# Gibraltar: A Rock Solid Interpretation of the Selectivity Criterion

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*Abstract*

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## I. Introduction

In his case note in EStAL 2012/2 Pierpaoli Rossi-Maccanico hailed the ECJ's judgment in joined cases C-106/09 P and C 107/09 P *Commission and Kingdom of Spain v. Government of Gibraltar and United Kingdom* (hereafter: Gibraltar) as a landmark judgment which finally clarified the application of the material selectivity test of Article 107 (1) TFEU.[1] Maccianico convincingly predicted that the ECJ's judgment in *Gibraltar* will stand the test of time, resting on the pillars of Hercules, since the ECJ focussed its appraisal on the effect of the tax measures involved and not on the underlying goals.[2] Moreover, the ECJ interpreted the selectivity test basically as a non-discrimination test. As a result the *Gibraltar* judgment has remained the rock on which the ECJ has built its subsequent case law. Despite this fact the interpretation of the selectivity criterion, and indeed the *Gibraltar* judgment, has not always been consistently applied by the EU Courts. The extensive judgments in cases T-219/10 *Autogrill España v Commission* and T-399/11 *Banco Santander and Santusa v Commission*, followed by the appeal against these judgements in joined cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa* (hereafter: World Duty Free) illustrate this point in particular.[3] This comment on the *Gibraltar* judgement will take the reader along the track that led from the ECJ's reasoning in *Gibraltar* to the *World Duty Free* judgment and will take into consideration some key developments in the case law of the ECJ on the notion of material selectivity.

## II. The Selectivity Test: *De Facto* Selectivity vs. Material Selectivity

An aid measure is selective when it favours certain undertakings or the production of certain goods over other undertakings.[4] In cases of individual aid the Commission can, without further analysis, decide that there is *de facto* selectivity. In case of a general measure the Commission has to establish whether this measure confers "an advantage of general application" and if so, whether this advantage is also selective. The ECJ has construed in its *Adria Wien* judgment a three-tier test for determining whether general tax schemes have a selective effect.[5] This test is called the "material selectivity test". The first step for the Commission is to determine whether a normal tax system is based on a common legal framework that applies without distinction and is applicable to every market operator in the national territory. In such a case Article 107(1) TFEU is not applicable. This common legal framework is called the so-called "normal reference system". The second step is to assess

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1 Case note on joined cases C-106/09P and C 107/09P *Commission and Kingdom of Spain v. Government of Gibraltar and United Kingdom,* judgment of 15 November 2011 by P Rossi-Maccanico, 'Gibraltar: beyond the pillars of Hercules of Selectivity' (2012) 2 EStAL, 443-448.

2 Ibid., 448.

3 Case T-219/10 *Autogrill España v Commission* [2014] ECLI-939; Case T-399/11 *Banco Santander and Santusa v Commission* [2014] ECLI-938; Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa* [2016] ECLI-981.

4 Case C-143/99 *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke* [2001] ECR I-08365.

5 Case C-143/99 *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke* [2001] ECR I-08365 ; See also Case C-279/08 P *Netherlands v Commission (NOx)* [2011] ECR I-07671; Joined cases C-78/08 and C- 80/08, *Paint Graphos* [2011] ECR I- 07671.

whether a derogation from this normal reference system leads to different treatment of undertakings, which, given the objective of the general measure, are in the same factual and legal situation. In case there is an exception from the normal reference, this measure constitutes *a priori* selective advantage. This means that the measure is selective, unless objectively justified by the Member State. Under these circumstances the Commission is required to assess, within the third and last tier, whether this exception was prescribed in the normal reference system and whether the exception aims for a legitimate objective and given this objective, whether undertakings in the same factual and legal situation are treated differently.[6]

## III. The ECJ's Judgement in *Gibraltar*

In 2002, the United Kingdom, on behalf of Gibraltar, notified its reformed corporate tax law system to the Commission. This important reform concerned provisions on payroll tax and taxation on business property in Gibraltar. According to the scheme, undertakings were obligated to pay taxes only when making a profit, starting at a minimum threshold of 15% of profits (the so-called "profit - cap"). The Commission considered the tax scheme to be selective, since the effect of both taxes inherently favoured offshore companies which have no real physical presence in Gibraltar and as a consequence do not incur corporate tax. Therefore, the Commission decided that the corporate tax scheme constituted incompatible State aid.[7] The Government of Gibraltar brought an action for annulment before the General Court. In Joined Cases T-211/04 and T-215/04 the General Court annulled the Commission's decision.[8] The General Court ruled that the Commission had misapplied the three-tier material selectivity test. More specifically, the General Court ruled that the Commission had failed to demonstrate that the specific taxes mentioned constituted derogations from a normal system of reference, namely the corporate tax system in Gibraltar.[9] Therefore the General Court reasoned that, given the autonomy of Gibraltar to design its own tax system, the Commission was not allowed to determine whether the tax scheme led to different treatment between a the group of offshore undertakings and other undertakings within the first tier.

