

## COMMISSION DECISION

of 16 October 2002

on the aid scheme C 50/2001 (ex NN 47/2000) — Finance companies — implemented by Luxembourg

(notified under document number C(2002) 3741)

(Only the French version is authentic)

(Text with EEA relevance)

(2003/438/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above <sup>(1)</sup>,

Whereas:

## I. PROCEDURE

(1) In 1997 the Ecofin Council adopted a code of conduct on direct business taxation with a view to putting a stop to unfair practices in this area <sup>(2)</sup>. Further to the undertaking contained in the code, the Commission in 1998 published a notice on the application of the state aid rules to measures relating to direct business taxation <sup>(3)</sup> (hereinafter referred to as the notice), in which it reaffirmed its determination to apply those rules rigorously and in accordance with the principle of equality of treatment. This procedure is covered by that notice.

(2) By letter of 12 February 1999 (D/50716), the Commission asked Luxembourg for information concerning the Luxembourg scheme for finance companies. By letter of 26 March 1999 (A/32604), the Luxembourg authorities informed the Commission that the scheme had been withdrawn on 20 February 1996.

(3) By letter of 25 April 2000 (D/51738), the Commission asked for further information in view of the fact that, although it had been withdrawn, the scheme might have produced effects and/or still be producing effects. The information was supplied to the Commission by letter from the Luxembourg authorities dated 10 May 2000 (A/34012).

(4) By letter SG(2001) D/289743 of 11 July 2001, the Commission informed Luxembourg that it had decided to initiate the formal investigation procedure laid down in Article 88(2) of the EC Treaty in respect of the tax scheme for finance companies. By letter of 14 September 2001 (A/37233), Luxembourg submitted its comments concerning the Commission's decision.

(5) The Commission decision to initiate the procedure was published in the *Official Journal of the European Communities* <sup>(4)</sup>. The Commission invited interested parties to submit their comments on the measure. It received no comments from interested parties.

(6) By letter of 21 March 2002 (D/51274), the Commission asked Luxembourg for further information that was provided by letter of 11 April 2002 (A/32745).

## II. DESCRIPTION OF THE MEASURE

(7) The status of finance companies is governed by Circular LIR No 120 of 14 July 1989 (hereinafter referred to as Circular 120 or the Circular). The Circular was repealed by Circular LIR No 1120 of 20 February 1996. A total of nine companies were approved as finance companies, of which seven became operational.

(8) An international group finance company is a resident limited company which is fully liable to tax, is part of

<sup>(1)</sup> OJ C 306, 31.10.2001, p. 2.

<sup>(2)</sup> OJ C 2, 6.1.1998, p. 1.

<sup>(3)</sup> OJ C 384, 10.12.1998, p. 3.

<sup>(4)</sup> See footnote 1.

an international group and has as its sole purpose the granting of loans to companies within the group that are refinanced using financial mechanisms and instruments such as public issues, private borrowings or bank loans. The bulk of the loans must be granted by the finance company to companies within the same group situated abroad. Within the meaning of the Circular, a foreign international group refers to companies that are financially linked and incorporated in at least two countries other than Luxembourg. The finance company's parent company must be one of the companies in the group and must have capital of at least LUF 7,5 billion (approximately EUR 187,5 million) or equivalent.

(9) Finance-company status was, in principle, granted for an unlimited duration.

(10) The Circular states that, for corporation tax purposes, the loans granted by finance companies to companies within the same group must generate an appropriate trading profit in line with the normal behaviour of a prudent manager in his relations with independent third parties. To that end, the minimum acceptable commercial profit of a Luxembourg finance company for tax purposes is  $\frac{1}{4}$  % (0,25 %) of the amount of loans granted and, if the financial risk is covered by statutory collateral, may be further reduced to  $\frac{1}{8}$  % (0,125 %). Each time a finance company enters margins resulting in a trading profit greater than the minimum profit, it is this trading profit that has to be used for the purpose of taxing the finance company.

