

COMMISSION

COMMISSION DECISION

of 30 March 2004

on the aid scheme implemented by the United Kingdom in favour of Gibraltar Qualifying Companies

(notified under document number C(2004) 928)

(Only the English text is authentic)

(Text with EEA relevance)

(2005/77/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⁾ and having regard to their comments,

Whereas:

mation on a number of tax measures, including the Gibraltar qualifying companies regime. The United Kingdom replied by letter dated 22 July 1999. The Commission requested further information on 23 May 2000 and a reminder was sent on 28 June 2000. The United Kingdom replied on 3 July 2000. By letter dated 12 September 2000, the United Kingdom submitted information on the Exempt Companies regime (A/37430). A meeting was held with the United Kingdom and Gibraltar authorities on 19 October 2000 to discuss Gibraltar's offshore tax schemes, the Qualifying Companies regime and the Exempt Companies regime. Further information in response to questions raised at that meeting were submitted by the United Kingdom on 8 January 2001 (A/30254).

- (2) By letter dated 11 July 2001 (D/289757), the Commission informed the United Kingdom that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the Gibraltar Qualifying Companies regime. Following an extension of the one month deadline, the United Kingdom replied by letter dated 21 September 2001 (A/37407).

I. PROCEDURE

- (1) By letter dated 12 February 1999 (D/50716), the Commission asked the United Kingdom to provide infor-

- (3) By application lodged at the Registry of the Court of First Instance of the European Communities on 7 September 2001, the Government of Gibraltar brought an action for

⁽¹⁾ OJ C 26, 30.1.2002, p. 9.

annulment of Decision SG(2001) D/289755 initiating the formal investigation procedure into the Gibraltar Qualifying Companies regime; the action was registered as Case T-207/01. A further application was brought by the Government of Gibraltar on the same date for the adoption of interim measures to suspend the Decision SG(2001) D/289755 to initiate the formal investigation procedure and to order the Commission to refrain from publishing it (Case T-207/01 R). By Order dated 19 December 2001, the President of the Court of First Instance dismissed the application for interim measures⁽²⁾. In its judgment of 30 April 2002, the Court of First Instance dismissed the application for annulment of the Decision⁽³⁾.

- (4) On 21 November 2001, the Commission requested information on the tax rate applicable to Qualifying Companies. In the absence of a reply, the Commission issued a formal reminder on 21 March 2002 (D/51275). The United Kingdom replied on 10 April 2002 (A/32681). Further clarification was requested by the Commission on 28 October 2002 (D/56088). The United Kingdom replied on 11 November 2002 (A/38454) and added additional remarks by letter dated 13 December 2002 (A/39209).
- (5) 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⁾. By letters dated 27 February 2002 (A/31518) and 28 February 2002 (A/31557), comments were received respectively from Charles A. Gomez & Co. barristers and acting solicitors from the Government of Gibraltar. These comments were forwarded to the United Kingdom, which replied by letter dated 25 April 2002 (A/33257).

II. DESCRIPTION OF THE MEASURE

- (6) The definition of a Qualifying Company is set out in Gibraltar's Income Tax (Amendment) Ordinance of 14 July 1983. Detailed rules for the implementation of the Qualifying Company regime have been adopted by means of the Income Tax (Qualifying Companies) Rules of 22 September 1983; these rules together are referred to in this Decision as 'the Qualifying Company legislation'.

⁽²⁾ Joined Cases T-195/01 R and T-207/01 R *Gibraltar v Commission* R [2001] ECR II-3915.

⁽³⁾ Joined Cases T-195/01 and T-207/01 *Gibraltar v Commission* [2002] ECR II 2309.

⁽⁴⁾ See footnote 1.

- (7) In order to obtain the Qualifying Company status, a company must fulfil, *inter alia*, the following conditions:
- it must be registered in Gibraltar under the Companies Ordinance,
 - it must have a paid up share capital of GBP 1 000 (or foreign currency equivalent),
 - it must deposit GBP 1 000 with the Gibraltar Government as security for future taxes,
 - it must pay a fee of GBP 250 for a Qualifying Company Certificate,
 - no Gibraltarian or Gibraltar resident may have a beneficial interest in the shares of the company,
 - it cannot keep any register of shares outside Gibraltar and must be prohibited by its memorandum or articles of association from doing so,
 - the company may not, without the prior consent of the Gibraltar Finance Centre Director, trade or carry on business in Gibraltar, with Gibraltarians or residents of Gibraltar. It may, however, trade with other Exempt or Qualifying companies.
- (8) A company which fulfils the above conditions obtains a Qualifying Company Certificate. Once issued the Certificate is valid for 25 years.
- (9) A Qualifying Company is liable to taxation on its profits at a rate which is always lower than the normal corporate tax rate, which currently stands at 35%. The rate of tax applied is negotiated between the company concerned and the Finance Centre Division, part of the Gibraltar Government's Department of Trade, Industry and Telecommunications. There is no statutory guidance for the conduct of these negotiations. The vast majority of Qualifying Companies pay a rate of tax of between 2 and 10% and, recently, the policy of the Gibraltar authorities has been to ensure that all Qualifying Companies pay between 2 and 10%. Within these parameters, the rate of tax is set with a view to ensuring consistency between all companies operating in the same sector⁽⁵⁾. The tax rates are:

⁽⁵⁾ Approximately 12 companies fall outside this 2 to 10% range. The tax rates for such companies have been negotiated on a case-by-case basis. They range from 0,5 to 1,5% and from 21 to 34%. There is no correlation between the tax rate applied and the area of activity of the company. The companies operate in diverse sectors including private investment holdings, marketing and selling holiday homes, offshore banking, ship repair and marketing consulting services.

Sector	Rate of taxation (%)
Private investment	5
Financial services	5
Gaming	5
Satellite operations	2
Shipping services including repair and conversion	2
General traders	5
Consultancy services	5
Others (e.g. philatelic services, commission agents)	2-10

(10) Other benefits resulting from the Qualifying Status include:

— fees payable to non-residents (including directors) and dividends paid to its shareholders are subject to withholding tax at the same prescribed rate as the company,

— there is no stamp duty on the transfer of shares of a Qualifying Company.

(11) According to information supplied by the United Kingdom, in circumstances where the intended operation requires a 'bricks and mortar' presence in Gibraltar, the company undertaking such activity would usually obtain Qualifying Company status rather than Exempt Company⁽⁶⁾ status. Qualifying Companies are also of particular benefit in situations where a subsidiary company needs to make income remittances to a foreign parent and is required to have suffered tax at a certain level to reduce further taxation in the home country.

III. GROUNDS FOR INITIATING THE PROCEDURE

(12) In its evaluation of the information submitted by the United Kingdom in the course of its preliminary investigation, the Commission considered that the relief from the obligation to pay the full amount of corporation tax was liable to confer an advantage on Qualifying Companies. 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 derogations on the general prohibition on State aid provided for in Articles 87(2) and 87(3) of the Treaty applied. On these 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 THE GOVERNMENT OF GIBRALTAR

(13) The Government of Gibraltar makes comments under four headings:

— the Qualify Companies legislation does not constitute aid within the meaning of Article 87 of the Treaty,

— if the Qualifying Companies legislation constitutes aid, it is existing aid and not new, illegal aid,

— if the Qualifying Companies legislation constitutes aid, it is compatible with the common market by virtue of the exemption provided for in Article 87(3)(b) of the Treaty,

— if the Qualifying Companies legislation constitutes illegal and incompatible aid, an order for the recovery of the aid would be contrary to general principles of Community law.