Rossi-Maccanico critcised this lack of an effect-based approach by the General Court.[10] He argued that the selectivity test also requires the Commission to assess whether general applicable measures may favour certain (groups) of undertakings. And indeed on appeal the ECJ agreed with Rossi-Maccanico's assessment that the General Court had failed to consider the effects. The ECJ made clear that the General Court had interpreted the selectivity test too formalistic by giving too much room to the objective of Gibraltar: introducing a general tax system for all companies in Gibraltar.[11] As a result the General Court failed to appraise the discriminatory nature of the tax regime as whole. Therefore the ECJ ruled that the General Court had lost out of side the important rule that Article 107(1) TFEU does not take into account the aims of State measures but solely the effects.[12] More specifically the ECJ reversed the judgment of the General Court concerning the application of the material selectivity test. The ECJ ruled that the General Court had misapplied the three-tier test. According to the ECJ the Commission had rightly established that the corporate tax law system was considered to be the national reference system. The ECJ considered the corporate tax system in itself to be *de facto* selective, since this system effectively favoured "offshore" undertakings. As a result the Commission was not obligated to investigate whether the payroll and property taxes constituted derogations, as these taxes constituted inherent elements of the normal system.[13] Within the first tier

6 Joined cases C-106/09P and C 107/09P *Commission and Kingdom of Spain v. Government of Gibraltar and United Kingdom* [2011] ECR I-11113,[ [46, 149-150]. See also Case C-270/15 P *Belgium v Commission* [2016] ECLI-489; Case C-518/13 and Case C-100/15 P *NMTA v Commission* [2016] ECLI-254.

7 Commission Decision 2005/261/EC of 30 March 2004.

8 Joined Cases T-211/04 and T-215/04 *Government of Gibraltar and United Kingdom* v *Commission* [2008] ECR II-3745.

9 Joined Cases T-211/04 and T-215/04 *Government of Gibraltar and United Kingdom* v *Commission* [2008] ECR II-3745, [171].

10 P Rossi Maccanico, 'Gibraltar and the Unsettled Limits of Selectivity in Fiscal Aids' (2009) 1 EStAL, 63 – 72.

11 Joined cases C-106/09 P and C-107/09 P *Commission and Kingdom of Spain v. Government of Gibraltar and United Kingdom* [2011] ECR I-11113, [88].

12 Joined cases C-106/09 P and C-107/09 P *Commission and Kingdom of Spain v. Government of Gibraltar and United Kingdom* [2011] ECR I-11113, [87-88, 95, 98].

13 Joined cases C-106/09 P and C-107/09 P *Commission and Kingdom of Spain v. Government of Gibraltar and United Kingdom* [2011] ECR I-11113, [150].

of the test the Commission is allowed to determine whether the reference system is *de facto* selective. The ECJ held that the fact that offshore companies were not taxed, was an inevitable effect from the design of the general tax measure.[14] These offshore companies constituted a group of undertakings that could only fulfil the conditions for avoiding taxation due to their specific characteristics.[15] Therefore the general tax system was designed to treat this group of undertakings preferentially because of the fact that these companies, due to their nature, all fulfilled the conditions.