(11) Neither the borrowings taken up for financing loans to group members nor the interest paid on those borrowings are to be included for the purposes of municipal trade tax, which is assessed on the basis of either operating capital or income.

(12) Outside finance available to the finance company temporarily may be entered into productive accounts only on an exceptional basis and for a maximum of eight days: any interest accruing must be added to the commercial profit.

(13) A finance company can deduct from its taxable profit withholding taxes imposed in other countries on interest payments to it. Tax on interest paid abroad by group companies cannot be taken into account for the purposes of Luxembourg corporation tax and/or deducted from trading profit.

### III. GROUNDS FOR INITIATING THE PROCEDURE

(14) In its evaluation of the information supplied by the Luxembourg authorities, the Commission examined whether the method of determining the margin, the exclusion of refinancing from the calculation of municipal tax and the exercise of possible discretionary power by the administration might confer an advantage on finance companies. It also took the view that such an advantage might have been granted from State resources, might affect competition and trade between Member States, and might be selective. Finally, it felt that none of the exceptions to the general principle that State aid is prohibited seemed to be applicable. These doubts led the Commission to initiate the formal investigation procedure in this case.

### IV. COMMENTS FROM LUXEMBOURG

(15) The comments submitted by the Luxembourg authorities may be summarised as follows.

(16) Since the scheme had been withdrawn, it was no longer producing any effects other than in respect of enterprises to which the provisions of Circular 120 applied up to the end of 2001. The Luxembourg authorities also pointed to the problems posed by transfer prices and defended the solution adopted<sup>(5)</sup>. Finally, they did not consider the measure to constitute aid within the meaning of Article 87 of the Treaty.

#### Transfer prices

(17) The links which exist between two enterprises within a particular group enable them (at least in theory) to determine conditions for supplying goods and services between them which differ from those which would have applied if the two parties had acted as independent enterprises operating on free markets. Enterprises may thus be tempted to allocate their profits within the group in such a way as to minimise the total tax burden on the group as a whole. In the case of multinational groups, allocating profits in this way often results in the tax base being increased in one country and reduced in another. This explains the concern of governments to ensure that transfer prices within a group are as close as possible to market prices.

<sup>(5)</sup> Transfer prices are the prices at which a company invoices goods or services to associated companies.