(14) These comments can be summarised as follows.

The Qualifying Companies legislation does not constitute aid

(15) Article 87(1) of the Treaty is not applicable to tax schemes, such as the Qualifying Company legislation, which are designed to operate in an international context. In particular, given that Qualifying Company status is granted to the extent that such companies do not undertake business within Gibraltar, there is no advantage in the form of an exemption from the normally applicable tax rates, as Gibraltar is not competent to grant an advantage relating to another jurisdiction.

(16) Although the Gibraltar Government accepts that the advantages granted by the Qualifying Company regime are ring-fenced from the domestic market in the sense of paragraph B of the Code of Conduct for Business Taxation⁽⁷⁾, adopted by the Resolution of the Council and the representatives of the governments of the Member States meeting within the Council of 1 December 1997, no State resources are involved. The measure places no financial burden on the budget of the Government of Gibraltar.

⁽⁶⁾ Exempt Companies do not pay tax on their profits, but instead pay a fixed annual tax of GBP 225 to 300.

⁽⁷⁾ OJ C 2, 6.1.1998, p. 2.

- (17) The measure is not selective since a Qualifying Company can be set up by any natural or legal person, irrespective of nationality or economic activity. The Gibraltar Government accepts that Qualifying Company status is not available to companies which trade in Gibraltar or in which Gibraltarians or Gibraltar residents have a beneficial interest. However, this is at most an act of reverse discrimination which does not affect competition.
- (18) The measure falls outside the scope of Article 87(1) of the Treaty insofar as some Qualifying Companies are established by individuals for tax planning reasons, for holding assets or property, or for managing their personal wealth. Such companies do not trade, produce or compete in the market.
- (19) Gibraltar does not form part of the Community's common customs territory and is treated as a third country for the purpose of trade in goods. Article 87 of the Treaty therefore cannot apply to any aid perceived to be granted to undertakings engaged in trade in goods, as goods produced in Gibraltar do not circulate freely in the common market but are subject to customs formalities. Trade between Member States cannot be affected in such circumstances.
- (20) The reasoning used in Commission Decision 2000/394/EC of 25 November 1999 on aid to firms in Venice and Chioggia by way of relief from social security contributions under Laws No 30/1997 and No 206/1995⁽⁸⁾, to find that the advantage granted to certain firms did not constitute State aid within the meaning of Article 87(1) of the Treaty applies to Qualifying Companies established for tax planning purposes and to those trading in goods.
- (21) A large number of companies enjoying Qualifying status would benefit from the currently applicable *de minimis* rules.

The Qualifying Companies legislation constitutes existing aid rather than illegal aid

- (22) The Qualifying Companies legislation dates from 1983, a time when it was far from clear to the Commission, to Member States or to economic operators whether, and to what extent, State aid rules were to be systematically

applied to national legislation on company taxation. There are few if any examples before the 1990s of Commission State aid action against general corporate tax measures. The legislation predates by 10 years the liberalisation of capital movements and by 15 years the clarification of the concept of State aid made by the Commission in its Notice on the application of the State aid rules to measures relating to direct business taxation⁽⁹⁾ (hereinafter the Notice). The Qualifying Companies legislation was modelled on the Exempt Company legislation of 1967, which predates the accession of Gibraltar to the European Union in 1973.

- (23) The Qualifying Companies legislation was notified to the 'Primarolo' group established in accordance with paragraph H of the Code of Conduct for Business Taxation by the United Kingdom Government even before the publication of the Notice of 1998. At the time there was no indication that measures designated as harmful under the Code of Conduct for Business Taxation would be treated by the Commission as new, unnotified aid measures.
- (24) The Notice contains the first comprehensive, albeit not exhaustive, definition of 'fiscal State aid'. It is an administrative innovation and can be regarded more as a policy statement as to future Commission action in this area rather than as a 'clarification' of the applicable legislation.
- (25) Article 1(b)(v) of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty⁽¹⁰⁾ provides that measures may become aid as a result of the evolution of the common market and through liberalisation of certain activities. The Qualifying Companies legislation constitutes a measure, as referred to in that provision, which became aid only subsequently. By failing to regard Qualifying Companies legislation as existing aid, the Commission is applying, retroactively, the relatively refined State aid criteria of 2001 to the different legal and economic situation which prevailed in 1983. In this regard, the Irish company tax scheme was initially not classified as aid, although the Commission's view subsequently changed⁽¹¹⁾ and reflected the gradual tightening of Community discipline regarding such tax incentive schemes.

⁽⁹⁾ OJ C 384, 10.12.1998, p. 3.

⁽¹⁰⁾ OJ L 83, 27.3.1999, p. 1. Regulation as amended by the 2003 Act of Accession.

⁽¹¹⁾ OJ C 395, 18.12.1998, p. 19.

⁽⁸⁾ OJ L 150, 23.6.2000, p. 50, recitals 90, 91 and 93.

- (26) By using its discretion to treat the Qualifying Companies legislation as new, illegal aid, the Commission has infringed the principle of proportionality. Such treatment has dramatic economic consequences. The significant damage that will be caused is disproportionate to any Community interest which might be served by the initiation of a procedure in respect of illegal aid, particularly in view of the diminutive size of Gibraltar's economy and the necessarily insignificant impact of the legislation in issue on competition and on international trade. The Commission would have taken a more equitable approach if it had considered the qualifying company legislation either under the Code of Conduct for Business Taxation, under Articles 96 and 97 of the Treaty or under the procedure applicable to existing aid.
- (27) Last, the Commission has infringed the principles of legal certainty and legitimate expectations by waiting 18 years before challenging the Qualifying Companies legislation and by not carrying out its investigation into the legislation within a reasonable time. The conformity of the legislation with Community law was never doubted by the Commission before February 1999. By analogy with the *Defrenne* case⁽¹²⁾, this prolonged failure by the Commission to act gave rise to legitimate expectations on the part of Gibraltar.
- (28) The Commission's investigations should be subject to a limitation period. Thus, pursuant to Article 15 of Regulation (EC) No 659/1999, any individual aid granted under an aid scheme 10 years before the Commission takes action must be deemed to be existing aid. Applying that rule, the Commission should have regarded the Qualifying Companies legislation as an existing aid scheme. In any event, the Commission infringed the principles of legitimate expectations and of legal certainty by allowing an excessively long period to elapse after opening its investigation into the legislation. The preliminary investigation began on 12 February 1999, but the formal investigation procedure was not initiated until two and a half years later. The preliminary investigation was punctuated by long periods of inactivity by the Commission. Given that there was some doubts within the Commission as late as November 2000 as to the utility of opening the State aid procedure on the harmful measures identified by the Code of Conduct Group, it is reasonable to claim that the existing aid procedure should have been used.

