

COMMISSION DECISION

of 19 July 2006

on aid scheme C 3/2006 implemented by Luxembourg for '1929' holding companies and 'billionaire' holding companies*(notified under document number C(2006) 2956)***(Only the French text is authentic)****(Text with EEA relevance)**

(2006/940/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

By letter of 20 July 2000 (A/36150), the Luxembourg authorities provided the further information requested.

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 invited interested parties to submit their comments in accordance with the above-mentioned provisions ⁽¹⁾,

Whereas:

(4) By letter of 26 March 2001 (D/51279), the Commission requested additional information, including the texts of the laws establishing the tax schemes in favour of exempt 1929 holding companies and exempt billionaire holding companies. By letter of 11 May 2001 (A/33928), the Luxembourg authorities provided the information requested.

(1) In 1997 the Council adopted a Code of Conduct for Business Taxation with a view to tackling harmful tax competition ⁽²⁾. In accordance with the commitments made under the Code, in 1998 the Commission published a notice on the application of state aid rules to measures relating to direct business taxation ⁽³⁾ emphasising its determination to apply those rules rigorously and to respect the principle of equal treatment. The present proceeding is to be seen in the context of that notice.

(5) By letter of 11 February 2002 (D/50571), the Commission informed the Luxembourg authorities of its preliminary views about the possible aid nature of Luxembourg's tax provisions, and invited them to submit their comments in accordance with the cooperation procedure with respect to existing aid schemes introduced by Article 17(2) of Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 [now Article 88] of the EC Treaty ⁽⁴⁾. Following a meeting with the Commission on 19 April 2002, the Luxembourg authorities provided the requested comments by letter of 2 May 2002 (A/33288). A second meeting took place between the Luxembourg authorities and the Commission on 17 October 2002.

I. PROCEDURE

(2) By letter of 12 February 1999 (D/50716), the Commission requested Luxembourg to furnish it with preliminary information on companies exempted from taxes under a 1929 Law. By letter of 26 March 1999 (A/32604), the Luxembourg authorities provided a description of the 1929 scheme of exemption for holding companies (hereinafter called 'exempt 1929 holding companies'), as amended by the Law of 29 December 1971 and the Law of 30 November 1978.

(6) With a view to finalising the preliminary examination of the scheme in question pursuant to the procedure laid down in Article 17(2) of Regulation (EC) No 659/1999, the Commission requested Luxembourg by letter of 9 March 2004 (A/51743) to update the information concerning the scheme by submitting all new proposed or approved provisions relating to the tax treatment of exempt 1929 holding companies. By letter of 6 May 2004, Luxembourg submitted the requested information to the Commission.

(3) By letter of 5 July 2000 (D/53671), the Commission requested Luxembourg to provide further information on exempt 1929 holding companies, including information on the Law of 17 December 1938 on the arrangements applicable to so-called billionaire holding companies (hereinafter called 'exempt billionaire holding companies').

(7) On 15 September 2004, a third meeting took place between the Luxembourg authorities and the Commission during which the Commission was informed of certain aspects of draft law No 5231 proposing certain amendments to the Law of 31 July 1929 on the exempt 1929 holding companies tax scheme.

⁽¹⁾ OJ C 78, 31.3.2006, p. 2.

⁽²⁾ OJ C 2, 6.1.1998, p. 1.

⁽³⁾ OJ C 384, 10.12.1998, p. 3.

⁽⁴⁾ OJ L 83, 27.3.1999, p. 1. Regulation amended by 2003 Act of Accession.