- (18) Within the Organisation for Economic Cooperation and Development (OECD), to which the Member States belong, the principle of full competition was adopted to eliminate the impact of special conditions on the level of profits. This principle, set out in Article 9 of the OECD Model Tax Convention, serves a dual objective: to ensure that tax is correctly assigned to each country and, as far as possible, to avoid double taxation. It also enables multinational enterprises and independent enterprises to be treated as equally as possible. The methods used to determine transfer prices include the 'comparable prices on the free market' method and the cost-plus pricing method.
- (19) Referring to the need to prevent tax avoidance and to the principle of full competition, the Luxembourg authorities point out that Article 164 of the Law of 4 December 1967 on income tax constitutes the legislative basis for transfer prices. It was in this context that Circular 120 was adopted to facilitate the taxation of the administrative activities of finance companies. The Luxembourg administration normally tries to compare prices charged within the same group with prices charged for comparable transactions between independent enterprises. This is not always possible, however, because the relevant comparative data are not available.
- (20) Consequently, the Luxembourg administration opted in this case for the cost-plus pricing method with a view to determining transfer prices for the intra-group services provided by finance companies of multinational groups. On the basis of a uniform method such as that recommended by the OECD, a minimum threshold for determining taxable income equal to 0,25 % of the amount of loans granted (0,125 % if the financial risk incurred is covered by statutory collateral) was laid down. Nevertheless, if a finance company realised a trading profit greater than the minimum amount resulting from the application of Circular 120, the higher trading profit had to be taken into account for the purposes of corporation tax.
- Circular 120 did not involve State aid within the meaning of Article 87 of the Treaty*
- The measure must give rise to an advantage**
- (21) The measure did not set out to lighten the tax burden normally borne by finance companies but solely to determine as accurately as possible a market price for intra-group services by applying the cost-plus pricing method. Luxembourg points out that, in paragraph 13 of its notice, the Commission stressed that tax measures of a purely technical nature, such as provisions to prevent double taxation or tax avoidance, do not constitute State aid. Given that Circular 120 was a general measure designed to prevent tax avoidance and to produce an appropriate and fair trading profit for finance companies, it did not constitute State aid.
- (22) The requirement that finance companies belong to a large international group with own funds of at least LUF 7,5 billion (approximately EUR 187,5 million) made it possible to ensure that, in most cases, the amount of payments was not too low because a higher rate would otherwise be necessary to guarantee consistency with market conditions.
- (23) Luxembourg notes that the Commission is merely questioning the way in which the principle of full competition is complied with and the consideration percentages are fixed and whether it is justified to exclude refinancing from the calculation of municipal tax.
- (24) The Luxembourg authorities consider that the Commission is criticising two aspects of the advantage enjoyed by finance companies: on the one hand, the practical application of the cost-plus pricing method as compared with the use of the transfer prices actually paid and, on the other, the fact that refinancing is excluded from the calculation of municipal tax.
- (25) As far as the first aspect is concerned, Luxembourg stresses that it was only where the transfer prices charged by the enterprise were higher than those resulting from the application of the cost-plus pricing method that the use of that method could have led to an advantage for the enterprise as a result of a smaller tax base being applied to it. Luxembourg takes the view that, in fact, the minimum margin referred to in Circular 120 was, at most, greater than the margin resulting from market conditions with the result that the arrangements presented no attraction in tax terms to finance companies. Should the Commission conclude that the application of Circular 120 in such cases constituted unlawful State aid and demand its recovery, the enterprises concerned would have to be identified and an individual calculation made for each enterprise on the basis of the real transfer prices.
- (26) Luxembourg would point out that the Commission accepts the use of methods such as the cost-plus pricing method and that there would not be any advantage if using such alternative methods resulted in taxation

equal or at least comparable to that which could have been arrived at between two independent operators applying the traditional method whereby taxable profit is calculated on the basis of the difference between the enterprise's income and charges. According to Luxembourg, the Commission considers that an advantage should be deemed to exist where the result of applying the cost-plus pricing method is not sufficiently comparable to that which would have been obtained by means of the traditional method. However, the Commission is not concerned with the extent of any such advantage, and Luxembourg considers that the cost-plus pricing method does not in any case give rise to any advantage to the point where the taxable income would no longer be comparable to that which could have been obtained between two independent operators by means of the traditional method.

- (27) As for the second aspect, Luxembourg considers that the Commission seems to be claiming that, by not including refinancing in the municipal trade tax base, an advantage might be conferred on finance companies. However, the Luxembourg authorities consider such exclusions to be justified. This is due to the fact that, until 1990, such charges were non-deductible for the purpose of calculating municipal trade tax. The result determined in accordance with the corporation tax rules also serves, with a few additions and exclusions, as a basis for municipal trade tax. Before 1990, financial charges were added to that end. Including financial charges led to absurd situations in which the amount of tax exceeded the actual profit. This justifies excluding financial charges from the taxable income for the purposes of municipal trade tax.

#### **The advantage must be granted from State resources**

- (28) Luxembourg acknowledges that, if any advantage was conferred by Circular 120, it came from state resources.

#### **The measure must be selective**

- (29) As for the alleged selectivity stemming from the application of a discretionary practice, the Luxembourg authorities confirm that the administration does not have any discretion to grant or refuse application of the scheme for finance companies. On the contrary,

although such selectivity results from a legislative or administrative exception to the tax provisions, they assert that the State aid rules have never been applied to a situation comparable to this case. The Commission has not cited any precedent.