Compatibility by virtue of Article 87(3)(b) of the Treaty

- (29) Article 87(3)(b) of the Treaty provides that aid to remedy a serious disturbance in the economy of a Member State

may be considered to be compatible with the common market. The Qualifying Companies legislation was enacted a year before the closure of the Royal Navy Dockyard (announced in 1981) and at a time when the British military presence in Gibraltar was being scaled down. The Dockyard was Gibraltar's main source of employment and income, accounting for 25% of employment and 35% of gross domestic product (GDP). Its closure caused serious disturbances to the Gibraltar economy, including structural change and economic distress in terms of unemployment, increased social costs and exodus of qualified workers. The Qualifying Companies legislation was a response to these serious disturbances.

- (30) Although the Commission and the Court of Justice of the European Communities have interpreted Article 87(3)(b) of the Treaty strictly as meaning that the disturbance in question must affect the whole economy of the Member State and not merely that of one of its regions or parts of its territory⁽¹³⁾, there are grounds for applying the exemption under Article 87(3)(b) to Gibraltar. Unlike a region or territory of a Member State, Gibraltar is in every relevant way totally separated from the United Kingdom, notably in constitutional, political, legislative, economic, fiscal and geographical terms. It is the only territory to which Community law applies by virtue of Article 299(4) of the Treaty. The Gibraltar and United Kingdom economies are entirely distinct and separate. Gibraltar receives no financial assistance from the United Kingdom and raises its own revenue to meet its expenditure commitments. Consequently, disturbances which affect one economy do not generally affect the other, as is the case with the bovine spongiform encephalopathy crisis, a disturbance which affected the United Kingdom economy but not Gibraltar, treated as an exceptional occurrence within the meaning of Article 87(2)(b) of the Treaty.

An order for the recovery of the aid would be contrary to general principles of Community law

- (31) Essentially similar reasoning to that summarised in recitals 22 to 28 on the question of existing aid can be used to argue in favour of the principle of legitimate expectations in the context of recovery. These arguments notably cover uncertainty on the scope of the State aid rules, the novelty of Commission action on corporate tax measures and the significance of the Notice as a policy statement, the age of the measure, notification to the Primarolo group, evolution of the common market and

⁽¹²⁾ Case 43/75 *Defrenne v Sabena* [1976] ECR 455, paragraphs 72, 73 and 74.

⁽¹³⁾ Joined cases T-132/96 and T-143/96, *Freistaat Sachsen and others v Commission* [1999] ECR II-3663 p. 167 et seq.

liberalisation, proportionality, prolonged failure of the Commission to act and the delays in the preliminary investigation. The legitimate expectations thus created prevent an order for recovery. In particular, at all times, both the Government of Gibraltar and the beneficiaries have acted in good faith.

(32) Paragraph 26 of the Decision opening the formal investigation procedure⁽¹⁴⁾ included a specific request for comments on possible legitimate expectations that would pose an obstacle to the recovery of aid. In its defences in cases T-207/01 and T-207/01 R, the Commission confirmed its hesitations as to the possibility of a recovery order and emphasised the unusual nature of the request for specific comments. The Commission also stated that the uncertainty that might have existed and the possibility that the measure existed in a 'grey zone' of legal uncertainty gave rise at most to a legitimate expectation and to a debate over the recovery of aid already paid. In his Order of 19 December 2001, the President of the Court of First Instance observed that this unusual request might convince companies not to leave Gibraltar and must, at first sight, allay to a considerable extent any concerns that beneficiaries might have⁽¹⁵⁾. Accordingly, the Commission has led the Gibraltar Government and beneficiaries to believe that recovery will not be ordered.

(33) The application of Article 87 of the Treaty to a classic 'offshore' scheme is novel and still has conceptual difficulties as regards the determination of an advantage, the financial burden on the State and selectivity.

(34) The Commission itself, at the time of opening the formal investigation, was, exceptionally, not able to decide the question of existing aid.

(35) Recovery would be contrary to the principle of proportionality. Under Community law, when there is a choice between several courses of action, the least onerous must be followed. The disadvantages caused must not be disproportionate to the aims pursued.

(36) Recovery of aid granted over the previous 10 years would place a disproportionate burden on the Gibraltar authorities. Gibraltar is a small territory with limited administrative resources, only around 2 000 companies are assessed for taxation in any given year. Recovery would involve, *inter alia*, requesting suitable accounts from Qualifying Companies (including those no longer

active), assessment of the tax liability for each year, issuing tax demands, handling appeals and counter appeals and pursuit of non-payment of tax due. The administrative burden, the limited powers of investigation of the Gibraltar Tax Department, the impossibility of tracing companies which have ceased activity and the absence of company assets in Gibraltar would paralyse governmental activity with no guarantee of achieving satisfactory recovery.

(37) Recovery would have a disproportionate effect on the Gibraltar economy and would be a disproportionate penalty in view of the circumstances which led to the adoption of the Qualifying Companies legislation, the limited effect on competition and trade and the small size of the beneficiaries. Financial services account for approximately 30% of Gibraltar's GDP and the employment directly related to Qualifying Companies is estimated at 1 400 (out of a total workforce of around 14 000). The financial sector has a significant impact on virtually all other sectors of the economy. A recovery order would lead to the winding-up, bankruptcy or exodus of the Qualifying Companies, a destabilisation of the financial services sector and a major unemployment crisis, in turn causing political, social and economic instability.

(38) A large number of Qualifying Companies would not be assessable to Gibraltar taxation as their income is not derived from, accrued or received in Gibraltar. As a result of the conditions for eligibility, in many cases, the beneficiaries would have no assets within Gibraltar's jurisdiction. Others which have ceased trading would be untraceable.

(39) A large number of beneficiaries would be in receipt of aid which would comply with the *de minimis* rule.

V. COMMENTS FROM CHARLES A. GOMEZ & CO.

(40) The comments from Charles A. Gomez & Co. can be summarised as follows.

(41) The Gibraltar legal profession has a substantial dependency on Finance Centre work to which Qualifying Companies make a major contribution. Some 130 legal practitioners employ several hundred more staff and make a substantial contribution indirectly to employment in Gibraltar and Spain.

⁽¹⁴⁾ See footnote 1.

⁽¹⁵⁾ Joined Cases T-195/01 R and T-207/01, paragraphs 104 and 113.

- (42) The recourse to Article 87(3)(a) of the Treaty cannot be restricted to areas where the standard of living is already low or where there is already serious unemployment. The principle of Article 87(3)(a) must also apply in the interest of preventing unemployment and poverty. When the Qualifying Company legislation was enacted, Gibraltar was faced with 20 years of economic sanctions by Spain and the imminent closure of the Royal Navy Dockyard. Faced with the option of poverty, unemployment and emigration, Gibraltar found an alternative source of prosperity by establishing the Gibraltar Finance Centre, to which the Qualifying Companies legislation is a major contributor. The European interest cannot link acceptance of poverty and unemployment by ruling out the application of Article 87(3)(a) of the Treaty to this situation when viable alternatives are available. Unlike other major financial centres, the Gibraltar centre was established through necessity. This necessity, self defence and the duty to mitigate damage caused by others all justify the Qualifying Companies legislation.
- (43) Since accession in 1973, the Community institutions have failed to defend the rights and interests of citizens of the Union residing in Gibraltar. Despite a judgment of the Court of Justice, citizens of the Union in Gibraltar are not represented in the European Parliament. In the absence of any involvement in the 'EU territory of Gibraltar', the insistence by the Commission on notification of defensive measures taken by Gibraltar appears excessive.

