

II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 17 February 2003

on aid scheme C54/2001 (ex NN55/2000) Ireland — Foreign Income

(notified under document number C(2003) 569)

(Only the English text is authentic)

(Text with EEA relevance)

(2003/601/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 ⁽¹⁾,

Whereas:

Code of Conduct Group. In this context, the Commission notes the parallelism between the work of the Code of Conduct Group and the Community's policy in respect of State aid, which share a common goal of abolishing measures which distort or threaten to distort competition within the single market. The Commission also notes the progress made towards achieving the ultimate objective of eliminating harmful tax competition and specifically the steps taken by Member States to abolish, or to remove the harmful features from, those tax measures identified as harmful.

I. PROCEDURE

(1) In 1997, the ECOFIN Council adopted a Code of conduct for business taxation ⁽²⁾ with the objective of tackling harmful tax competition; it subsequently established a Group to assess tax measures that fall within the scope of that Code. Following its commitment taken by way of the Code, the Commission published in 1998 a Notice on the application of State aid rules to measures relating to direct business taxation ⁽³⁾, stressing its determination to apply them rigorously and to respect the principle of equality of treatment. It was within this framework that the Commission embarked upon its examination of measures identified as harmful by the

(2) By letter dated 29 May 2000 (D/53182), the Commission requested information on the so-called Foreign Income scheme. Following an extension to the deadline, Ireland replied by letter dated 19 July 2000 (A/36170). A second request for information was sent on 8 August 2000, and a reminder was sent on 13 September 2000. Ireland replied on 20 September 2000 (A/37792).

(3) By letter dated 11 July 2001 (SG 2001 D/289754), the Commission informed Ireland that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the Foreign Income scheme. By letter dated 4 October 2001 (A/37839), Ireland submitted its observations.

⁽¹⁾ OJ C 308, 1.11.2001, p. 2.

⁽²⁾ OJ C 2, 6.1.1998, p. 1.

⁽³⁾ OJ C 384, 10.12.1998, p. 3.

- (4) The Commission Decision to initiate the formal investigation procedure was published in the *Official Journal of the European Communities*, inviting interested parties to submit their observations⁽⁴⁾. No comments were received.
- (5) By letter dated 24 January 2002 (D/50287), the Commission sought further information. Following an extension to the deadline, Ireland replied on 26 March 2002 (A/32369).
- (9) No particular category of investment or employment is specified, provided that the trading activities concerned and the employment itself are in Ireland. The investment may be made by the company in activities it carries out directly or may be made indirectly — for example, by subscription for shares in another company which would then make the investment. The employment may either be new jobs in a new or expanding business, or existing jobs in a business which, in the absence of the investment, would probably close down or reduce the size of the workforce. There is no requirement as to the number of jobs created or maintained. The amount qualifying for exemption can be reduced where the full amount of the dividends is not spent on the approved investment plan.

II. DESCRIPTION OF THE MEASURE

- (6) In Ireland, double taxation relief is normally given to companies via the credit system, under which Irish tax on doubly taxed income and gains is reduced by the foreign tax incurred on that income or those gains. The tax credit cannot exceed the amount of tax due in Ireland on that foreign income or gains. However, under the Foreign Income scheme, relief is instead provided by exempting the foreign source income or gains from Irish corporation tax. The Irish Foreign Income scheme consists of two separate measures: one for foreign dividends, the other for foreign branch profits and gains. They are set out in sections 222 and 847 of the Taxes Consolidation Act 1997.

