory minimum capital requirement of EUR 18,000. This requirement is not at all a condition for the application of the 5% tax rate, and therefore, in my view, its abolition is completely irrelevant for the assessment of whether the group interest box constitutes forbidden State aid or not. The low tax rate is still available only for a part of the finance market.

The fact that the group interest box would become compulsory does not make the regime non-selective.[17] As follows from earlier policy and decisions,[18] a mandatory favourable tax regime is still selective. This also follows from the EC decision on the Hungarian regime in which the option only was 'an additional factor to consider that measure' selective.[19]

In substance, the amended regime would still effectively favour transnational group financing activities established in the Netherlands only. For example, within the Netherlands, the application of the fiscal unity regime would avoid potential adverse consequences of the compulsory application of group interest box. Next to this, the acquisition of Dutch-based companies by non-resident companies financed through debts taken up with non-resident group financing companies and allocated to an acquisition holding company resident of the Netherlands (and on top of a fiscal unity) would be disfavoured. The interest paid would only be deductible at a rate of 5%, whereas the interest received would likely be taxed at higher rate. Such a result could be avoided by transferring the non-resident group financing company or its activities to the Netherlands. Therefore, it could be argued that the establishment of group financing activities in the Netherlands would even be favoured more under the amended rules. At least, this result of amended rules would perfectly fit with the (original) essential aim of the group interest box: improving the attractiveness of the Netherlands as place of business for group finance activities. Therefore, I do not feel that the EC's conclusion is right that the benefits in cross-border situations are not triggered (anymore) by the Dutch group interest box,[20] but that they are the result of tax disparities between different tax jurisdictions and, therefore, that they should be excluded from the scope of the State aid.[21]

Another element of selectivity is that, also after the amendments, the 5% tax rate would only be open for interest on money loans and comparable agreements. Therefore, not all interest payments would be covered.

4. Conclusions

As follows from the analysis above, I believe that the EC has recently gone on the wrong track in respect of assessing whether group interest tax regimes constitute forbidden State aid. Its recent analyses are incomplete and inconsistent with previous decisions and case law. Furthermore, from a policy perspective, I feel that the decision on the Dutch group interest box is not desirable either.[22] Although it is at this moment clear that the Netherlands will not introduce this box,[23] other Member States may see this decision as a guideline to introduce such a box or similar regimes. Such a development would contribute to a rat-race-to-the-bottom. However, the relative advantage for such Member States may be only rather temporary. Furthermore, I do not believe that such tax benefits really contribute to a structural strengthening of the Member States' and EU's economic infrastructure. The earlier EC's assessments that tax benefits for group financing activities constitute operational State aid confirm this opinion. As we know from newspaper reports, the Netherlands already experienced the easy move of group finance activities by a Dutch multinational out of the Netherlands to Switzerland, when the abolition of the predecessor of the group interest box, the Dutch CFA regime, was discussed. This example shows that such favourable tax regimes do not structurally contribute to the economic infrastructure, but only as long as such regimes are applied.

16 See *ibid.*, paras 86–104.
17 See also Szudoczky & van de Streek, *supra* n. 6, 273–274.
18 See n. 7.
19 See n. 3.
20 See also Szudoczky & van de Streek, *supra* n. 6, 271–273.
21 See Commission Decision of 8 Jul. 2009, COM (2009)4511 final, *supra* n. 1, paras 110–117.
22 See also, van der Geld, *supra* n. 6, 188–191, and Kemmeren, *supra* n. 6, 374.
23 See, e.g., Letter to the Dutch Lower House (*Tweede Kamer*) of 5 Dec. 2009, No. DB/2009/674M on Update on possible measures in the corporate income tax (*Stand van zaken mogelijke maatregelen in de vennootschapsbelasting*), published in *Vakstudie-Nieuws* 2009/62.14, and Report of Code of Conduct Group (Business Taxation) of 25 May 2010 (doc. 10033/10 FISC 47), 5.