VI. COMMENTS FROM THE UNITED KINGDOM

- (44) The United Kingdom restricted its initial comments to the question of recovery of aid and to regional selectivity and made further observations in its comments on those of the Government of Gibraltar. They can be summarised as follows.

Recovery of aid

- (45) If the Qualifying Companies legislation is found to be illegal aid incompatible with the common market, there is a general principle of Community law, legitimate expectations, which precludes any order for recovery of aid already paid. Although legitimate expectations arise in only exceptional circumstances where a recipient could legitimately have assumed that the aid was lawful⁽¹⁶⁾, such circumstances exist in this case and it would be inappropriate and unlawful for the Commission to make an order for recovery.
- (46) This procedure under Article 88(2) of the Treaty flows from the adoption of the Code of Conduct for Business Taxation in 1997 in which the Commission committed itself to the strict application of the State aid rules to

measures relating to direct business taxation. It is implicit in that statement that in the past, the State aid rules had not been so strictly applied to fiscal regimes of the type addressed in the Code of Conduct for Business Taxation.

- (47) It is highly unlikely that in 1984, any consideration was given by either the Government of Gibraltar or the United Kingdom Government to the possibility that the rules in question were in breach of the United Kingdom's State aid obligations. While it was clear at that time that a highly specific or sectoral tax advantage was capable of being State aid, the application of the State aid rules to more general company tax schemes, such as the Qualifying Companies regime, had been the subject of neither serious academic comment nor pronouncement by the Commission. It would be unreasonable to expect diligent businessmen to raise questions about the compliance of the measure with the State aid rules. They would have made business plans and altered their economic positions on the basis of the Qualifying Companies legislation and were entitled to assume that the tax benefits were lawful.
- (48) Point 26 of the Notice specifically mentions circumstances where non-resident companies are treated more favourably than resident ones. This was the first time that differential tax treatment between resident and non-resident companies had been acknowledged by the Commission as an act of selection or 'specificity' capable of bringing the State aid rules into play. The Qualifying Companies legislation had been in place for many years prior to this time without any criticism or comment from the Commission.

Regional specificity

- (49) The sole fact that the Qualifying Companies regime is a feature of Gibraltar legislation that has no application in the rest of the United Kingdom cannot give rise to the element of selectivity required by Article 87(1) of the Treaty. Gibraltar is a separate jurisdiction from the rest of the United Kingdom for tax purposes, with autonomy in relation to tax matters. It is not the case that any divergence between taxation laws applicable in Gibraltar and those applying in the rest of the United Kingdom would automatically give rise to State aid. One jurisdiction within a Member State with autonomy in relation to taxation matters cannot create a State aid purely because a particular aspect of its taxation system results in a lower (or higher) level of taxation than that applicable to the rest of the Member State. If a tax measure is general within the relevant tax jurisdiction, it cannot be caught by Article 87(1) of the Treaty. To rule otherwise would be to call into question the tax raising and tax varying powers enjoyed by devolved and decentralised administrations across the Community. This would constitute a serious intervention in Member States' constitutional arrangements.

⁽¹⁶⁾ Case 223/85, *Rijn-Schelde-Verolme v Commission* [1987] ECR 4617.

Government of Gibraltar's comments

- (50) The United Kingdom supports the Government of Gibraltar's contention that the Qualifying Companies legislation should be treated as existing aid in accordance with Article 1(b)(v) of Regulation (EC) No 659/1999. In the 1970s and 1980s it was universally assumed that Member States' sovereignty over fiscal issues was not limited by the State aid rules as far as entire corporate tax systems were concerned. The Commission made no attempt to apply the State aid rules to the Gibraltar tax regime or indeed to other tax regimes within the Community, which offered favourable tax treatment to certain classes of company over others. It was only after agreement on the complete liberalisation of capital movements and financial services liberalisation in the 1980s and early 1990s and then on the establishment of a Single Currency in the 1990s that attention was seriously focused on limiting harmful competition arising out of Member State tax regimes. The use of the State aid provisions of the Treaty to give effect to such tax policy is a phenomenon only experienced in the last four years. The common market has evolved over the last three decades and many State aid instruments today would not have been considered State aid 30, 20 or even 10 years ago.
- (51) Even if the Commission is correct in the light of the current state of Community law in viewing the introduction of the Qualifying Companies legislation as a State aid measure which would require notification if adopted today, neither the Commission nor the Court of Justice would have considered it to be State aid requiring notification at the time it was adopted. In 1984 Spain was not yet a Member State, and many Member States maintained banking laws and exchange controls preventing the use of tax advantages such as those available in Gibraltar. It is far from clear that the Gibraltar measures were capable of distorting competition and affecting trade between Member States at that time.
- (52) At that time, the Commission itself addressed cases of differential tax treatment where possible, using Article 95 of the Treaty (now Article 90), rather than relying on the State aid rules. Academic commentators and tax law practitioners did not consider that State aid principles applied to cases other than those where specific tax exemptions were offered to individual companies or groups of companies for industrial policy reasons. It is not possible to sustain an argument that measures such as the Gibraltar Qualifying Companies legislation were capable of being State aid until after the publication of the Notice on 10 December 1998.
- (53) On the question of recovery, the United Kingdom in particular endorses the Government of Gibraltar's arguments that the Commission's commitment systematically to apply the State aid rules to direct taxation measures is novel and that any aid would be impossible

to recover. Recovery would place a disproportionate burden on the Gibraltar authorities, many Qualifying Companies would not have a corporation tax liability in Gibraltar, it would be impossible to assess and/or recover the aid in a large number of cases and many beneficiaries would be in receipt of *de minimis* aid.

VII. ASSESSMENT OF THE AID MEASURE

- (54) After having considered the observations of the United Kingdom authorities as well as those of the Government of Gibraltar and Charles A. Gomez & Co., the Commission maintains its position, expressed in its decision of 11 July 2001⁽¹⁷⁾ to the United Kingdom authorities initiating the procedure under Article 88(2) of the Treaty, that the scheme under examination constitutes unlawful, operating State aid, within the scope of Article 87(1) of the Treaty.