Section 847

- (7) The exemption for foreign dividends was originally introduced by section 41 of the Finance Act 1988, under which dividends received by an Irish resident company from its foreign subsidiaries are exempt from Irish corporation tax where those dividends are applied to an investment plan. A 'foreign subsidiary' is a company resident in a State with which Ireland has a double taxation Treaty and which is a 51 % subsidiary of the Irish resident company seeking the exemption. The investment plan must be submitted in advance to the Irish authorities who issue an exemption certificate in respect of a specified amount of dividends if they are satisfied that the investment is directed towards the creation or maintenance of employment in Ireland. The exempted dividends must be applied for the purposes of the plan within a three-year period, beginning one year before and ending two years after their receipt in Ireland.
- (8) Section 40 of the Finance Act 1991 amended the measure to allow the submission of an investment plan within one year of its commencement and to allow the Irish authorities to extend the three-year period in which the dividends may be applied.
- (10) The exemption for foreign branch profits and gains was originally introduced by section 29 of the Finance Act 1995. Guidelines were issued in 1995.
- (11) In order to qualify for the exemption, a company must submit an investment plan in advance setting out details of the investment proposed by itself or by an associated company. Information submitted with the plan must include, *inter alia*: a background note on the company; details and nature of the activities, both initial and planned; the level and type of investment; timescale; funding arrangements; financial forecasts; projected employment; and location of proposed activities.
- (12) The Irish authorities may certify the company as a 'qualifying company' (and may accordingly grant the exemption) if they are satisfied that the plan is directed at the creation of 'substantial new employment' in Ireland, that the investment will be made, that the creation of employment will be achieved and that the maintenance of the employment in Ireland is dependent on the carrying-on of the foreign trading activities. The minimum level of sustainable employment created must be of the order of 40 new, incremental jobs and must be achieved at the latest by the end of a three-year period starting from the start-up date specified in the exemption certificate. Substantial permanent capital is such amount as is considered 'appropriate' by the Irish authorities and is specified in the exemption certificate. The income and gains from foreign trading activities are only exempt from tax where they are carried out in the country specified in the exemption certificate.

⁽⁴⁾ See footnote 1.

III. GROUNDS FOR INITIATING THE PROCEDURE

- (13) In its evaluation of the information submitted by Ireland in the course of its preliminary investigation, the Commission considered that the Irish authorities conferred an advantage on particular companies by exempting from Irish taxation certain dividends from foreign subsidiaries or certain foreign branch profits and gains. It considered that this advantage was granted via State resources, affected trade between Member States, and was selective. The Commission also considered that none of the exceptions on the general prohibition on State aid provided for in Article 87(2) and (3) of the EC Treaty applied. On those grounds the Commission had doubts as to the compatibility of the measure with the common market and therefore decided to initiate the formal investigation procedure.

IV. COMMENTS FROM IRELAND

- (14) In their letter of 4 October 2001, apart from summarising the requirements, respectively, of sections 222 and 847 of the Taxes Consolidation Act (see paragraphs 7 to 12 above), the Irish authorities made some general observations, added further comments on the two measures, and sought to correct any inaccurate descriptions or misinterpretations contained in the Commission's letter of 11 July 2001. They also provided arguments on possible legitimate expectations of companies granted relief under the schemes. In their letter of 26 March 2002, the Irish authorities provided further information on the practical application of the two measures. These comments can be summarised as follows.

General comments

- (15) Section 86 of the 2001 Finance Act abolished the tax relief for foreign dividends granted by section 222, by restricting the relief to dividends certified before 15 February 2001. Section 89 of the 2001 Finance Act provided that no company may avail itself of the relief under section 847 unless it holds an exemption certificate issued before 15 February 2001.
- (16) In the evaluation ⁽⁵⁾ of the measure (both reliefs together) by the Code of Conduct Group, the measure was not considered to be in breach of any of the criteria under paragraph B of the Code ⁽⁶⁾. The rationale used by the Group does not relate to exemption of foreign branch trading profits.
- (17) Both reliefs are investment aid, because both include investment plans. Most of the sums relieved of tax were invested in plant, machinery, land, buildings and

working capital. At the time, the whole of Ireland was a region falling within the scope of Article 87(3)(a) of the Treaty. The measures are therefore compatible with the common market. Most of the companies to which exemption certificates were issued were in the Dublin region, but they involved investment in both Dublin and other parts of Ireland. The remaining companies were located in the South-East or Mid-West regions. Before 1 January 2000, the maximum State aid intensity for these regions was 57 %. As the highest rate of corporation tax in the period concerned was 43 % in 1989, this ceiling could not have been breached, even though there were no specific controls. Since the rate of corporation tax has declined, little or no tax relief would have been granted in recent years.