## IV. Developments in the Case Law of the ECJ after the *Gibraltar* Judgment

### 1. The Purpose of *Gibraltar*: Solid as a Rock or Affected by Erosion?

The clarity provided by the ECJ in *Gibraltar* on the application of the selectivity criterion togeneral schemes has allowed the ECJ in subsequent case law to build a rock solid concept on which the selectivity test could find its roots. The ECJ continued to apply the effect-based approach beyond the domain of fiscal aids.[16] In the Case C-100/15 P *NMTA*, Case C-518/13, *Eventech*, Case C-270/15 *Belgium v Commission* and Case C-15/14 P *Commission v MOL* the ECJ consistently held that that the concept of selectivity in essence contains a non-discrimination test.[17] Despite this apparent consistency in judicial review the application of the material selectivity test has become more controversial in recent years.[18] The three-tier analysis can prove difficult to assess for the reviewing EU Courts. Especially in its *Autogrill* and *Banco Santander* judgments the General Court had a hard time as concernss the distinction between the first and second tier of the selectivity test.[19] In cases T- 219/10 and T-399/11, the General Court was asked to annul Commission Decisions 2011/5/EC and 2011/282/EU.[20] In these contested decisions the Commission decided that a Spanish tax reduction of financial goodwill for foreign shareholding acquisition (hereafter: "the tax amortisation") constituted a tax advantage and declared this measure incompatible with the internal market.[21] The Commission decided that the measure was an exception to the general applicable corporate tax scheme in Spain. The measure allowed for undertakings to receive a tax reduction on condition that these undertakings: (i) are taxable in Spain; (ii) have acquired a shareholding in a "foreign" company of at least 5% of that company's capital over the period of a year and; (iv) acquire goodwill from that shareholding. Concerning the first tier of the material selectivity test the Commission decided that the reference framework, the general corporate tax scheme, was not selective. However in its assessment of the second tier the Commission concluded that the tax amortisation scheme constituted a derogation, which discriminated between two categories of undertakings in comparable situations. Although the measure was applicable to every taxable undertaking in Spain, undertakings which acquire shareholdings abroad were treated differently compared to undertakings that did not acquire foreign shareholdings.[22] Therefore the measure seemed to favour export undertakings. In its assessment of the measure the General Court applied the same analytical method as the Commission, the material selectivity test, but came to a radically different outcome.[23] The General Court considers that the tax amortisation scheme is indeed a derogation from the reference system, however it

14 Joined cases C-106/09 P and C-107/09 P *Commission and Kingdom of Spain v. Government of Gibraltar and United Kingdom* [2011] ECR I-11113, [105].

15 Joined cases C-106/09 P and C-107/09 P *Commission and Kingdom of Spain v. Government of Gibraltar and United Kingdom* [2011] ECR I-11113, [107].

16 See for example Case C-279/08 P *Netherlands v Commission (NOx)* [2011] ECR I-07671 and Case C-518/13 *Eventech* [2015] ECLI-9. These cases revolved around respectfully emission trade schemes and public transport policies.

17 See Opinion AG Bobek, Case C-270/15 P *Belgium v Commission* [2016] ECLI-489, [101]; Case C-518/13 *Eventech* [2015] ECLI-9, [53-55]; Case C-15/14 P *Commission* v *MOL* [2015] ECLI-362, [59]; Case C-100/15 P *NMTA v Commission* [2016] ECLI-254, [85-86].

18 See for instance the Opinion of AG Wathelet of 28 July 2016 concerning joined cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa,* [5].

19 Case T-219/10 *Autogrill España v Commission* [2014] ECLI-939; Case T-399/11 *Banco Santander and Santusa v Commission* [2014] ECLI-93853.

20 European Commission, Decisions 2011/5/EC, OJ 2011 L 7, p. 48; European Commission, Decision 2011/282/EU OJ 2011 L 135, p. 1.

21 See Articles 1(1) and 4 of Decision 2011/EC and Articles 1(1) and 4 of Decision 2011/282/EU.

22 See also the Opinion of AG Wathelet, joined cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa,* [49].

23 See also the Opinion of AG Wathelet, joined cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa,* [41].

rules that the scheme does not make any distinction between groups of undertakings. First of all, the General Court considers that the measure does not favour a group of undertakings, since the measure is *a priori* available to any undertaking. Moreover the General Court rules that the measure was not aimed at any particular category of undertakings, but at a category of economic transactions: namely the purchase of particular financial assets.[24] According to the General Court, any undertaking taxable in Spain could make such a transaction. Therefore the General Court concludes that the Commission had misapplied the second tier of the material selectivity test. The General Court reasoned that the Commission had failed to prove any effects of the amortisation tax scheme. It referred back to the *Gibraltar* judgement and the ECJ's effect-based approach. Accordingly the General Court held that the Commission should have identified any specific characteristics of the beneficiary undertakings distinguishing them from other undertakings.[25] Therefore the General Court annulled the Commission's Decision to declare the amortisation scheme as incompatible aid.[26]