- (30) Luxembourg points out that, in paragraph 20 of the notice, the Commission explains that some tax benefits are on occasion restricted to certain types of undertaking, to some of their functions or to the production of certain goods and may therefore constitute State aid. However, Luxembourg indicates that there is no example of a decision or judgment of the Court of Justice of the European Communities in which a measure has been deemed to be selective because it applied only to some types of undertaking or to some of their functions.

- (31) According to Luxembourg, the specificity criterion is not met because Circular 120 stems from the normal application of the Luxembourg tax rules. The Circular applies to all international groups of a sufficient size and forms part of efforts to combat abnormally low transfer prices. The only conditions imposed relate to the size of the group and to its establishments in several countries. Such limitations are necessary in order to guarantee that serious operations are managed from Luxembourg in a volume which is sufficient to give rise to difficulties in determining the transfer prices of the enterprises concerned. The principles to be applied in determining the taxable result of a finance company, as proposed in the Circular, are based on the rules for transfer prices set out by the OECD, which are general in scope and applicable to all taxpayers encountering intra-group invoicing. The Circular does not involve the application of a lower tax rate to finance companies but, at most, lays down how the tax base is to be calculated, taking account of the specific characteristics of multinational companies.

- (32) As an ancillary argument, Luxembourg takes the view that, even if the arrangements for finance companies were considered by the Commission to be a derogation from the normal arrangements, they are justified by the nature and general scheme of the system. The Luxembourg authorities wanted to reconcile the principles of linking the tax balance sheet to the commercial balance sheet and of legal certainty with that of full competition. For the reasons outlined above, they chose the cost-plus pricing method in order to give the taxpayers concerned a point of reference by laying down a minimum threshold for declaring profits earned on internal operations.

### The measure distorts competition and affects trade between Member States

- (33) Since the rules on transfer prices are designed to prevent disguised transfers of profits abroad by means of inappropriate invoicing methods, Circular 120 was addressed to international groups. The aim was not to permit an overall reduction of taxable profits within international groups but to prevent tax avoidance. Therefore, according to Luxembourg, the Circular cannot be considered to confer an advantage which improves the competitive position of the enterprises making up such groups within the common market.

### The principle of legitimate expectations

- (34) In Luxembourg's view, the taxpayers to which Circular 120 was applicable had legitimate expectations which militate against the repayment of any State aid resulting from application of the Circular. There is no precedent for applying the State aid rules to the choice of methods for calculating the tax base. Applying them in this way would involve a radical and unforeseeable extension of the current scope of Article 88 of the Treaty.
- (35) Moreover, the Commission considered at the time that rules governing the taxation of European headquarters of multinational groups did not fall within the scope of the Treaty's provisions on State aid <sup>(6)</sup>. Consequently, Luxembourg had legitimate grounds for believing that the Circular was legal.
- (36) Moreover, until publication of the notice in 1998, Community policy on State aid was unclear. Recovery could at most extend to the advantages obtained after the date on which the notice was published.

### The principle of non-retroactivity of tax laws

- (37) Luxembourg takes the view that a request for recovery of the alleged aid would be tantamount to a retroactive amendment of the ordinary tax rules that would run counter to the basic constitutional principle of non-retroactivity of tax laws. The Commission cannot reasonably impose recovery where aid results from a general tax scheme contested after the event by the Commission.

### Impossibility of recovering the alleged aid

- (38) Luxembourg considers that there is consistent case law to the effect that, where it is in fact impossible to recover illegal aid, a Member State may not be required to recover it. This is the situation in which Luxembourg finds itself in this case. A figure cannot be put on the amount of the aid because it would not be possible to establish the real transfer prices which should have been charged by finance companies or to envisage using any other of the methods described by the OECD.