Section 222

- (18) At the time at which this relief was introduced in 1988, the Irish economy was going through a very difficult phase and had an unemployment rate as high as 16,3 %. Dramatic remedial action was being taken to overcome the severe imbalance in public finances. The aim of the relief was to bring back dividends to Ireland so as to help Irish employment. It was not intended to promote the trading operations of the foreign subsidiaries. In total, 12 certificates for the repatriation of specified dividends have been granted to Irish companies. In two cases, the plan was not subsequently implemented and no tax relief was claimed and in a third case it is possible that the relief was never in fact claimed. In another, less than 20 % of the approved relief was claimed. The first certificate was issued on 1 February 1989 and the last on 5 December 1996. All the investments made on the basis of approved plans were executed before the end of 1999, when all of Ireland was considered a region covered by Article 87(3)(a).
- (19) If the dividends were not repatriated to Ireland, then no Irish tax liability would arise in respect of the foreign subsidiaries. The incentive was that no additional tax would arise if the dividends were repatriated.
- (20) Most of the companies granted relief were in the manufacturing sector and most of the repatriated dividends were applied for investment in plant, machinery, buildings, land and working capital. One company was a major Irish bank. In that case, the dividends were lent out for productive investment in the fishing, farming, tourism, health and small business sectors as well as for training courses and venture capital.

⁽⁵⁾ Report of Code of Conduct Group (Business Taxation) to ECOFIN Council, SN 1401/99, 23.11.1999.

⁽⁶⁾ See footnote 2.

- (21) Only three companies definitely claimed relief for dividends repatriated to finance investment plans in respect of which a certificate was issued.
- (22) No assessment was made of the dividend repatriation history of the companies concerned at the time when the reliefs were granted. It is not known whether the exempted dividends would have been repatriated without the relief.
- (23) One major Irish multinational manufacturing group, active in other sectors including forestry, tourism and financial services, was issued certificates on seven occasions between 1988 and 1996 in respect of a total of dividends of IEP 99 million repatriated from subsidiaries located in the United States. The approved plans related to investments in, *inter alia*:
- (a) new machinery, plant, equipment, vehicles and software;
 - (b) forestry;
 - (c) certain group companies, in the form of capital injections;
 - (d) a new hotel and golf club;
 - (e) a golf club;
 - (f) hotel and golf club developments, designed to offset start-up losses;
 - (g) a timber processing plant, offsetting operating losses;
 - (h) existing group financial services companies and a new financial services company;
 - (i) a special job creation enterprise fund;
 - (j) software;
 - (k) upgrading plant, equipment, machinery and software;
 - (l) computerisation.
- (24) Another company group in the manufacturing sector was granted a certificate in respect of IEP 10 million of dividends from a subsidiary in the United States. The approved plan related to investments in: the construction of a new liquid milk plant; the construction of a new cheese plant; the total refurbishment of slaughtering and meat-boning plants to meet Community and Irish regulations; and the refurbishment of a cheese plant.
- (25) The Irish bank was granted a certificate in respect of IEP 125 million repatriated from a subsidiary in the United States. The approved plan involved subsidised lending to various business sectors under various schemes, including:
- (a) the Operational Programme for Small Business: this provided loans to small- and medium-sized enterprises (SMEs) in the services, manufacturing, food and tourism sectors for the construction or refurbishment of premises, the purchase of new or second-hand plant and equipment, and the provision of long-term working capital;
 - (b) loans to projects in certain seaside resorts: these provided loans for capital investments in resort accommodation and for the construction, renovation and refurbishment of resort amenities;
 - (c) special loans for the purchase of milk quota: these provided finance in 2000 for the purchase of milk quota by farmers under the Irish Department of Agriculture's EU Milk Quota Restructuring Scheme;
 - (d) enterprise loan scheme: this provided loans to start-up and early stage companies in the period 1994-2001;
 - (e) loans for various Government initiatives: these provide finance for rural renewal in the Upper Shannon region (construction and refurbishment of residential and commercial buildings), the construction or refurbishment of nursing homes and the development of the Irish white-fish fleet;
 - (f) two venture capital funds.
- (26) The company for which it has not been possible to establish whether the relief granted was in fact claimed is a leisure company. The investment plan concerned the development of a golf club and holiday villas. The exemption covered only IEP 0,15 million of dividends: the vast bulk of the project finance came from other sources.