Existence of aid

- (55) In order to be considered State aid within the meaning of Article 87(1) of the Treaty, a measure must fulfil the four following criteria.
- (56) First, the measure must afford the beneficiaries an advantage that reduces the costs they normally bear in the course of their business. According to point 9 of 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 Qualifying Companies regime clearly fulfils this criterion. Rather than be subject to income tax at the standard Gibraltar corporate rate of 35%, Qualifying Companies negotiate their rate of tax with the Gibraltar authorities as described in recital (9) above.
- (57) The observation that Qualifying Companies legislation is a tax scheme designed to operate in an international context is not relevant to its qualification as a State aid measure. Although the Commission accepts the argument that Gibraltar is not competent to grant tax advantages relating to other jurisdictions, the fact that Qualifying Companies negotiate their tax rate, demonstrates clearly that they earn revenue which, in the absence of their special treatment, would be subject to company taxation at the standard rate. Irrespective of the type of activities in which Qualifying Companies may be active, their Qualifying status is granted to the extent that they are companies registered in Gibraltar or are registered branches of overseas companies. Consequently, Qualifying Companies benefit from a special and more beneficial tax treatment in Gibraltar, when compared with other companies registered in Gibraltar.

⁽¹⁷⁾ See footnote 1.

- (58) Second, the advantage must be granted by the State or through State resources. The grant of a tax reduction, such as that negotiated between a Qualifying Company and the Gibraltar 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.
- (59) The Government of Gibraltar's argument that, through ring-fencing, the measure places no apparent burden on its budget, must be rejected. The Commission considers that the tax advantage, for the purposes of Article 87(1) of the Treaty, is granted through State resources, since the origin of this advantage is the renunciation by the Member State of tax revenue which it would normally have received⁽¹⁸⁾. In the absence of the ring-fenced tax advantage, the activities of Qualifying Companies, to the extent that they occur under the jurisdiction of the Gibraltar authorities, would be subject to the full rate of tax in Gibraltar. This difference in tax rate represents the tax revenue foregone.
- (60) Third, the measure must affect competition and trade between Member States. This criterion is fulfilled to the extent that Qualifying Companies are able, actually or potentially, to trade with companies located in other Member States or to be active in third country markets open to undertakings from other Member States. This is particularly the case since Qualifying Companies may not, in normal circumstances, trade or carry on business in Gibraltar, with Gibraltarians or with residents of Gibraltar.
- (61) Even if some Qualifying Companies are established by individuals for tax planning purposes and do not trade, produce or compete in the market, they are not precluded from doing so. However, the fact that Qualifying Companies tend to have a 'bricks and mortar' presence in Gibraltar and generate income that is subject to company taxation, albeit at a reduced rate, suggests that they do in fact engage in economic activity. This is confirmed by the wide range of sectors in which Qualifying Companies are active (see recital 9).
- (62) The Commission notes that Gibraltar does not form part of the Community's common customs territory. However, this does not affect the application of the State aid rules to those undertakings in Gibraltar engaged in trade in goods. Such undertakings are not precluded from trading with undertakings within the common customs territory, nor are they precluded from competing in third country markets where other Community undertakings are active, actually or potentially. Therefore, to the extent that the tax advantage granted to Qualifying Companies engaged in trade in goods strengthens their position, trade and competition is affected.
- (63) The parallels drawn with the Commission's reasoning in Decision 2000/394/EC in respect of aid to firms in Venice and Chioggia must also be rejected. The circumstances of the two cases are quite different. In particular, the conclusion that there was no impact on trade and consequently no aid to three particular companies was based, *inter alia*, on the local nature of the services provided. These considerations are clearly not applicable to Qualifying Companies, which, as the Government of Gibraltar itself points out, operate in an international context.
- (64) The *de minimis* rule cannot be used to justify the application of the Qualifying Companies regime. There is no mechanism to prevent the grant of aid in excess of that allowed under the *de minimis* rule, nor does the measure exclude sectors where the *de minimis* rule does not apply.
- (65) Last, 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 Gibraltar companies in whose shares no Gibraltarian or Gibraltar resident may have a beneficial interest. In addition, Qualifying Companies may not in normal circumstances trade or carry on business in Gibraltar with Gibraltarians or residents of Gibraltar. The measure is therefore selective, in so far as it grants privileged tax treatment to those non-Gibraltar owned companies operating in or from Gibraltar.
- (66) The observation that the measure is not selective because any person can establish a Qualifying Company and that the limitations on the availability of Qualifying Company status is an act of reverse discrimination against Gibraltar residents fails to demonstrate that the measure is not selective. When examining a measure, comparison must be made with the generally applicable system, in this case the standard regime of corporation tax in Gibraltar. The Qualifying Company regime is clearly an exception to the general system.

⁽¹⁸⁾ See, for instance, Case C-156/98 *Germany v Commission* [2000] ECR I-6857, paragraph 26.

(67) The Commission notes the United Kingdom's observations on regional specificity. The Commission also notes that the United Kingdom has not attempted to argue that the Qualifying Companies regime constitutes a general measure within the Gibraltar tax jurisdiction. The Commission accordingly stands by its conclusion that the measure is materially selective within Gibraltar. It is therefore not necessary to examine in this case the question of regional selectivity which is assessed in detail in the Commission decision of 30 March 2004 on the Gibraltar Government Corporation Tax Reform⁽¹⁹⁾.

Existing aid or illegal aid

(68) This question has been considered by the Court of First Instance, which rejected the Government of Gibraltar's arguments against the Commission's provisional assessment of illegal aid in respect of the Qualifying Companies regime⁽²⁰⁾. Regardless of whether it was modelled on the 1967 Exempt Company regime, the Qualifying Company legislation was enacted in 1983, after the United Kingdom's accession to the Community. It therefore cannot be considered to be 'existing aid' within the meaning of Article 1(b)(i) of Regulation (EC) No 659/1999. The Court of First Instance itself concluded that there were sufficient grounds for the Commission to open the formal investigation procedure.

(69) As early as 1973, the European Court of Justice expressly confirmed the applicability of the State aid rules to fiscal measures⁽²¹⁾. Even if there have been few examples of Commission action against general corporate tax measures, this does not affect the existing or illegal nature of the aid measure. In this case, the Qualifying Companies legislation is not a general corporate tax measure, but quite specific in its scope. In any event, the application of a Treaty provision for the first time to a particular situation does not constitute the retroactive application of a new rule.

(70) The Qualifying Companies legislation was not notified to the Commission in accordance with Article 88(3) of the Treaty. The fact that it was brought to the attention of the Primarolo group cannot be treated as formal notification to the Commission under the State aid rules.

(71) As for the Notice constituting an administrative innovation or policy statement, the Court of First Instance has already confirmed⁽²²⁾ that 'nowhere in (the Notice) does the Commission announce any change of practice in its decisions concerning the assessment of tax measures in the light of Article 87 EC and 88 EC'. It therefore follows that the United Kingdom is wrong to assert that measures such as the Qualifying Companies regime were not capable of being classified as State aid until after the publication of the Notice.

(72) In advancing its claim that the Qualifying Companies legislation became aid only after it was put into effect in 1983 in the sense of Article 1(b)(v) of Regulation (EC) No 659/1999, the Government of Gibraltar argues, with the support of the United Kingdom, that the measure predates the liberalisation of capital movements by 10 years. However, this general observation has not been supported by specific arguments relating to Qualifying Companies and therefore cannot, *per se*, establish that the measure, in 1983, did not constitute aid. It is clear from the legislation itself that there are no limitations on the sectors of economic activity in which Qualifying Companies can engage. The extent to which, if at all, unspecified restrictions on capital movements in 1983 affected companies benefiting from the tax advantages granted by the measure is therefore not apparent.