### V. ASSESSMENT OF THE MEASURE

- (39) After considering the comments submitted by the Luxembourg authorities, the Commission would confirm its initial position as set out in its letter to Luxembourg of 11 July 2001 initiating the formal investigation procedure laid down in Article 88(2) of the Treaty <sup>(7)</sup>. It takes the view that the comments submitted by Luxembourg have not enabled the doubts it expressed in that letter to be dispelled and, consequently, that the tax scheme under review constitutes State aid within the meaning of Article 87(1) of the Treaty. Moreover, it deems the aid in question to be illegal and to constitute operating aid which cannot be declared compatible with the common market. Nevertheless, it considers that, in this case, Luxembourg and the recipient enterprises were justified in having legitimate expectations and that the aid need not therefore be recovered.
- (40) To begin with, the Commission is able to accept Luxembourg's comments concerning the problems posed by transfer prices in an international context. There is nothing to prevent tax administrations from using a cost-plus pricing method to determine the tax base for intra-group services provided by finance companies. This system can be likened to a tax measure of a technical nature, as referred to in the second indent of paragraph 13 of the notice. Nevertheless, some of the rules for applying the method in this case suggest that the possible granting of aid cannot be ruled out.
- (41) In order to be regarded as aid within the meaning of Article 87(1) of the Treaty, a measure must meet all of the four criteria set out below.

### Advantage

- (42) Firstly, the measure must confer on recipients an advantage which relieves them of charges that are

<sup>(6)</sup> Written Question No 1735/90 (OJ C 63, 11.3.1991, p. 37).

<sup>(7)</sup> See footnote 1.

normally borne from their budgets. The objective of using alternative methods of determining taxable income in order to prevent certain transactions from hiding undue advantages or donations with the sole purpose of avoiding taxation must normally be to achieve taxation comparable to that which could have been arrived at between independent operators on the basis of the traditional method, whereby the taxable profit is calculated on the basis of the difference between the enterprise's income and charges. This complies with the principle of full competition. In the area of transfer prices, this international principle is set out in Article 9 of the OECD Model Tax Convention (and, in more detail, in the 1995 OECD Transfer Pricing Guidelines). Since an analysis requires individual facts and circumstances to be taken into account, the OECD Guidelines do not recommend the use of 'safe harbours' (such as fixed margins).

- (43) The Luxembourg authorities have not provided any information on how the margins used to establish the tax base for finance companies under the cost-plus pricing method are determined in practice. While the Commission can accept the argument that the administration did not have any discretionary power to grant or refuse the application of the scheme for finance companies, it is clear from the answers given by Luxembourg that the administration did have such power when it came to determining the margins to be applied. Circular 120 laid down a minimum rate of 0,25 % of the amount of loans granted (0,125 % if the financial risk incurred was covered by statutory collateral). Nevertheless, it did not lay down any rules or guidelines on how to determine the margin in practice. Indeed, the Luxembourg authorities expressly indicated that only the minimum rates (0,25 % in one case and 0,125 % in six cases) recommended in the Circular were applied. The Commission thus concludes that finance companies and the groups to which they belong were able to derive an advantage by dint of the fact that, in practice, Luxembourg systematically granted the minimum rate without checking whether it corresponded to the economic reality of the underlying services.
- (44) It should be noted that, in the case of cross-border intra-group services, it is not necessary to compare the cost-plus pricing system with real transfer prices but to ensure that the system results in taxation which is comparable to what would have been obtained by means of the traditional method. The extent of the advantage derived from the system need not be determined at this stage of the analysis but only for the purpose of recovering the aid, if this proves necessary: the Commission notes that the minimum rate of 0,25 % of the amount of loans granted (0,125 % if the financial risk incurred was covered by statutory collateral) was systematically applied in this case. Luxembourg has not provided any indication of the existence of checks to ensure that the application of the minimum rate tallied

with the level of taxation which would have resulted from the application of the traditional method. Consequently, the Commission takes the view that the conduct of the tax administration had the effect of conferring an advantage.

- (45) As for the exclusion of refinancing from the municipal trade tax base, the Commission is able to accept the arguments put forward by Luxembourg.