Section 847

- (27) Only three certificates have been granted. In one case, the relief concerned branches located in a number of countries, although branches were established in only four countries: Germany, Italy, South Africa and Japan. The certificate was issued in July 1999 and was effective from September 1996.
- (28) In the two other cases, the relief has never been claimed, in one case because no incremental Irish tax would have been due and in the other because the foreign branches concerned have never been established.

Legitimate expectations

- (29) Companies could claim to have legitimate expectations to receive the reliefs for which they qualified under the legislation, as they were not aware until recently that no State aid approval had been obtained for the measures. They submitted plans, were granted certificates, and incurred expenditure implementing their plans in the belief that, having been certified by the Irish authorities, they would be entitled to the relief in accordance with the legislation. The companies could not reasonably have foreseen a situation in which, following substantial investment and job creation, the relief would not be allowed to run its course. The manner in which the measures were amended by the 2001 Finance Act — closing the section 847 relief to new entrants and effectively abolishing the section 222 relief — acknowledges the existence of companies' legitimate expectations.

V. ASSESSMENT OF THE MEASURE

- (30) After having considered the observations of the Irish authorities, the Commission maintains its position, expressed in its letter of 11 July 2001 ⁽⁷⁾ to Ireland initiating the procedure under Article 88(2) of the Treaty, that the scheme under examination constitutes unlawful State operating aid, within the scope of Article 87(1) of the Treaty. In the assessment that follows, the Commission explicitly examines the scheme as formed by the two individual measures set out in sections 222 and 847 of the Taxes Consolidation Act 1997. This assessment is not intended to provide an assessment of any individual grants of aid to particular undertakings under the two measures. No individual case was notified to the Commission with all the necessary information for the Commission to assess it. The Commission is bound by the very nature of the two measures to make a general and abstract examination both on the existence of State aid within the meaning of Article 87(1) and on the question of the compatibility of such aid. Thus, all the elements necessary to assess whether the Foreign Income scheme involves State aid and whether it is compatible with the common market can be found in the scheme itself. The Treaty itself, Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty ⁽⁸⁾, and the case law of the Court of Justice of the European Communities ⁽⁹⁾ empower the Commission to conduct such an analysis. The Commission will not therefore formally examine the application of the measures in

each individual case. The Commission does not know the identity of the beneficiaries of the scheme, nor all the relevant information in any individual case.

Existence of State aid

- (31) The Commission notes the observations of the Irish authorities on the evaluation of the Foreign Income scheme by the Code of Conduct Group. However, this evaluation has no bearing on the objective assessment of the existence, or otherwise, of State aid.
- (32) In order to be considered State aid within the meaning of Article 87(1), a measure must fulfil the following four criteria:
- (33) First, the measure must afford the beneficiaries an advantage that reduces the costs they normally bear in the course of their business. Both tax credits and tax exemptions are mechanisms for avoiding the double taxation of corporate income. Where a foreign tax credit is granted, the taxes paid on the income in the foreign jurisdiction is deducted from the liability to tax on that income in the domestic tax jurisdiction, up to the limit of that domestic tax liability. In contrast, where foreign income is exempted, no domestic corporation tax is payable. Thus, where the domestic tax liability is greater than the tax paid in the foreign source jurisdiction, under a credit system, further tax is payable, whereas under an exemption system, no further tax is due. Therefore, where a specific tax exemption for foreign income is granted under a system where the general rule provides for a credit, this exemption constitutes a tax advantage and reduces the beneficiary company's tax burden.
- (34) According to point 9 of the Commission Notice on the application of the State aid rules to measures relating to direct business taxation ⁽¹⁰⁾ (hereinafter 'the Notice'), the tax advantage may be granted through different types of reduction in the company's burden and, in particular, through a reduction in the amount of tax. The Foreign Income scheme clearly fulfils this criterion. By exempting the foreign source income and gains from any taxation in Ireland, the companies concerned and the groups to which they belong are relieved, to the extent to which it would otherwise occur, of the additional tax liability after the application of the generally applied tax credit. The scheme is not a technical measure applying to all firms without distinction, of the sort envisaged by point 13 of the Notice.