- (8) By letter of 4 May 2005 (D/53536), the Commission asked to be provided with any information on the approval, on 19 April 2005, of draft law No 5231 so that it could complete the preliminary assessment of the scheme in question. By letters of 1 June 2005 (A/34536) and 23 June 2005 (A/35047), the Luxembourg authorities submitted the requested information to the Commission.
- (9) By letter of 11 July 2005 (D/55311), the Commission informed Luxembourg that it had come to the conclusion as part of its preliminary assessment that the scheme in question (as amended following the approval by the Luxembourg Parliament on 19 April 2005 of draft law No 5231, which had become the Law of 21 June 2005 amending Article 1 of the Law of 31 July 1929 on the holding companies tax scheme) constituted aid incompatible with the common market.
- (10) On 25 July 2005, a fourth meeting took place between the Luxembourg authorities and the Commission during which the matter was examined in the light *inter alia* of the amendments made to the scheme in question by the Law of 21 June 2005.
- (11) By letter of 28 July 2005 (D/55780), the Commission informed Luxembourg of its preliminary assessment that the Law of 31 July 1929, as amended by the Law of 21 June 2005, was in the nature of aid incompatible with the common market and invited Luxembourg to submit its comments pursuant to Article 17(2) of Regulation (EC) No 659/1999.
- (12) By letters of 5 September 2005 (D/56729) and 19 September 2005 (D/57172), the Commission urged the Luxembourg authorities to send the requested comments.
- (13) Since no reply was received within the period prescribed, the Commission, by letter of 25 November 2005 ⁽⁵⁾, proposed to Luxembourg the following appropriate measures pursuant to Article 88(1) of the Treaty:
- (a) that the Luxembourg authorities close the exempt 1929 holding companies scheme to any new applicants within 30 days from the date of acceptance of these appropriate measures;
- (b) that the Luxembourg authorities take any legislative, administrative or other measures necessary to repeal the exempt 1929 holding companies scheme or to eliminate from it any aid elements within the meaning of Article 87(1) of the EC Treaty;
- (c) that the Luxembourg authorities notify to the Commission any proposed amendments to the exempt 1929 holding companies scheme, within the scope of the preceding point (a), in accordance with Article 2 of Regulation (EC) No 659/1999;
- (d) that the Luxembourg authorities issue, within 30 days from the date of acceptance of these appropriate measures, a public statement on the introduction of the necessary amendments in the tax legislation.
- (14) In the same letter, the Commission also asked the Luxembourg authorities to inform it in writing, within one month of receipt of the proposal, whether Luxembourg accepted, pursuant to Article 19(1) of Regulation (EC) No 659/1999, unconditionally and unequivocally the appropriate measures in their entirety, and to indicate by what date at the latest the scheme would be abolished. The Commission indicated that it might otherwise initiate, in accordance with Article 19(2) of the said Regulation, proceedings pursuant to Article 4(4).
- (15) By letter of 9 December 2005 (A/40451), Luxembourg informed the Commission that it did not accept the appropriate measures proposed. In the light of Luxembourg's rejection and the Luxembourg authorities' comments in the aforementioned letter, the Commission decided to initiate the procedure laid down in Article 88(2) of the Treaty.
- (16) By letters of 9 February 2006 (SG D/200621) and 28 March 2006 (SG D/201345), the Commission notified Luxembourg of the decision to initiate the procedure laid down in Article 88(2) of the Treaty together with a corrigendum to that decision.
- (17) The Commission's decision (as corrected) was published in the *Official Journal of the European Union* ⁽⁶⁾. In its decision, the Commission called on interested parties to submit their comments. In this context, the Commission received no comments from interested third parties.
- (18) Luxembourg submitted its comments by letter of 13 April 2006 (A/32917).
- (19) On 6 July 2006, a further meeting took place between the Luxembourg authorities and the Commission during which the former provided additional information on the financing activities of 1929 holding companies and on those companies' possible legitimate expectation in continuing to enjoy exemption during a transitional period.

⁽⁵⁾ SG(2005) D/205866.

⁽⁶⁾ See footnote 1.

II. DESCRIPTION OF THE MEASURE

(20) The Organic Law of 31 July 1929 on the exempt holding companies introduced a tax vehicle to encourage distribution of profits accumulated by operating companies in a multinational group, while avoiding the multiple taxation of the profits received by the beneficiary holding companies and further distributed to their shareholders. In 1937, following amendments to the Law of 31 July 1929, Luxembourg introduced an ancillary exempt status for billionaire holding companies formed by an initial contribution of paid-up share capital of at least one billion Luxembourg francs (LUF). Luxembourg further introduced a participation exemption scheme whereby dividends, royalties, capital gains and liquidation proceeds from the sale of shares in participated companies are not taxable, subject to certain conditions. Luxembourg accordingly nowadays possesses, in addition to a general participation exemption scheme governed by ordinary law (e.g. Article 166 of the Income Tax Act), transposing the Parent-Subsidiary and Interest-Royalty Payments Directives⁽⁷⁾, a specific exemption scheme for exempt 1929 holding companies and exempt billionaire holding companies.

(21) Under the Law of 31 July 1929, exempt 1929 holding companies are not subject to any direct taxes in Luxembourg, such as, for example, corporate income tax (*impôt sur le revenu des collectivités*), municipal business tax (*impôt commercial communal*)⁽⁸⁾ and net worth tax (*taxe sur la valeur nette*)⁽⁹⁾. They are, however, liable to taxes on capital, such as real estate tax (*impôt foncier*)⁽¹⁰⁾ and the annual subscription tax (*taxe d'abonnement*)⁽¹¹⁾. Accordingly, dividends, interest, royalties and capital gains earned by an exempt 1929 holding company are not taxable in Luxembourg. Payments of dividends, royalties⁽¹²⁾ and

interest made by an exempt 1929 holding company are not subject to any withholding taxes⁽¹³⁾. Lastly, there is no withholding tax on interest paid abroad by exempt 1929 holding companies as by any other Luxembourg company, while the interest received by non-exempt resident companies is always regarded as taxable income.

(22) Interest payments made by exempt 1929 holding companies (as by any other Luxembourg company) to individuals — beneficial owners within the meaning of Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments⁽¹⁴⁾ — who are resident in another Member State are subject to the withholding tax provided for by the said Directive, in Luxembourg. There is a similar 10 % final withholding tax on interest paid to resident individuals, introduced in Luxembourg as from 1 January 2006, to which interest payments by an exempt 1929 holding are subject.