#### **Competition and trade between Member States are affected**

- (46) This criteria is met in that the bulk of loans had to be granted by the finance company to companies within the same group situated abroad. Moreover, in accordance with the case law of the Court of Justice <sup>(8)</sup> and as stressed in paragraph 11 of the notice, the mere fact that a measure strengthens a firm's position compared with other firms competing in intra-Community trade is enough for it to be concluded that trade has been affected. In this particular case, finance companies or enterprises in the groups to which they belong might have found their position to have been strengthened as a result of the reduced tax burden of their company in Luxembourg. Assuming this to be the case, and taking account of the possibility that the groups in question are active in sectors characterised by the existence of trade between Member States, the Commission takes the view that the measure is liable to affect such trade.
- (47) Even if, as the Luxembourg authorities claim, the main objective of Circular 120 was not to allow an overall reduction in taxable profit but rather to prevent disguised transfers, a measure must be assessed according to its effects and not according to its objectives. As consistently confirmed by case law <sup>(9)</sup>, the objective pursued by the scheme in question cannot prevent it from being classified as State aid within the meaning of Article 87(1) of the Treaty.

#### **Selectivity**

- (48) Given that the tax provisions in question concerned only finance companies belonging to multinational

<sup>(8)</sup> Case 730/79 Philip Morris v Commission [1980] ECR 2671.

<sup>(9)</sup> Case C-75/97 Belgium v Commission [1999] ECR I-3671, paragraph 25.

groups present in at least two countries other than Luxembourg, only some enterprises had access to the advantages described above. As for the requirement that finance companies belong to a large international group with a minimum capital, the Commission notes that Luxembourg has not provided any proof demonstrating that, without such a threshold, a higher rate would be necessary to guarantee consistency with market conditions. Moreover, as stated in paragraph 20 of the notice, some tax advantages are on occasion restricted to certain functions, such as intra-group services. This also holds for the Luxembourg scheme for finance companies. The criterion of selectivity is thus met.

(49) Another aspect of selectivity stems from the fact that the finance company's parent company must have own funds of at least LUF 7,5 billion (approximately EUR 187,5 million). This implies selectivity in favour of large groups in so far as groups which had been unable to achieve the minimum capital expenditure threshold would have been excluded from equal treatment under the cost-plus pricing method. The Luxembourg authorities themselves admit that the requirement that finance companies belong to a large international group was such as to ensure a sufficient volume of activity in Luxembourg.

(50) The Commission considers these aspects of selectivity to be unjustified by the nature or general scheme of the Luxembourg tax system. In particular, it does not consider such limitations to be necessary to ensure that serious operations are managed from Luxembourg in a volume sufficient to give rise to difficulties in determining the transfer prices of the enterprises concerned<sup>(10)</sup>. The difficulties linked to the determination of transfer prices apply in principle to all services or goods supplied between associated companies. While the international nature of such supplies is likely to increase those difficulties, they are faced not only by companies belonging to a large-scale multinational group. In any case, the difficulties in question are not relevant since the Luxembourg authorities systematically applied a minimum rate to calculate cost-plus prices.

(51) As regards Luxembourg's comment to the effect that there is no precedent in the form of a Court decision or judgment, the Commission would merely point out that such precedents are not necessary. Classification of the scheme for finance companies as State aid stems directly from Article 87(1) of the Treaty. However, it should be noted that, according to recent case law, tax measures are selective and constitute State aid where they apply

solely to undertakings which carry out investments exceeding a certain amount or create a certain number of jobs<sup>(11)</sup>. The Commission takes the view that the same reasoning must be applied in this case.

(52) When it comes to reconciling the principles of linking the tax balance sheet to the commercial balance sheet and of legal certainty with that of full competition and providing taxpayers with a point of reference, there is nothing to prevent tax administrations from opting for the cost-plus pricing formula. The Commission is not criticising the use of that system as a means of facilitating the determination of transfer prices for transactions between associated entities. Nevertheless, in the case at issue, the systematic application of the minimum rate must be regarded as a derogation from the correct use of the cost-plus pricing method which is liable to have conferred an advantage on some enterprises without being justified by the nature or general scheme of the system.