(73) Even if, as the United Kingdom maintains, some Member States' banking laws and exchange controls, at the time, prevented the use of such offshore tax advantages, the existence of the tax benefits would nevertheless still have strengthened the position of Qualifying Companies in markets not subject to such restrictions compared with their competitors in other Member States. In this respect, the Government of Gibraltar has advanced essentially the same arguments used in its pleadings before the Court of First Instance. The Court rejected these arguments against the Commission's provisional classification of the Qualifying Companies legislation and concluded that such 'general arguments are not capable of establishing that the 1983 tax scheme must, owing to its intrinsic characteristics, be classified as an existing aid scheme'⁽²³⁾. The Court also rejected parallels drawn with the Irish Corporation Tax case⁽²⁴⁾ on the grounds that the factual and legal circumstances were quite different⁽²⁵⁾. The Commission therefore sees no grounds on which to change its view.

⁽¹⁹⁾ Commission decision of 30 March 2004, not yet published.

⁽²⁰⁾ See Joined Cases T-195/01 and T-207/01, paragraphs 117-131.

⁽²¹⁾ Case 173/73, *Italy v Commission*, [1974] ECR 709, paragraph 13.

⁽²²⁾ Joined cases T-269/99, T-271/99 and T-272/99, *Diputación Foral de Guipúzcoa and others v Commission* [2002] ECR II-4217, paragraph 79.

⁽²³⁾ See Joined Cases T-195/01 and T-207/01.

⁽²⁴⁾ OJ C 395, 18.12.1998, p. 14.

⁽²⁵⁾ Joined Cases T-195/01 and T-207/01, paragraphs 120 and 123.

- (74) As for the alleged infringements of the principles of proportionality, legal certainty and legitimate expectations, the arguments of the Government of Gibraltar presume a margin of discretion that the Commission does not possess. In the *Piaggio* case⁽²⁶⁾, the Court ruled that the Commission's classification of the scheme at issue as an existing aid, for reasons of practical expediency, when that scheme had not been notified in accordance with Article 88(3) of the Treaty, could not be accepted. Accordingly, as confirmed by the Court of First Instance⁽²⁷⁾, the classification of a measure as new or existing aid must be determined without reference to the time which has elapsed since the measure was enacted and independently of any previous administrative practice, regardless of any alleged economic consequences. For these reasons, the suggestion by Charles A. Gomez & Co. and the United Kingdom that the Commission has acted excessively by considering the measure to have required notification must be rejected. Similarly, the limitation period in Article 15 of Regulation (EC) No 659/1999 does not set out a general principle under which illegal aid is transformed into existing aid but merely precludes recovery of aid established more than 10 years before the Commission's first intervention.
- (75) The Commission notes that the procedure under Articles 96 and 97 of the Treaty concerns differences between general provisions of Member States⁽²⁸⁾. In contrast, the Qualifying Companies legislation is not such a general provision but a selective measure of narrow scope falling clearly within the scope of the State aid rules. The Commission also notes that its action is entirely consistent with paragraph J of the Code of Conduct for Business Taxation.
- (76) In particular, the closure of the Naval Dockyard cannot be considered to be an exceptional occurrence within the meaning of Article 87(2)(b) of the Treaty. The Commission's decision-making practice has established that this derogation only applies in circumstances where the exceptional occurrence is unpredictable and outside the control of the Member State's authorities. The United Kingdom authorities announced the closure of the Dockyard in 1981, three years before it closed in 1984.
- (77) The derogations provided for in Article 87(2) of the Treaty, 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.
- (78) The derogation 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. Point 3.5 of the Commission's Guidelines on national regional aid⁽²⁹⁾ establishes the methodology to be used in demarcating areas to be considered eligible to benefit from the derogation in Article 87(3)(a) of the Treaty. This uses historical data. Contrary to the assertion of Charles A. Gomez & Co., this provision cannot be used prospectively and applies only to areas where conditions of a low standard of living or serious underemployment already exist. Such areas are defined by the United Kingdom's regional aid map⁽³⁰⁾. The United Kingdom authorities did not propose Gibraltar as an assisted area and accepted that no regional aid could be granted in Gibraltar for the period 2000 to 2006. Since Gibraltar is not and never has been such an area, Article 87(3)(a) does not apply. In any event, it has not been argued that Gibraltar has a per capita gross domestic product below the threshold set in point 3.5 of the Commission's Guidelines on national regional aid. Article 87(3)(a) cannot be used to palliate uncertain and unquantifiable future effects which can themselves be prevented or attenuated by the national authorities through the use of other policy instruments.

Compatibility

- (76) Insofar as the Qualifying Companies regime constitutes State aid within the meaning of Article 87(1) of the Treaty, its compatibility with the common market must be evaluated in the light of the derogations provided for in Articles 87(2) and 87(3).
- (77) The derogations provided for in Article 87(2) of the Treaty, 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.
- (78) The Qualifying Companies regime cannot be considered either to be a project of common European interest or to remedy a serious disturbance in the economy of a Member State, as referred to in Article 87(3)(b) of the Treaty. As the Government of Gibraltar has observed, the Commission and the Court of Justice interpret Article 87(3)(b) strictly as meaning that a serious disturbance must affect the whole economy of a Member State⁽³¹⁾. The disturbance in question, the closure of the Naval

⁽²⁶⁾ Case C-295/97 *Piaggio v Ifitalia and others*, [1999] ECR I-3735.

⁽²⁷⁾ Joined Cases T-195/01 and T-207/01, paragraph 121.

⁽²⁸⁾ See point 6 of the Notice.

⁽²⁹⁾ OJ C 74, 10.3.1998, p. 9.

⁽³⁰⁾ OJ C 272, 23.9.2000, p. 43 and Commission approval letter No SG(2000) D/106293 of 17 August 2000.

⁽³¹⁾ See Joined cases T-132/96 and T-143/96, *Freistaat and others v Commission*, ECR [1999] II-3663, paragraphs 166, 167 and 168.

Dockyard, did not disturb the whole of the United Kingdom's economy. Whilst the Commission notes the Government of Gibraltar's argument that Gibraltar is separated from the United Kingdom in constitutional, political, legislative, economic, fiscal and geographic terms, this does not alter the fact that for the purposes of the State aid rules, Gibraltar forms part of the United Kingdom, regardless of the unique scope of Article 299(4) of the Treaty. In any event, there are other areas of the Community which are also characterised by varying types and degrees of separation from the Member State of which they form part. None of these areas is treated as a Member State in its own right for the purposes of Article 87(3)(b). The parallels that the Government of Gibraltar draws with measures adopted in response to the bovine spongiform encephalopathy (BSE) crisis in the United Kingdom are not relevant. The BSE crisis was considered to be an exceptional occurrence and accordingly these measures fell within the scope of Article 87(2)(b) of the Treaty. There is no requirement that, for Article 87(2)(b) to apply, the exceptional occurrence must affect the whole of a Member State concerned.

(81) The Qualifying Companies regime does not have as its object the promotion of culture and heritage conservation as provided for by Article 87(3)(d) of the Treaty.