(23) Exempt 1929 holding companies are normally excluded from the bilateral double taxation and tax fraud prevention conventions concluded by Luxembourg.

(24) As regards capital taxation, exempt 1929 holding companies are subject to a 1 % capital duty (*droit d'apport*) on cash or asset contributions⁽¹⁵⁾. In addition, they are subject to an annual subscription tax (*taxe d'abonnement*) of 0,2 % of the paid-up share capital and share premiums' value as set on the date of closing of the preceding financial year⁽¹⁶⁾. Exempt 1929 holding companies may borrow funds from their shareholders or from banks or other credit institutions and they may issue bonds. With a view to avoiding non-payment of subscription tax, thin capitalisation rules are applied if the funding by means of debt as opposed to

⁽⁷⁾ Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ L 225, 20.8.1990, p. 6), as amended by Directive 2003/123/EC of 22 December 2003; and Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (OJ L 157, 26. 6.2003, p. 49).

⁽⁸⁾ Luxembourg resident companies and permanent establishments of foreign companies are subject to corporate income tax levied at the maximum rate of 22 % and to municipal business tax levied at a variable rate depending on the municipality, but with an average of 7,5 %, on the taxable income corresponding to the gross income less expenses excluding non-deductible expenses such as direct taxes, hidden payments of dividends and directors' fees.

⁽⁹⁾ Luxembourg imposes a net worth tax on resident companies and on permanent establishments of foreign companies at a rate of 0,5 % applied as at 1 January of each year to the net assets, these being the difference between the assets estimated at their fair market value and liabilities vis-à-vis third parties.

⁽¹⁰⁾ A municipal tax levied on the value of real estate owned by undertakings.

⁽¹¹⁾ Equal to 0,2 % of the paid-up share capital and share premiums value.

⁽¹²⁾ Luxembourg has abolished the tax on royalties as from 1 January 2004 (except in the case of payments abroad).

⁽¹³⁾ Dividends distributed by a non-exempt company are subject to withholding tax at the rate of 20 % on the gross amount paid (25 % if the withholding cost is borne by the payer), unless Directive 90/435/EEC applies or qualifying participations within the meaning of Article 147 of the Income Tax Act are involved. This withholding tax may be reduced pursuant to treaty provisions. Interest is generally not subject to any withholding taxes, unless qualified as hidden dividends. Most types of royalties paid to non-resident beneficiaries are subject to withholding tax levied at the rate of 10 % (11,11 % if the withholding cost is borne by the payer). Luxembourg recently adopted in its tax legislation the exemption provided for by Directive 2003/49/EC. This withholding tax maybe reduced or waived pursuant to treaty provisions.

⁽¹⁴⁾ OJ L 157, 26.6.2003, p. 1. Directive as last amended by Directive 2004/66/EC (OJ L 168, 1.5.2004, p. 35).

⁽¹⁵⁾ Any contribution in cash or in kind to a Luxembourg company is subject to a 1 % capital duty.

⁽¹⁶⁾ Where dividends are distributed by an exempt 1929 holding company in excess of 10 % of the paid-up capital existing on the date of closing of the financial year during which the distribution was made, the subscription tax due the following year is levied on a deemed basis of 10 times the said dividends.

equity exceeds certain financial ratios. Finally, the fees (*tantièmes*) paid to resident or non-resident members of an exempt 1929 holding company's board of directors, managers or statutory auditors are subject to a 20 % withholding tax.

Conditions

- (25) Exempt 1929 holding company status is available only to companies ⁽¹⁷⁾ registered in Luxembourg, and not to one-person businesses, contractual joint ventures not in the form of a company, or permanent establishments, branches or local offices of foreign companies. The amount of subscribed capital of an exempt 1929 holding company depends on the legal form adopted. A grand-ducal decree of 29 July 1977 requires an exempt 1929 holding company to have a fully paid-up share capital of at least EUR 24 000.
- (26) Companies established in Luxembourg can be registered as exempt 1929 holding companies provided they engage only in acquiring, holding and maximising the value of any forms of participation in other Luxembourg or foreign companies, including by providing loans, holding patents and licensing copyright or know-how to the participated companies. An exempt 1929 holding company is not allowed to carry on any industrial activities on its own account or to maintain a commercial establishment open to the public. An exempt 1929 holding company extending its activities beyond the above scope loses its status and is treated as a fully taxable commercial company.
- (27) The authorised activities of an exempt 1929 holding company include, in particular:
- (a) acquiring, holding, managing and selling equity interests in any Luxembourg or foreign company with limited liability;
 - (b) acquiring, holding, managing and selling Luxembourg or foreign bonds, deposit certificates and debentures;
 - (c) acquiring, holding, managing and selling Luxembourg or foreign companies' stocks;
 - (d) granting loans, advances or guarantees in any form to companies in which it has a direct equity interest. In order to safeguard such loans, a minimum 25 % equity stake in such companies is required;
 - (e) holding gold or commercial paper linked to the value of gold;
- (f) issuing bonds or deposit certificates (whether publicly traded or privately issued);
 - (g) acquiring and holding patents, exploiting them by granting licences to its subsidiaries and receiving royalties in consideration (licences may also be offered to third parties, but there may be no trading therein);
 - (h) holding trademarks and licences that are complementary to the holding of a patent and exploiting them by receiving royalties from its subsidiaries is also allowed, but only by way of ancillary activity;
 - (i) holding equity interests in simple partnerships, provided the exempt 1929 holding company's share of the paid-up capital comes to at least EUR 1 240 000 and its financial liability is limited to the capital contributed.
- (28) The prohibited activities include:
- (a) carrying on any industrial or commercial activity or providing any kind of service;
 - (b) running a commercial establishment open to the public;
 - (c) owning land or buildings other than that used for its own premises;
 - (d) carrying on the activities of agent, banker, or manager on behalf of any company for consideration, unless the other company is a subsidiary;
 - (e) issuing short- or medium-term commercial paper;
 - (f) granting loans, advances or guarantees in any form to any entities other than its subsidiaries;
 - (g) acquiring non-patentable intellectual property rights;
 - (h) direct involvement in the affairs of its subsidiaries.
- (29) Exempt 1929 holding companies are subject to supervision by the Luxembourg Land Registration and Estates Department (*Administration de l'Enregistrement et des Domaines*), which is entitled to inspect their books, but only as far as is necessary to confirm whether the holding companies' activities are within the limits laid down by the 1929 legislation.