#### State resources

(53) In this case, the reduction in the amount of tax resulting from the application of Circular 120 involves a reduction in tax revenues, which constitute State resources.

#### Compatibility

(54) The Luxembourg authorities have not challenged the preliminary assessment of the compatibility of the scheme for finance companies, which is set out in the decision to initiate the formal investigation procedure<sup>(12)</sup> and which the Commission hereby confirms. That assessment may be summarised as follows:

(55) The derogations provided for in Article 87(2) of the Treaty regarding aid having a social character granted to individual consumers, aid to make good the damage caused by natural disasters or exceptional occurrences, and aid granted to certain regions of the Federal Republic of Germany are not applicable in this case.

<sup>(11)</sup> Joined Cases T-127/99, T-129/99 and T-148/99 *Territorio Histórico de Álava — Diputación Foral de Álava and others v Commission*, paragraph 157, and Joined Cases T-92/00 and T-103/00, paragraphs 39 and 40 and 49 and 50, not yet published.

<sup>(12)</sup> See footnote 1.

<sup>(10)</sup> See recital 31: argument put forward by Luxembourg.

- (56) The derogation provided for in Article 87(3)(a) regarding aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment is also not applicable.
- (57) Likewise, the scheme for finance companies does not fall within the category of important projects of common European interest eligible for the derogation provided for in Article 87(3)(b) and, given that it is not designed to promote culture and heritage conservation, cannot qualify for the derogation provided for in Article 87(3)(d).
- (58) It should also be examined whether the scheme is eligible for the derogation provided for in Article 87(3)(c), which authorises aid to facilitate the development of certain economic activities or of certain economic areas in cases where such aid does not adversely affect trading conditions to an extent contrary to the common interest. The tax advantages granted under the scheme are not linked to investment, job creation or specific projects. They merely constitute ongoing tax relief and must consequently be classified as operating aid. The Commission thus takes the view that the aid in question is liable to adversely affect trading conditions to an extent contrary to the common interest.

### Recovery

- (59) The measures in question may not be regarded as existing aid within the meaning of Article 88(1) of the Treaty and Article 1(b) of Council Regulation (EC) No 659/99 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty<sup>(13)</sup> (now Article 88 of the EC Treaty). This is because they were implemented after the entry into force of the Treaty, have never been notified to the Commission as required by Article 88(3) of the Treaty, are not covered by a limitation period and constituted aid from the moment they were put into effect. They therefore constitute new aid. Where State aid granted illegally is found to be incompatible with the common market, the natural consequence is that the aid must be recovered from the recipients in accordance with Article 14 of Regulation (EC) No 659/99. The purpose of recovery is to restore as far as possible the competitive situation which existed before the aid was granted. Neither the absence of precedent for applying the State aid rules to

choices concerning methods of calculating the tax base nor the alleged lack of clarity of Community State aid policy would justify an exemption from this basic principle.

- (60) As for the claim that it would be impossible to recover the aid and the principle of the non-retroactivity of tax laws, the relevant case law indicates that, even if recovery of a tax credit presents difficulties from an administrative point of view, that fact is not such as to enable recovery to be deemed to be technically impossible<sup>(14)</sup>. Moreover, as consistently confirmed by case law, a Member State may not plead provisions, practices or circumstances existing in its internal legal system in order to justify a failure to comply with its obligations under Community law. In particular, a provision laying down a time-limit for the revocation of an administrative act must, like all the relevant provisions of national law, be applied in such a way that the recovery required by Community law is not rendered practically impossible and the interests of the Community are taken fully into consideration<sup>(15)</sup>. If this were not the case, Member States could escape effective monitoring of State aid by not complying with their obligation under Article 88(3) of the Treaty to notify in advance plans to grant aid.