(82) Finally, the Qualifying Companies regime must be examined in the light of Article 87(3)(c) of the Treaty, 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. The tax advantages granted by the Qualifying Companies regime are not related to investments, to job creation or to specific projects. They simply constitute a reduction of charges that should normally be borne by the undertakings concerned in the course of their business and must therefore be considered as operating State aid, the benefits of which cease as soon as the aid is withdrawn. According to the constant practice of the Commission, such aid cannot be considered to facilitate the development of certain activities or of certain economic areas under Article 87(3)(c) of the Treaty. Operating aid, according to points 4.15 and 4.16 of the Commission's Guidelines on national regional aid, may only be granted in exceptional circumstances or under special conditions. In addition, Gibraltar is not included in the regional aid map for the United Kingdom for the period 2000 to 2006, as approved by the Commission under State aid N 265/00⁽³²⁾.

⁽³²⁾ Joined cases T-132/96 and T-143/96.

Recovery

(83) The Court of Justice has repeatedly ruled that 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⁽³³⁾. 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) No 659/1999 provides that 'the Commission shall not require the recovery of the aid if this would be contrary to a general principle of Community law'.

(84) The Government of Gibraltar's arguments to the effect that legitimate expectations have been created by the uncertainty of the scope of the State aid rules and the rarity or novelty of Commission action against tax measures, whether offshore in nature or not, must be rejected. Only in exceptional circumstances may a recipient of unlawful aid escape the obligation to repay such aid and it is for the national courts alone to assess the circumstances of the individual case⁽³⁴⁾. Similarly, as the publication of the Notice represented neither a policy statement by the Commission, nor, as the United Kingdom implies, a tightening of the application of the State aid rules, it cannot have created legitimate expectations⁽³⁵⁾. The application of a Treaty rule to a specific situation for the first time cannot create a legitimate expectation in respect of the past. In any event, contrary to what the United Kingdom suggests, the differential tax treatment between resident and non-resident companies has played an important part in previous Commission State aid decisions⁽³⁶⁾.

(85) The notification of the Qualifying Companies legislation to the Primarolo group, far from creating legitimate expectations, placed the measure clearly within the scope of the Commission's commitment, mentioned in paragraph J of the Code of Conduct for Business Taxation, to examine or re-examine Member States' existing tax arrangements, with all the consequences that State aid investigations bring.

⁽³³⁾ See for example Case C-169/95, *Spain v Commission* [1997] ECR I-135, paragraph 47.

⁽³⁴⁾ See for example Cases C-5/89 *Commission v Germany* [1990] ECR I-3437, T-67/94 *Ladbroke Racing v Commission* [1998] ECR II-1, T-459/93 *Siemens v Commission* (ECR [1995] II 1675).

⁽³⁵⁾ See footnote 23.

⁽³⁶⁾ See, for example, Commission Decision 95/452/EC of 12 April 1995 on State aid in the form of tax concessions to undertakings operating in the Trieste Financial Services & Insurance Centre pursuant to Article 3 of Italian Law No 19 of 9 January 1991 on, OJ L 264, 7.11.1995, p. 30, recital 10.

- (86) As for the evolution of the common market and liberalisation of capital movements and financial services, the Government of Gibraltar has provided only general arguments insufficient to establish the existence of legitimate expectations. In particular, the Commission notes that no specific reasoning has been advanced as to how the evolution of the common market has created such expectations, nor has any argument been given relating to the impact of specific liberalisation measures. In addition, it is clear that the scope of the Qualifying Companies legislation is wider than those sectors that may have been affected by restrictions on capital movements and financial services.
- (87) The Government of Gibraltar draws on the Defrenne case to support its argument that the delays both before and during the investigation into the Qualifying Companies regime have created legitimate expectations. However, the factual and legal situation in the Defrenne case were quite different. In particular, through its prolonged failure to take infringement action against certain Member States, despite its own investigations into the infringements concerned and repeated warnings that it would initiate action, the Commission led Member States to consolidate their belief as to the effect of Article 119 of the Treaty (now Article 141). In contrast, the Commission's attention had not been repeatedly drawn to the Qualifying Companies regime and it was only on the adoption of the Code of Conduct for Business Taxation that the Commission started a systematic examination of Member States' tax arrangements.
- (88) Similarly, the alleged delays in the preliminary investigation cannot create legitimate expectations. The United Kingdom's failure to meet the deadlines set in requests for information contributed to any delays, if there were indeed such delays. The preliminary investigation must also be put into the wider context of the Commission's follow-up to the adoption of the Code of Conduct for Business Taxation in which it sought information from Member States on around 50 tax measures. The Qualifying Companies regime was but one of these measures. The Commission was not inactive during the preliminary investigation, but had to proceed on Qualifying Companies in parallel with its preliminary investigation into the other measures.
- (89) Part of the time was spent on the investigation into the Exempt Companies legislation, on which, according to the Government of Gibraltar, the Qualifying Company regime was modelled nearly 'word for word'. In this case, the Government of Gibraltar has itself referred to submissions it has made on Exempt Companies (for example its paper submitted by the United Kingdom in the letter of 12 September 2000), saying that the observations on Exempt Companies apply, *mutatis mutandis*, to Qualifying Companies. As far as the Commission is aware, the United Kingdom authorities kept the Government of Gibraltar informed as to the conduct of the investigation. The Government of Gibraltar was also given the opportunity to discuss the investigation into its offshore tax regimes at the meeting held on 19 October 2000 and at all stages had the opportunity to enquire as to its progress, timing and likely outcome.
- (90) It may be true that there were some doubts as to the utility of opening the State aid procedure on certain tax measures pending progress on the rollback of harmful measures. However this related in part to those existing aid measures, for which, if rolled back in accordance with the Code of Conduct for Business Taxation, a State aid investigation would no longer have any meaning. The Commission also took the view that in the interests of equality of treatment, it would be better to initiate proceedings on a number of measures concerning a wide range of Member States at the same time, rather than to adopt a piecemeal approach.
- (91) As for the claim that there should be a limitation period, such a period does in fact exist and is provided for in Article 15 of Regulation (EC) No 659/1999. It precludes recovery of aid established more than 10 years before the Commission's first intervention, in this case, 10 years before the Commission's letter of 12 February 1999.
- (92) The Commission notes the Government of Gibraltar's comments on the significance of the Commission's specific request for observations on the recovery of aid. Whilst the request clearly expressed the Commission's uncertainties on the question of recovery, it also served as an explicit signal to the beneficiaries that, in the event that the measure was found to constitute illegal and incompatible aid, recovery remained a distinct possibility and was in principle the logical outcome. Whilst the President of the Court of First Instance observed that this 'unusual request must, at first sight, allay to a considerable extent any concerns that beneficiaries might have', he did not conclude that such concerns had been dispelled⁽³⁷⁾. If he had done so, the Commission would have been put in the absurd situation where the perverse consequence of seeking views on a course of action precluded that very course of action itself.
- (93) Similarly, any doubts that the Commission may have publicly expressed on the existing or illegal nature of the aid measure would serve to emphasise that a finding of illegal aid, with all its consequences, was a clear possibility.