⁽¹⁷⁾ These are the public limited company (*société anonyme*), the private limited company (*société à responsabilité limitée*), the limited partnership with a share capital (*société en commandite par actions*), and the cooperative company (*société coopérative*).

Exempt billionaire holding companies

- (30) There is among exempt 1929 holding companies a specific form of holding company, namely the exempt billionaire holding company. This may be formed either by contributing shares in foreign companies or by increasing the paid-up share capital and reserves to at least EUR 24 million (LUF 1 billion). Exempt billionaire holding companies may opt for a tax regime whereby the subscription tax is replaced by a so-called income tax. Pursuant to the grand-ducal decree of 1937 on exempt billionaire holding companies, this income tax is levied on interest paid to bond and security holders, dividends paid to shareholders, and fees paid to directors, auditors and liquidators of such a company.
- (31) Where the aggregate amount of interest paid to bond or security holders for the financial year concerned is more than EUR 2,4 million, the tax is calculated according to a specific schedule including 3 % of the interest paid, 1,8 % of the dividends, fees and remunerations up to an aggregate distribution amount of EUR 1,2 million, and 0,1 % of any dividends, fees and remunerations in excess thereof. Where the aggregate amount of interest paid to bond or security holders for the financial year is less than EUR 2,4 million, the tax is calculated according to a different schedule including 3 % of the interest paid, 3 % of the dividends, fees and remunerations up to an amount equal to the difference between EUR 2,4 million and the aggregate amount of interest paid, 1,8 % of the surplus dividends up to EUR 1,2 million, and 0,1 % of any dividends, fees and remunerations in excess thereof. As a result, exempt billionaire holding companies are not subject to the ordinary thin capitalisation rules applicable for subscription tax purposes, and no withholding tax is applied on fees and remunerations paid.
- (32) The authorised activities of an exempt billionaire holding company include:
- (a) providing financial assistance to any company over which it exercises, either directly or indirectly, effective control;
 - (b) providing financial assistance to any company in which companies it controls hold a participation of at least 25 % and with which continuous economic relations are maintained;
 - (c) providing financial assistance to subsidiaries effectively controlled by companies in which it holds a 25 % participation.

Exempt financial holding companies

- (33) The tax exempt status described above has been extended under certain conditions to so-called exempt financial

holding companies — a subcategory of exempt 1929 holding companies. These are responsible for financing the activities of the subsidiaries or affiliates of a group of companies. In this connection, companies are considered to be members of a group if they use a common denomination which constitutes the symbol of reciprocal dependence or if the companies of the same group hold a substantial participation (of at least 25 %) in their share capital and maintain continuous economic relations between them.

- (34) Similarly to exempt billionaire holding companies, exempt financial holding companies may carry on a greater range of activities than exempt 1929 holding companies with respect to intra-group financing. Whereas exempt 1929 holding companies may only finance companies in which they hold a direct participation, exempt financial holding companies may grant loans to any member companies within their group. More particularly, the authorised activities of exempt financial holding companies include:
- (a) financing other group members by granting loans to companies in which no direct participation is held in addition to directly participated companies;
 - (b) issuing bonds the proceeds of which are used to finance the activities of any other group members;
 - (c) performing invoice discounting activities as factor within the group;
 - (d) receiving cash deposits from companies within the group in order to provide advances to other companies.