### Legitimate expectations

- (61) Nevertheless, Article 14(1) of Regulation (EC) No 659/1999 lays down that 'the Commission shall not require recovery of the aid if this would be contrary to a general principle of Community law'. The case law of the Court of Justice and the Commission's own practice in previous decisions have established that recovery would be contrary to a general principle of Community law if, following the Commission's action, the recipient had legitimate expectations that the aid was granted in accordance with Community law.
- (62) In *Van den Bergh and Jurgens*<sup>(16)</sup> the Court stated that:

'The Court has consistently held that any trader in regard to whom an institution has given rise to

<sup>(14)</sup> Case C-280/95 *Commission v Italy* [1998] ECR I-259, paragraph 23, and Case 378/98 *Commission v Belgium* [2001] ECR I-5107, paragraph 42.

<sup>(15)</sup> Case C-5/89 *Commission v Germany* [1990] ECR I-3437, paragraphs 18 and 19.

<sup>(16)</sup> Case C-265/85 *Van de Bergh and Jurgens and others v Commission* [1987] ECR 1155, paragraph 44.

<sup>(13)</sup> OJ L 83, 27.3.1999, p. 1.



justified hopes may rely on the principle of the protection of legitimate expectation. On the other hand, if a prudent and discriminating trader could have foreseen the adoption of a Community measure likely to affect his interests, he cannot plead that principle if the measure is adopted.'

(63) In Commission Decision 2001/168/ECSC of 31 October 2000 on Spain's corporation tax laws<sup>(17)</sup>, the Commission noted the similarities between the Spanish system and a French system it had approved on the basis that it did not constitute aid within the meaning of Article 92(1) of the EEC Treaty (now Article 87(1) of the EC Treaty). In the present case, it notes that, in some respects, the Luxembourg scheme for finance companies resembles the scheme introduced in Belgium by Royal Decree No 187 of 30 December 1982 on the taxation of coordination centres. Both schemes relate to intra-group activities and use the cost-plus pricing method to determine the tax base. In its decision of 2 May 1984, the Commission took the view that the scheme did not involve state aid within the meaning of Article 92(1) of the EEC Treaty. Even though that decision was not published, the fact that the Commission did not raise any objection to the Belgian scheme was made public at the time in the XIVth Report on Competition Policy and in an answer to a Parliamentary question<sup>(18)</sup>.

(64) In this connection, the Commission notes that its decision on the Belgian scheme for coordination centres was adopted before the entry into force of the Luxembourg scheme for finance companies. It also notes that all the beneficiaries of the scheme were approved as finance companies before the Commission's decision of 11 July 2001 to initiate the formal investigation procedure. It would further point out that Circular 120 was repealed on 20 February 1996 and that it has not applied to the beneficiaries since 31 December 2001. Consequently, the Commission accepts the arguments put forward by Luxembourg concerning the beneficiaries' legitimate expectations and waives recovery of the aid granted.

## VI. CONCLUSION

The Commission finds that the Luxembourg scheme for finance companies constitutes State aid within the meaning of Article 87(1) of the Treaty and that none of the derogations provided for in Article 87(2) or (3) are applicable. It also finds that Luxembourg unlawfully implemented the system in question in breach of Article 88(3) of the Treaty. Nevertheless, it notes that the system was withdrawn on 20 February 1996 and that the tax advantages granted to beneficiaries ceased on 31 December 2001. Lastly, it acknowledges that the beneficiaries had legitimate expectations such as to rule out recovery of the State aid found to be incompatible with the common market. Consequently, it is not requiring that the aid be recovered,

HAS ADOPTED THIS DECISION:

### *Article 1*

The tax scheme for finance companies implemented by the Grand Duchy of Luxembourg by means of Circular LIR No 120 of 12 June 1989 constitutes State aid which is incompatible with the common market.

### *Article 2*

This Decision is addressed to the Grand Duchy of Luxembourg.

Done at Brussels, 16 October 2002.

*For the Commission*

Mario MONTI

*Member of the Commission*

<sup>(17)</sup> OJ L 60, 1.3.2001, p. 57.

<sup>(18)</sup> See footnote 6.