⁽⁷⁾ See footnote 1.

⁽⁸⁾ OJ L 83, 27.3.1999, p. 1.

⁽⁹⁾ Judgments of the Court of 14 October 1987 in Case 248/84 *Germany v. Commission* [1987] ECR 4013, at paragraphs 17-18; of 5 October 1994 in Case C-47/91 *Italy v. Commission* [1994] ECR I-4635, at paragraphs 20-21; of 17 June 1999 in Case C-75/97 *Belgium v. Commission* [1999] ECR I-3671, at paragraph 48; of 19 October 2000, Joined Cases C-15/98 and C-105/99, *Italy and Sardegna Lines v. Commission* [2000] ECR I-8855, at paragraph 51.

⁽¹⁰⁾ See footnote 3.

- (35) The observation that if the dividends were not repatriated to Ireland, then no Irish tax liability would arise in respect of the foreign subsidiaries does not alter the fact that the measure grants a tax advantage to the beneficiaries. Although the advantage under this measure is granted in order to encourage a particular course of action, this fact cannot affect the objective analysis of whether the measure constitutes State aid.
- (36) Secondly, the advantage must be granted by the State or through State resources. The grant of a tax reduction, such as that conferred on companies under the Foreign Income scheme by the Irish authorities, involves a loss of tax revenue which, according to point 10 of the Notice, is equivalent to the use of State resources in the form of fiscal expenditure.
- (37) Thirdly, the measure must affect competition and trade between Member States. As is explained in point 11 of the Notice, this criterion is fulfilled if a company benefiting from a measure carries on an economic activity involving trade between Member States. Companies granted tax relief under the Foreign Income scheme necessarily form part of international groups with foreign subsidiaries or branches. On the basis of the information supplied by the Irish authorities, it is clear that at least some of the companies concerned, or the groups to which they belong, were active in sectors subject to intra-Community trade.
- (38) Lastly, the measure must be specific or selective in that it favours 'certain undertakings or the production of certain goods'. The beneficiaries of the measure are only those companies that have obtained an exemption certificate in accordance with the specific requirements of either section 222 or section 847 (see paragraphs 7 to 12 above). The conditions set out in the legislation are very restrictive. Accordingly, the Foreign Income scheme cannot be considered a general measure but constitutes a selective advantage to those few companies that satisfy its requirements and therefore constitutes a State aid scheme.
- (39) However, notwithstanding this general assessment of the scheme, the Commission notes the comments from the Irish authorities to the effect that no new exemption

certificates can be delivered and that only one of the three companies granted an exemption certificate under section 847 has in fact claimed the tax exemption. The Commission also notes that from the current financial year, corporation tax is 12,5 % and that, in principle, such a rate is lower than those applied in those jurisdictions where the branches of the relevant company are established. Therefore, the Commission accepts that, under the present circumstances, exemption under section 847 no longer confers an advantage on those companies to which certificates have been granted. Accordingly, in respect of those companies, the measure no longer falls within the scope of Article 87(1) of the Treaty.

Compatibility

- (40) In so far as the Foreign Income scheme constitutes State aid within the meaning of Article 87(1) of the Treaty, its compatibility must be evaluated in the light of the exceptions provided for in Article 87(2) and (3).
- (41) The exceptions provided for in Article 87(2), which concern aid of 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 areas of the Federal Republic of Germany, do not apply in this case.
- (42) The exception provided for in Article 87(3)(a) provides for the authorisation of aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment.
- (43) The Commission notes the observations from the Irish authorities that the Foreign Income scheme constitutes investment aid rather than operating aid, that all the investments aided by the section 222 measure were made before the end of 1999, at a time when the whole of Ireland was considered as an Article 87(3)(a) region for State aid purposes, and that all the applications and certifications under section 847 were also finalised before the end of 1999.