Amendments to the exempt 1929 holding companies scheme

- (35) On 6 November 2003, the Luxembourg Government presented to Parliament draft law No 5231 amending the Law of 31 July 1929 on the exempt 1929 holding companies scheme. At its sitting of 19 April 2003, the Luxembourg Parliament approved the above-mentioned draft subject to certain amendments. The new law was promulgated on 21 June 2005 and published in the Official Journal of the Grand Duchy of Luxembourg on 22 June 2005. The Law of 21 June 2005 entered into force on 1 July 2005.
- (36) Under the Law, holding companies receiving 5 % or more of the total dividends distributed in the year by non-resident companies which are not subject to an income tax comparable to Luxembourg's income tax lose their exempt 1929 holding company status and become ordinarily taxable companies. The parliamentary documents accompanying the draft law explain that, for an income tax to be

considered comparable to Luxembourg income tax, it needs to be levied at a rate of at least 11 % (corresponding to 50 % of Luxembourg corporation tax) and that the basis of calculation of this foreign income tax has to be similar to the one applicable in Luxembourg.

- (37) It is apparent from the commentaries to the Law that these amendments were adopted in order to reconcile the 1929 holding companies tax scheme with the recommendations presented to the Luxembourg authorities on 3 June 2003 by the Council as part of the review under the Code of Conduct for business taxation. In this respect, the new Law introduced a transitional regime safeguarding the existing advantages for companies enjoying exempt 1929 holding company or billionaire holding company status, from the date of its entry into force until 1 January 2011.

III. REASONS FOR THE INITIATION OF THE FORMAL INVESTIGATION PROCEDURE

- (38) In its decision of 9 February 2006, the Commission found in substance that the exempt 1929 holding companies scheme constituted aid within the meaning of Article 87(1) of the Treaty. In the Commission's opinion, the scheme conferred exclusively on the holding companies in question several economic advantages consisting in exceptional exemptions from corporation, withholding, net worth and real estate taxes. The above advantages translated into reduced tax liabilities towards the Luxembourg Treasury in favour of the holding companies and the economic groups to which they belonged.
- (39) These advantages appeared to the Commission to involve the use of state resources in the form of foregone tax revenue for the Luxembourg Treasury. The scheme seemed to be selective in that it was reserved for holding companies carrying on only certain types of business activity, including financial, managerial, licensing and treasury functions. The scheme was also deemed to be restricted to intra-group activities as the beneficiaries had to operate within a group in order to benefit from it. It was thus not open to all undertakings but only to those operating within a group structure, with the creation of a holding company in Luxembourg exclusively devoted to carrying on certain activities such as financing, managing holdings, coordinating and granting licences and patents.
- (40) In its decision to initiate the formal investigation procedure, the Commission took the view that this advantage distorted competition and affected trade between Member States in that the financial and management activities typically carried on by exempt 1929 holding companies generally took place in international markets where competition was intense. In this respect, competition seemed to be distorted because the exempt 1929 holding companies were treated more favourably than independent service providers and

financial intermediaries, including traditional banks and consultancy firms. Trade seemed to be affected because the advantages conferred by the exempt 1929 holding companies scheme benefited only holding companies exercising certain essentially cross-border financial functions.

- (41) None of the derogations provided for in Article 87(2) and (3) of the Treaty seemed to be applicable, as the measure in question constituted an operating aid not linked to the execution of specific projects and it seemed merely to reduce the beneficiaries' current expenditure without contributing to the achievement of any Community objectives.
- (42) The Commission also concluded that what was involved here was an existing aid measure within the meaning of Article 1(b)(i) of Regulation (EC) No 659/1999. The amendments introduced by the 2005 law amending the exempt 1929 holding companies scheme did not appear to alter the existing nature of the aid in question as they left the advantages conferred by the scheme unchanged, while temporarily limiting the circle of beneficiaries to those not receiving certain dividends subject to reduced taxation outside Luxembourg.
- (43) In initiating the formal investigation procedure, the Commission called on the Luxembourg authorities to furnish any information that might be relevant for purposes of assessing the effects of the scheme in question, notably in the financial services sector. It also invited Luxembourg and interested third parties to submit their comments on the possible existence of a legitimate expectation on the part of beneficiaries such as might justify the adoption of transitional measures should it ask that the scheme in question be abolished.

IV. COMMENTS FROM THE LUXEMBOURG AUTHORITIES AND THIRD PARTIES

- (44) No interested third party formally submitted comments following publication of the Commission's decision of 9 February 2006 in the *Official Journal of the European Union* ⁽¹⁸⁾. Several representatives of exempt 1929 holding companies contacted the Commission informally, however, asking to be informed *inter alia* of the legal consequences for individuals of the formal investigation procedure initiated by the Commission under Article 88(2) of the Treaty and of the legality of the tax exemptions they had received.
- (45) The Luxembourg authorities sent their comments by letter dated 13 April 2006. They disagreed with the finding that the 1929 holding companies exemption scheme constituted aid within the meaning of Article 87(1) of the Treaty and

⁽¹⁸⁾ See footnote 1.

did not comment on the scheme's compatibility with the common market.

(46) In its letter of 13 April 2006 Luxembourg also refused to furnish any relevant information for purposes of assessing the measure in question and its effects on competition and trade in, among others, the areas of financial services, intra-group activities and the management of intellectual property rights. No information was forthcoming on investments managed by exempt 1929 holding companies, nor was a list provided of exempt holding companies. The Luxembourg authorities claimed it was impossible to draw up such a list because exempt 1929 holding companies were not subject to administrative authorisation.