## 2. Back to the Rock: the ECJ's Judgment in *World Duty Free*

On appeal in the case *Commission v World Duty Free, Banco Santander and Santusa* (hereafter: World Duty Free), the Commission contested the judgement of the General Court in *Autogrill and Santander* concerning the material selectivity test. The *World Duty Free* judgment provides an excellent overview on how the selectivity criterion must be assessed by the Commission and the EU Courts. The ECJ starts by clearly distinguishing the first tier (establishing a normal reference system) from the second tier (establishing whether a derogation from the normal reference system is not discriminatory). To that end, the ECJ first of all makes clear that this case is distinct from the particular situation in *Gibraltar* in which the normal reference system was in effect discriminatory, *de facto* favouring offshore undertakings.[27] The ECJ makes a distinction between determining whether aid is de inherently selective and *a priori* selective.[28] In the *Gibraltar* case the Commission ascertained whether the normal reference system was *de facto* discriminatory. According to the ECJ the Commission may only in such a case determine the "specific characteristics" of those undertakings that are inherently favoured by the scheme.[29] Such an assessment falls only within the first tier and definitely not within the second tier of the material selectivity test. The ECJ therefore considers that the General Court misapplied this test, since it had decided that there was no exception and therefore no *a priori* selectivity.[30] Accordingly the ECJ held that the General Court had failed to examine the effects of the different treatment of undertakings. First of all, the concept of selectivity also includes economic transactions performed by undertakings. Therefore the ECJ agreed with AG Wathelet that the General Court had applied an excessively formalistic and restrictive approach in requiring the Commission to identify a specific group of undertakings, rather than focusing on the different treatment of undertakings in a comparable situations.[31] It sufficed to show that the tax reduction – as an exception to the general measure – had the effect that Spanish undertakings, owning shareholdings abroad would be treated preferentially. The General Court could therefore not rule based on *Gibraltar* that the Commission was required to identify specific characteristics, besides the conditions of the amortisation scheme that would prove that a

24 Case T-219/10 *Autogrill España v Commission* [2014] ECLI-939, [53]; Case T-399/11 *Banco Santander and Santusa v Commission* [2014] ECLI-938, [53, 57].

25 Case T-219/10 *Autogrill España v Commission* [2014] ECLI-939, [64-68]; Case T-399/11 *Banco Santander and Santusa v Commission* [2014] ECLI-93853, [68–72].

26 The General Court annulled the Commission's decision to declare the tax amortisation scheme as incompatible aid which had to be recovered, as was stipulated in the Articles 1(1) and 4 of Decision 2011/3 in judgement T-219/10 *Autogrill España v Commission* [2014] ECLI-939, [85, 89] and the Articles 1(1) and 4 of Decision 2011/282/EU in judgment T-399/11 *Banco Santander and Santusa v Commission* [2014] EU:T:2014:938, para. 89, 93.

27 Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa* [2016] ECLI-981, [54, 71].

28 Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa* [2016] ECLI-981, [74, 75].

29 Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa* [2016] ECLI-981, [71-77].

30 Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa* [2016] ECLI-981, [65-69].

31 Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa* [2016] ECLI-981, [104]. See Opinion of AG Wathelet in Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa* [2016] ECLI-981, [84-85].

group of beneficiaries was treated preferentially.[32] On the contrary, the ECJ finds that the Commission, could conclude that the amortisation scheme, through its effects, is a derogation which does not treat all undertakings equally, as only undertakings that have assets shareholdings abroad can apply for a tax reduction.[33] According to the ECJ, the General Court erred in law, because of the fact that the Commission had correctly applied the material selectivity test. The Court annuls the judgments of the General Court concerning the compatibility and refers the case back to the General Court for the assessment of Article 107(1) TFEU.[34]

32 Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa* [2016] ECLI-981, [78].

33 Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa* [2016] ECLI-981, [79-82].

34 Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free, Banco Santander and Santusa* [2016] ECLI-981, [123].

## IV. Concluding Remarks

In the end the judgement of the ECJ in *Gibraltar* remains the clear landmark judgment for the correct application of the selectivity criterion. It brought the necessary clarity in the field of fiscal aids and has contributed to the interpretation of the selectivity criterion as a precondition for non-discrimination. In *World Duty Free*, the ECJ prevented that the General Court eroded the material selectivity test. The ECJ made a clear distinction between determining a normal reference system on its inherent discriminatory nature and determining a derogation of a normal reference system by investigating the effects of the measure to economic undertakings in a comparable situation. By doing so, the ECJ clarified the concept of selectivity in line with the purpose of the *Gibraltar* judgment. And in line with Rossi-Maccanico's earlier description, the concept of material selectivity now truly rests on two pillars of Hercules: the judgments in *Gibraltar* and *World Duty Free*.