(44) At first sight, section 222 might appear to be an investment aid measure. However, nothing in the legislation or in the information provided by the Irish authorities demonstrates that the criteria for granting the tax relief satisfy the regional aid guidelines in force at the time ⁽¹¹⁾. To the extent that these guidelines provide for aid to be granted for initial investment or job creation, the Commission notes that, according to Ireland, tax relief was granted in respect of, *inter alia*, working capital, start-up and operating losses, capital injections, upgrading of plant, machinery and software, and refurbishment of facilities. As the Commission has consistently ruled in previous decisions, none of these is normally considered to constitute initial investment or job creation for which State aid may be granted. Similarly, the Commission notes that section 222 provides for tax relief for the maintenance of employment as well as for its creation. This is borne out by information provided by Ireland on the practical application of section 222. Similarly, nothing in the legislation or in the information provided by the Irish authorities demonstrates that controls were in place to ensure compliance with other rules on State aid, notably aid to sensitive sectors, aid to companies in difficulty and cumulation of aid. In particular, the Commission notes that relief was given in respect of production and processing of goods featuring in Annex I to the EC Treaty and in respect of operations which, according to the Irish authorities, would otherwise have been unviable.

(45) The Commission therefore concludes that section 222 grants operating aid to those companies awarded a tax exemption for dividends repatriated from foreign subsidiaries. Although operating aid may be granted in the areas envisaged in Article 87(3)(a), such aid is subject to strict conditions. In particular, the aid must be limited in time and designed to overcome the structural handicaps of enterprises located in such regions ⁽¹²⁾. Although aid granted under section 222 is, in principle, limited to a duration of three years, nothing in the legislation or in the information provided by Ireland demonstrates that the tax relief granted is designed to overcome the structural handicaps of enterprises located in Ireland. In this respect, the Commission notes that the measure is narrow in scope. Rather than helping to offset the structural handicaps faced by enterprises in Ireland in general, it is targeted at a very restricted group of companies that have foreign subsidiaries in certain tax jurisdictions where the overall rate of taxation is lower than in Ireland. It is hard to establish what, if any, particular structural handicaps these firms faced. It also appears

that in some cases at least, the aid granted through the tax relief was not a critical factor in determining whether the investment would take place. The Commission also notes that the investment supported by the relief can be made indirectly through subscription to shares in a company which would then undertake the investment. However, it is not clear that this mechanism acts as an incentive for the creation or maintenance of employment. In order for this to be the case, the Irish authorities would have to be sure that in the absence of the specific subscription to shares the investment would not take place, and that the subscription would not materialise unless the tax relief was granted. Nothing in the legislation or in the information provided by Ireland demonstrates that such control mechanisms were in place.

(46) As was mentioned in paragraph 30, the Commission makes no specific assessment as to whether an aid element is present in the individual tax reliefs granted under the Foreign Income scheme, nor whether those reliefs are compatible. However, in respect of the bank granted tax relief under section 222, the Commission would make the following observations. Regardless of the purpose to which the repatriated dividends were applied, the tax relief must be viewed as operating aid to the bank. Even if some aid was passed on by the bank to its customers as part of new lending, by increasing the resources of the bank available for lending, the relief would have strengthened the competitive position of both the bank itself and the international group to which it belongs. The Commission also notes that no controls were put in place to ensure that the lending of the bank under the approved investment plan itself satisfied the requirements of the relevant State aid rules. By way of example, the Commission would note that, as it has consistently held in previous decisions, State aid for the purchase of milk quota is incompatible with the common market ⁽¹³⁾.

(47) The Commission notes the comments from Ireland that, once granted, the tax relief under section 847 applies on an ongoing basis if the conditions continue to be met and that there is, at present, no closing date for the reliefs already granted. The Commission also notes that, according to the wording of section 847, one of the conditions of the relief is that the maintenance of the employment created depends on the carrying-on of foreign trading activities in respect of which the exemption is granted. It is therefore clear that rather than grant investment aid, section 847, which was conceived at a

⁽¹¹⁾ Commission Communication on the method for the application of Article 92(3)(a) and (c) to regional aid: OJ C 212, 12.8.1988, p. 2.
⁽¹²⁾ Point 6, first indent, of the 1988 Communication on regional aid.