(47) Lastly, on the issue of the existence of a legitimate expectation on the part of beneficiaries of the exemption scheme justifying the adoption of transitional measures in the event of a negative final decision, the Luxembourg authorities observed that the abolition of the exempt 1929 holding companies scheme would have such an impact on Luxembourg's tax system that the expectations of operators acting under the scheme would have to be protected. The latter could not expect a legal status to be done away with overnight.

(48) In substance, in their letter of 13 April 2006 the Luxembourg authorities dispute the finding that the tax scheme in question constitutes aid.

(49) First of all, they state that the exempt 1929 holding companies scheme confers no advantages compared with the standard taxation regime applicable to holding companies, being designed merely to avoid a multiplication of the tax burden linked to the profits distributed by operating companies. Without the exemption scheme in question, exempt 1929 holding companies would in effect be penalised from a tax point of view, the profits of an operating company being taxed once as profits of that company, a second time when they were distributed as participation income of the holding company and, lastly — in the event of a subsequent distribution — as dividends of the holding company's shareholders.

(50) Secondly, according to the Luxembourg authorities, the exempt 1929 holding companies scheme is not selective and therefore does not distort competition or affect trade between Member States. All companies in a comparable factual and legal situation, involving *inter alia* the acquisition of equity interests and the management, financing and value maximisation of shareholdings in controlled companies, can potentially benefit from the scheme.

(51) Lastly, the exempt 1929 holding companies scheme is not, so the Luxembourg authorities say, capable of distorting

competition and trade within the Community because the beneficiary holding companies are exclusively passive recipients of income and are not in situations comparable to those of other operators acting as independent service providers. At all events, the Commission has not, it is claimed, shown that the scheme in question has the effect of strengthening the position of exempt 1929 holding companies compared with that of other types of holding company.

V. ASSESSMENT OF THE SCHEME

(52) Article 87(1) of the Treaty provides that 'any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.'

Aid nature of the scheme

(53) The Commission has carefully examined the exempt 1929 holding companies scheme in the light of the comments submitted by the Luxembourg authorities. The numerous objections raised are not such as to cause the Commission to alter its preliminary assessment that the tax advantages granted by the scheme to such companies constitute aid within the meaning of Article 87(1) of the Treaty.

(54) The classification of a national measure as state aid presupposes that the following cumulative conditions are met: (1) the measure confers an advantage; (2) that advantage is conferred through state resources; (3) the advantage is selective; and (4) the measure distorts or threatens to distort competition and is capable of affecting trade between Member States ⁽¹⁹⁾.

(55) In the present case, the Commission considers in substance that the 1929 Law grants tax advantages which are not confined to elimination of the double taxation of the income received by other holding companies in Luxembourg, i.e. those which are in principle taxable but which receive allowances related to taxes already paid either in Luxembourg or abroad.

(56) The Commission considers, in this context, that the scheme affords several extraordinary tax advantages and that these advantages favour certain undertakings carrying on a limited number of activities in Luxembourg generally falling within the financial sphere. Consequently, the scheme is selective in character. In view of the seriousness of the objections raised by Luxembourg, the Commission considers it necessary to give the precise reasons for finding that the scheme in question, as described above, meets all the conditions mentioned in paragraph 53.

⁽¹⁹⁾ See, for example, judgment of the Court of Justice of the European Communities in Case C-222/04 *Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Firenze*, not yet reported, paragraph 129.

Existence of an advantage

- (57) In its comments of 13 April 2006, Luxembourg stated that the exempt 1929 holding companies taxation scheme constituted a general tax scheme applicable to companies exclusively earning passive income already taxed at the time of generation, irrespective of their size, area of activity or legal form. It also stated that the scheme was justified by the overall structure of the Luxembourg tax system, which was aimed at avoiding double taxation, and that fully taxable companies could avail themselves of other, comparable forms of relief against double taxation. In particular, in Luxembourg's view, the scheme afforded no advantages for two main reasons.
- (58) Firstly, the Luxembourg company taxation system provided for a number of schemes alternatively applicable to comparable situations and accessible to all operators without discrimination. As the Court of Justice had acknowledged in *Banks*, such a system could not therefore involve any advantages within the meaning of Article 87(1) of the Treaty ⁽²⁰⁾. In that judgment, the Court had held that there was no aid where different taxation formulas, involving potential advantages in the light of the choices actually made by economic operators, were accessible to all operators without discrimination.
- (59) Secondly, according to the Luxembourg authorities, the evaluation of the tax burden to which exempt 1929 holding companies were subject should take into account all the factors, both advantageous and disadvantageous, of the scheme. In their view, however, the Commission had manifestly not followed that approach. In this connection, the Luxembourg authorities claim to have provided, in their letter of 13 April 2006, three examples of holding companies that had been placed at a disadvantage by the application of the scheme in question compared with taxed holding companies.
- (60) The Commission cannot share the Luxembourg authorities' conclusions. Contrary to what those authorities maintain, the scheme in question is characterised by several tax exemptions, notably from income tax, municipal business tax and net worth tax. These exemptions derogate from the rule of the taxation of the companies concerned. Moreover, they are intended not just to avoid the multiple taxation of income but to relieve from the payment of some taxes certain economic activities coming under the Law of 31 July 1929 carried on by exempt holding companies.
- (61) While it is true that the 1929 exemption scheme from which exempt holding companies benefit does not cover all the taxes to which Luxembourg companies are normally subject ⁽²¹⁾, the present proceeding is nevertheless limited

