State aid and selective taxes

The EU's General Court has held that the EU Commission was wrong to classify a progressive Polish tax on the retail sector involving a high starting threshold as State aid.

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The EU's General Court has rejected the EU Commission's classification of a Polish tax on the retail sector as State aid: *Poland v Commission* (Joined Cases T-836/16 and T-624/17).* The fact that the tax was progressive in nature with a high threshold was not sufficient to meet the requirement that the measures enacted by Poland should be "selective".

The judgment is an important one in the context of the application of State aid principles to taxation. In particular, concerns have been raised over the legality of some proposed digital services taxes on similar grounds. Whilst it is likely that the case will go on appeal to the EU's Court of Justice for a final decision, the approach of the EU's General Court will (if upheld) bolster the position of Member States considering introducing similar taxes, including those on the tech giants.

Background

In September 2016, the Polish Government enacted provisions to impose a tax on the retail sector pursuant to which all retailers were liable to pay a tax based on their turnover. However, the basis of assessment was a monthly turnover of more than 17m Polish zloty and progressive tax rates were applied to the excess over 17m. As such, the target of the tax was clearly larger retailers (such as supermarkets) whilst small retailers paid no tax.

Due to concerns raised by the EU Commission that the proposed tax constituted State aid the Polish Government suspended application of the tax. In June 2017, the Commission issued its decision that the proposed tax constituted illegal State aid on the basis that the tax constituted a selective measure favouring certain undertakings on account of the progressive nature of the rates applied to the turnover. Poland appealed against the decision, requesting the General Court to annul the Commission's decision.

Decision of the General Court

In an important decision on the scope of State aid when applied to taxes, the General Court has ruled that the Commission's decision was incorrect.

The Court has stressed that, in order to demonstrate the existence of a favourable tax treatment reserved for certain businesses, it is necessary for the Commission to show that, in the context of the particular legal regime, the measure

favours certain undertakings over others who are in a comparable legal and factual situation in the light of the objective pursued by the regime in question.

Therefore, in order to classify a favourable tax measure as “selective”, it is necessary:

- first, to identify the common or “normal” system of taxation applicable and
- second, to assess any advantage granted by the tax measure and determine whether that advantage may be selective, by demonstrating that the measure derogates from that “normal” system by introducing a means of differentiating between operators who are in a comparable legal and factual situation.

Importantly, the General Court has held that tax rates (whether progressive or a single rate) are part of the substance of the normal system and forms part of the “fundamental characteristics of a tax levy’s legal regime, just as the basis of assessment, the taxable event and the group of taxable persons do” (General Court’s press release, at p 2). The Commission had based its decision on the hypothesis that the “normal” system was a single rate system and it had not been entitled to take such an approach. Whether or not a tax advantage is selective must be analysed in the light of the actual characteristics of the normal system of taxation of which it forms part. In this case, the only “normal” system which could be used as the basis for comparison was the tax on the retail sector itself, with its structure of progressive rates.

In particular, the General Court noted that (based on the case law of the EU’s Court of Justice) taxes may contain “adaptation mechanisms” which may include exemptions without leading to the grant of selective advantages. Therefore, a tax based on progressive rates from a certain threshold (even a high threshold) does not in itself imply the existence of a selective advantage.

Moreover, the General Court was satisfied that there was nothing in the structure of the tax which was contrary to its objective (ie raising tax for general government spending). Not only had the Commission wrongly rejected Poland’s explanation of the objective of the tax, but it had also thereby undermined Poland’s competence in the field of taxation.

Accordingly, the General Court has annulled the decision of the Commission.

Comment

It is highly likely that the Commission will appeal the decision to the EU’s Court of Justice, given the general importance of the case. In particular, the Polish retail sector tax bears similarities to some of the digital service taxes being introduced or considered by Member States frustrated by the lack of progress at an EU level, such as the UK’s proposed digital services tax. If the ruling of the General Court is upheld, this may provide some comfort for Member States that a digital services tax with a high threshold and targeted at the tech giants only may prove to be compliant with State aid principles.

* At the time of writing this note, the General Court’s judgment was not yet available in the English language. The note is based on the EU General Court’s press release which was sanity-checked against the text of the judgment in other languages.

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