⁽¹³⁾ See for example Commission Decisions 1996/616/EC, OJ L 274, 26.10.1996, p. 26 and 2002/411/EC, OJ L 144, 1.6.2002, p. 49.

time when the rate of corporation tax in Ireland was much higher than it is now, constituted an operating aid measure, the benefit of which would cease as soon as it was withdrawn. Since tax relief granted under section 847 applied on an ongoing basis without a closing date, it fails to meet the requirement that operating aid under Article 87(3)(a), where given, is limited in time ⁽¹⁴⁾.

(48) According to Ireland, the investment plan of the one company to have claimed section 847 relief 'was prepared in September 1994 and commitments were given by the Irish Authorities in December 1994 to bring in the tax relief in question'. In this respect, given these circumstances as well as the narrow scope and very limited uptake of the section 847 relief, the Commission notes that an individual ad hoc aid payment made to a single firm, or aid confined to one area of activity, may have a major impact on competition in the relevant market and that its effects on regional development are likely to be too limited for the purposes of its Guidelines on National Regional Aid ⁽¹⁵⁾.

(49) According to point 33 of the Notice, in order to be considered compatible with the common market, State aid intended to promote the economic development of particular areas must be in proportion to, and targeted at, the aims sought. The Irish authorities have provided little evidence to demonstrate that either section 222 or section 847 meets these requirements. Very few applications for aid were made. In a number of cases, either the tax relief was not fully taken up, being incidental to the execution of the investment plan, or the investment was not executed. The Irish authorities have also admitted that although reliefs were granted, little or no tax relief would have been claimed in recent years. The Commission also notes that both reliefs were open to companies in the financial services sector. The Commission's practice in previous decisions, consistent with point 33 of the Notice, has been to exclude financial services from the scope of operating aid measures ⁽¹⁶⁾.

(50) Therefore, tax relief under sections 222 and 847 cannot be held to be compatible with the common market in accordance with Article 87(3)(a).

(51) The exceptions laid down in Article 87(3)(b) and (d) do not apply to the Foreign Income scheme. It does not have the objective either to promote the execution of an important project of common European interest or to

remedy to a serious disturbance in the economy of Ireland. Nor is it intended to promote culture or heritage conservation.

(52) Finally, the Foreign Income scheme must be examined in the light of Article 87(3)(c), which provides for the authorisation of aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent that is contrary to the common interest. As was established in paragraphs 43 to 46, the tax advantages granted by the Foreign Income scheme are operating aid, the benefits of which cease as soon as the aid is withdrawn. According to previous decisions of the Commission, such aid cannot be considered to facilitate the development of certain activities or of certain economic areas.

(53) The Irish authorities have not attempted to argue that the Foreign Income scheme complies with the Guidelines on aid to employment ⁽¹⁷⁾ under which certain aid measures may be considered compatible with the common market by virtue of Article 87(3)(c). However, the Commission notes that to the extent that section 222 is aimed at the maintenance of employment, the measure does not grant aid to a firm to persuade it not to lay off its workers, with the subsidy being calculated on the basis of the number of employees at the time the aid is granted. To the extent that both section 222 and section 847 are aimed at job creation, neither provision provides that the amount of aid per worker must be justified, nor that it shall not represent too high a proportion of the firm's production costs. The Foreign Income scheme cannot therefore be regarded as falling within the scope of the Guidelines on aid to employment.

Legitimate expectations and recovery

(54) Where illegally granted State aid is found to be incompatible with the common market, the natural consequence of such a finding is that the aid should be recovered from the beneficiaries ⁽¹⁸⁾. Through recovery of the aid, the competitive position that existed before the aid was granted is restored as far as is possible. However, Article 14(1) of Regulation (EC) 659/1999 ⁽¹⁹⁾ states that 'the Commission shall not require the 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

⁽¹⁴⁾ Point 6, first indent, of the 1988 Communication on regional aid.