to the tax exemptions established and concerns several personal taxes from which exemption is granted ⁽²²⁾. As regards direct taxes, in particular income tax, municipal business tax and net worth tax (wealth tax), the exemption enjoyed by 1929 holding companies is total.

- (62) In view of the above, the Commission acknowledges that, as far as real estate tax is concerned, exempt 1929 holding companies are subject thereto in accordance with the Law of 1 December 1936 and that, contrary to what it stated in its decision of 9 February 2006, the said holding companies do not enjoy any advantages in this respect.
- (63) As regards the exemption from income tax and municipal business tax, the scope of the exemption granted to 1929 holding companies in respect of the income from shareholdings (dividends and capital gains) goes far beyond the exemption of shareholdings granted in respect of dividends and capital gains earned by non-exempt holding companies with a view to preventing their double taxation. In particular, exempt 1929 holding companies are exempted therefrom, irrespective of whether or not they satisfy the conditions for benefiting from the common exemption arrangements aimed at avoiding double taxation ⁽²³⁾. Unlike taxable companies, they therefore benefit automatically from these exemptions. In these circumstances, the Commission considers that the exemption in question gives exempt 1929 holding companies an advantage by mitigating the charges which are normally included in their budgets ⁽²⁴⁾.
- (64) Still on the subject of income tax and municipal business tax, the Commission would add that interest and royalties received by exempt 1929 holding companies are totally exempted therefrom, in contrast to the ordinary taxation applicable to other Luxembourg holding companies. Such exemption cannot be justified by the wish to prevent the double taxation of the income in question inasmuch as the related charges are deducted upstream by those bearing them. The exemption of this income under the Law of 31 July 1929 is therefore in the nature of an exception and contradicts the principle that interest and royalty payments are subject, at least once, to income tax. In view of the exceptional nature of this exemption, the Commission accordingly considers that exempt 1929 holding companies also benefit in this case from a mitigation of the charges which are normally included in their budgets.
- (65) As regards withholding taxes on distributed income, dividends and royalties made by exempt 1929 holding companies, the Commission notes that the said holding companies are not subject to the withholding tax normally applied by Luxembourg to payments made to non-resident

⁽²⁰⁾ Judgment in Case C-390/98 *H.J. Banks & Co. Ltd v The Coal Authority and Secretary of State for Trade and Industry* [2001] ECR I-6117, paragraphs 49 and 50.

⁽²¹⁾ Exempt 1929 holding companies are thus not exempted from payment of indirect taxes such as capital duty, registration duty and VAT.

⁽²²⁾ For the purposes of this proceeding, for example, impersonal taxes, based on the nature of the transactions carried out, are not relevant.

⁽²³⁾ Paragraphs 46-54 of the Commission's decision of 9 February 2006.

⁽²⁴⁾ See, for example, the judgment of the Court of Justice in Case C-387/92 *Banco Exterior de España* [1994] ECR I-887, paragraph 14.

recipients, including — in the case of billionaire holding companies — the withholding tax imposed on directors' fees. It accordingly considers that exempt 1929 holding companies also benefit in this case from a mitigation of the charges which are normally included in their budgets.

(66) Even supposing that this withholding tax exemption benefits directly the income recipients, and only indirectly exempt 1929 holding companies, the Commission considers that it nonetheless has the effect of relieving the latter of charges normally borne by distributing companies taxable in Luxembourg. This assessment is borne out by the fact that, where a withholding is applied, the rate of tax is higher if its cost is borne by the distributor and that the latter is under no legal obligation, in such a case, to pass on the tax to the recipient of the income. Furthermore, exempt 1929 holding companies receive an indirect advantage in terms of easier access to risk/debt capital due to the higher return to investors resulting from the exemption.

(67) Finally, exempt 1929 holding companies are not subject to the net worth tax applicable to companies taxable in Luxembourg. Even supposing that this exemption has an economically limited scope, it nonetheless relieves exempt 1929 holding companies of a charge normally borne by companies in Luxembourg.

(68) It follows from all the foregoing that, in the Commission's view, the advantages in question constitute exceptional measures which are capable of favouring certain undertakings compared with other undertakings which are, in the light of the objective pursued by the said scheme — namely the prevention of multiple taxation — in a comparable factual and legal situation. The Commission considers in this context that the reference made by the Luxembourg authorities to the judgment in *Banks* is irrelevant. In that case, of the various possible formulas for applying certain taxes, none appeared *a priori* more advantageous. In the present case, however, an exemption is, in principle, more advantageous than the taxation of income. The Commission concludes from this that exempt 1929 holding companies benefit actually and not potentially from a mitigation of the charges which are normally included in their budgets.