⁽³⁷⁾ Joined Cases T-195/01 R and T-207/01 *Gibraltar v Commission*, paragraph 113.

- (94) The claim that an order for recovery would infringe the principle of proportionality must also be rejected. The Court of Justice has consistently held⁽³⁸⁾ that the recovery of unlawfully granted State aid with a view to re-establishing the previously existing situation cannot in principle be regarded as disproportionate.
- (95) The Commission rejects the assertion that an order for recovery would place a disproportionate administrative burden on the Gibraltar authorities. According to the United Kingdom, there are around 140 Qualifying Companies. This represents less than 10% of the companies assessed for taxation each year in Gibraltar. Given that most, if not all, Qualifying Companies pay some income tax, albeit at a reduced rate, and that such companies tend to have a 'bricks and mortar' presence in Gibraltar, the Commission concludes that the administrative burden would not be excessive. As for the suggestion that the powers of investigation of Gibraltar Tax Department are limited, the Court of Justice has ruled that national provisions cannot be invoked in such a way as to render recovery impossible⁽³⁹⁾.
- (96) Arguments similar to those in recital 37 on the consequences of recovery for the Gibraltar economy were used by the Government of Gibraltar in an attempt to prevent publication of the decision to open the formal investigation procedure⁽⁴⁰⁾. They have not materialised. It is far from certain that they would do so as a result of a recovery order in this case. The Commission also notes that the arguments on the impact of recovery on the Gibraltar economy encompassed both the Qualifying Companies and the Exempt Companies regimes. However, since the Government of Gibraltar made its observations, the threat of recovery has diminished to the extent that following the annulment of the Commission's decision initiating the formal State aid investigation procedure⁽⁴¹⁾, the original 1967 Exempt Companies legislation is now under investigation as an existing aid scheme. There can be no recovery order in respect of this legislation and consequently the impact forecast by the Government of Gibraltar, to the extent it materialises at all, will be reduced. In any event, the Commission cannot allow such hypothetical considerations to impede the restoration, as far as possible, of the competitive situation that existed before the implementation of an illegal aid measure.
- (97) The Commission notes the Government of Gibraltar's comments that some Qualifying Companies would not be assessable to taxation in Gibraltar, that some would have no assets within its jurisdiction, that some would have ceased trading and that some would be in receipt of aid below the *de minimis* threshold. However, such considerations cannot, by themselves, preclude a recovery order. Nor can they relieve a Member State's authorities of the obligation to take the necessary steps to give full effect to a recovery order, since they become relevant only in the context of an examination of an individual case. In this context, the Commission notes that the benefits of Qualifying Company status are not limited to *de minimis* aid, nor are they limited to enterprises that are assessable to taxation in Gibraltar or that have no assets within the jurisdiction of the Gibraltar authorities.
- (98) The Commission makes no observation on the good faith, or otherwise, of the Gibraltar authorities. However, it follows from the rulings of the Court of Justice⁽⁴²⁾ that, when an existing aid measure is altered, in order for the measure to become new aid by virtue of the modification or for the modification itself to be new aid, the alteration must widen the scope of the measure and/or increase the advantage available.
- (99) In the present case, the Commission notes the ruling by the Court of First Instance that Gibraltar's 1967 Exempt Companies legislation must be considered to be an existing aid measure⁽⁴³⁾. The Commission also notes that the Qualifying Companies legislation was modelled very closely on the Exempt Company legislation. The conditions for eligibility are largely identical. The substantive differences concern the determination of the annual tax due. Rather than pay only a very low, fixed annual tax, Qualifying Companies pay a percentage of their annual profits. It therefore follows that Qualifying Companies pay tax on their profits at a higher rate than Exempt Companies. The more restrictive Qualifying Companies regime can therefore be considered to offer a reduced advantage, within the meaning of Article 87(1) of the Treaty, compared with the Exempt Companies regime. The Commission also notes that in the unlikely event that the tax paid by a Qualifying Company would be lower than the fixed annual tax of an equivalent Exempt Company, the difference would fall below the *de minimis* threshold. The legislation provides for a minimum tax rate of 0% for a Qualifying Company, whilst Exempt Companies pay a fixed annual tax of between GBP 225 and 300.

⁽³⁸⁾ See, for example, Joined cases C-278/92, C-279/92 and C-280/92 *Spain v Commission* [1994] ECR I-4103.

⁽³⁹⁾ See for example case C-24/95 *Rheinland Pfalz v Alcan*, [1997] ECR I-1591.

⁽⁴⁰⁾ Joined Cases T-195/01 R and T-207/01 *Gibraltar v Commission*, paragraphs 94 to 105.

⁽⁴¹⁾ Joined Cases T-195/01 and T-207/01, paragraph 115.

⁽⁴²⁾ Joined Cases T-195/01 and T-207/01, paragraph 111.

⁽⁴³⁾ Joined Cases T-195/01 and T-207/01, paragraph 113.

(100) The Court of Justice has consistently ruled that where a diligent businessman could have foreseen the adoption of a Community measure likely to affect his interests, he cannot rely on the principle of protection of legitimate expectations if the measure is adopted⁽⁴⁴⁾. Given the similarities between the Exempt Companies and Qualifying Companies regimes, it is hard to see how a diligent operator could have anticipated that the two regimes would be subject to different State aid procedures. The differences between the two schemes, rather than being inherent in their design, reflect the practice of the Gibraltar authorities to require those offshore companies with a physical presence in Gibraltar to pay tax, albeit at a low level. It is therefore reasonable to assume that a conscientious businessman, acting in good faith, could legitimately have believed that by opting for the less generous Qualifying Companies regime rather than the manifestly legal (in State aid terms, existing) Exempt Companies regime, he would also enter a regime whose legality was not in doubt. Accordingly, the Commission concludes that an order for recovery would, in the exceptional circumstances of this case, be contrary to a general principle of Community law.

VIII. CONCLUSIONS

(101) It is concluded that the Gibraltar Qualifying Companies regime 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 Article 87(3) apply. It is also concluded that the United Kingdom has unlawfully implemented the scheme in question, in breach of Article 88(3) of the Treaty. However, beneficiaries of the scheme were entitled to entertain a legitimate expectation that the legality of the scheme was not in doubt. Recovery of aid granted under the

Qualifying Companies legislation should therefore not be required,

HAS ADOPTED THIS DECISION:

Article 1

The State aid which the United Kingdom has implemented under the Qualifying Companies regime, contained in the Gibraltar Income Tax (Amendment) Ordinance of 14 July 1983 and the Gibraltar Income Tax (Qualifying Companies) Rules of 22 September 1983, is incompatible with the common market.

Article 2

The United Kingdom shall withdraw the scheme referred to in Article 1.

Article 3

The United Kingdom shall inform the Commission, within two months of notification of this Decision, of the measures taken to comply with it.

Article 4

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels, 30 March 2004.

For the Commission

Mario MONTI

Member of the Commission

⁽⁴⁴⁾ See for example Case 265/85, *Van den Bergh and Jurgens v Commission* [1987] ECR, 1155, paragraph 44.