⁽¹⁵⁾ OJ C 74, 10.3.1998, p. 9; see heading 2.

⁽¹⁶⁾ See for example Article 2 of Commission Decision on the Fiscal Regime in the Azores, SG (2002) 233143.

⁽¹⁷⁾ OJ C 334, 12.12.1995, p. 4.

⁽¹⁸⁾ See for example case C-169/1995, *Spain v. Commission* ECR [1997] I 135, paragraph 47.

⁽¹⁹⁾ See footnote 8.

Commission's own practice have established that where, as a result of the Commission's actions, a legitimate expectation exists on the part of the beneficiary of a measure that the aid has been granted in accordance with Community law, then an order to recover the aid would infringe a general principle of Community law.

- (55) In the judgment on the *Van den Bergh en Jurgens* case ⁽²⁰⁾, the Court ruled:

'The Court has consistently held that any trader in regard to whom an institution has given rise to justified hopes may rely on the principle of 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.'

- (56) In the present case, the Commission notes that the scheme introduced in Belgium by Arrêté royal No 187 of 30 December 1982 dealing with the tax treatment of coordination centres ⁽²¹⁾, like the Irish Foreign Income scheme, is a measure which affects the taxation of multinational companies and concerns rules that are designed to avoid double taxation. In its decision of 2 May 1984, the Commission considered the Belgian scheme not to be an aid within the meaning of Article 92(1) of the EEC Treaty (now Article 87(1) of the EC Treaty). Even if this Decision was not published, the fact that the Commission had not raised any objections to the Belgian coordination centres scheme was publicised both in the XIVth Competition Report and in an answer to a parliamentary question ⁽²²⁾. In particular, in this answer, the Commission stated that 'such rules do not fall within the scope of Articles 92 and 93 of the EEC Treaty (now Articles 87 and 88 of the EC Treaty)'.

- (57) Accordingly, the Commission accepts that the beneficiaries of the measures were entitled to entertain a legitimate expectation that the measures did not constitute State aid. These considerations therefore prevent the Commission from ordering the recovery of any aid granted.

VI. CONCLUSIONS

- (58) The Commission finds that Ireland has illegally implemented the Foreign Income scheme as set out in sections 222 and 847 of the Taxes Consolidation Act 1997. The

Commission concludes that the tax reliefs in question constituted a scheme of operating aid that was not covered by any of the derogations to the prohibition on State aid set out in Articles 87(2) and 87(3) of the EC Treaty and is therefore incompatible with the common market. The Commission notes that section 222 has in effect been abolished and that since section 847 was introduced, the rate of corporation tax has fallen to the extent that section 847 no longer constitutes State aid with respect to the companies which currently benefit from it. The Commission also concludes that to the extent that aid was granted by sections 222 and 847, the beneficiaries were entitled to entertain legitimate expectations that the Irish Foreign Income scheme did not constitute State aid. Therefore, the Commission does not require recovery of any aid granted,

HAS ADOPTED THIS DECISION:

Article 1

The State aid scheme in the form of tax exemptions, unlawfully put into effect by Ireland, in breach of Article 88(3) of the EC Treaty, through section 41 of the Finance Act 1988 and section 29 of the Finance Act 1995, consolidated under sections 222 and 847 of the Taxes Consolidation Act 1997, is incompatible with the common market.

Article 2

Outstanding tax exemption certificates issued under section 847 of the Taxes Consolidation Act 1995 shall not be considered State aid within the meaning of Article 87(1) of the Treaty.

Article 3

This Decision is addressed to the Republic of Ireland.

Done at Brussels, 17 February 2003.

For the Commission

Mario MONTI

Member of the Commission

⁽²⁰⁾ Case C-265/85, *Van den Bergh en Jurgens BV v. Commission* [1987] ECR 1155, at paragraph 44.

⁽²¹⁾ *Moniteur belge*, 13.1.1983 (Dossier No 1982-12-30/69).

⁽²²⁾ Written question No 1735/90, OJ C 63, 11.3.1991, p. 37.