(69) The three examples given by the Luxembourg authorities in their letter of 13 April 2006 are not of such a character as to call into question the conclusion that the scheme at issue confers advantages derogating from ordinary tax law which are not justified by the nature of the Luxembourg tax system. First of all, they concern situations which are not representative of the actual use made of the exempt 1929 holding companies scheme. Secondly, they concern only situations in which the ordinary scheme already grants total exemption from income taxes. On the other hand,

Luxembourg ignores situations in which exemption is not ordinarily granted, despite the fact that, as previously observed, it is only in such situations that the scheme enables beneficiaries under it to retain a specific advantage compared with the ordinary scheme.

(70) The Commission considers, therefore, that it is not necessary to take into account all applicable direct and indirect taxes in order to determine whether there exists an actual tax advantage granted to exempt 1929 holding companies, the existence of that advantage being already sufficiently proven. The Commission would point out, moreover, that such an analysis would be impossible to carry out in view of the indeterminate number of possible situations.

(71) In conclusion, the Commission considers that the scheme in question constitutes an advantage conferred on exempt 1929 holding companies.

Selectivity

(72) The specific nature of a state measure, namely its selective application, constitutes one of the necessary elements of the concept of state aid within the meaning of Article 87(1) of the Treaty. In that regard, it is necessary to determine whether or not the tax scheme in question entails advantages accruing exclusively to certain undertakings or certain sectors of activity⁽²⁵⁾. In the present case, according to the Luxembourg authorities, the exempt 1929 holding companies scheme is not selective because all undertakings in comparable situations, i.e. those carrying on exclusively the activities of managing and maximising the value of participations held in controlled companies and of receiving income derived from those activities, can benefit from it.

(73) The Commission shares the view of the Luxembourg authorities that the selectivity of a measure such as the tax exemption for holding activities must be assessed in the light of comparable situations⁽²⁶⁾. It considers, however, that what should be taken into consideration for comparison purposes here are companies receiving income comparable to that of exempt 1929 holding companies. It would observe though that, among Luxembourg companies, only the exempt 1929 holding companies are completely exempted from tax on all the income they receive, irrespective of any tax already borne upstream on their income by companies in which they hold a participation.

(74) In these circumstances, the Commission can only conclude that such an exemption scheme is selective since it favours certain undertakings carrying on exclusively certain

⁽²⁵⁾ See the judgment of the Court of Justice in Case C-241/94 *France v Commission* [1996] ECR I-4551, paragraph 24, and in Case C-200/97 *Ecotrade* [1998] ECR I-7907, paragraphs 40 and 41. See also the judgment of the Court of First Instance in Case T-55/99 *CETM v Commission* [2000] ECR II-3207, paragraph 39.

⁽²⁶⁾ See in this connection the judgment of the Court of Justice in Case C-143/99 *Adria-Wien Pipeline v Finanzlandesdirektion für Kärnten* [2001] ECR I-8365, paragraph 41.

activities among the various undertakings and activities which are subject to the risk of multiple taxation.

- (75) This assessment is borne out, moreover, by the fact that, according to the Luxembourg authorities, the Law of 31 July 1929 is designed to prevent an excessive extension of this favourable regime to companies other than exempt 1929 holding companies so as to prevent it from placing an undue burden on the state budget. The Commission would point out in this connection that a justification based on the nature or overall structure of the tax system must reflect the consistency of a specific tax measure with the internal logic of the tax system in general ⁽²⁷⁾. Such cannot be the case here, however, inasmuch as Luxembourg has not justified, by reference to the nature or overall structure of the national tax scheme, the exceptional arrangement from which exempt 1929 holding companies alone benefit.
- (76) The Commission would point out, moreover, that the benefit of the exemption under the Law of 31 July 1929 is subject to fulfilment of several conditions linked essentially to the existence of a registration system monitored by the authorities and to compliance with certain legal requirements relating to minimum net worth and to the actual, exclusive pursuit of certain strictly defined activities. In the Commission's view, the existence of these stringent criteria enhances the selective nature of the scheme in question.
- (77) The Commission would note in this respect that exempt 1929 holding companies must limit their activities to the acquisition of participations, in whatever form, in other undertakings and to the management and value maximisation of those participations. The summary definition of the value maximisation of participations given in the Law of 31 July 1929 has been clarified by the Land Registration and Estates Department, which has interpreted it broadly as including several economic activities, directly or indirectly linked to the value maximisation of participations, taking the form notably of financing activities. Holding companies are thus authorised to grant long- or short-term advances and loans to companies in which they directly hold a participation ⁽²⁸⁾.
- (78) Under the Law of 31 July 1929, collateralisation in favour of creditors of companies in which exempt 1929 holding companies hold a participation and collateralisation of their capital increases also come under the concept of the value

maximisation of participations. Moreover, in addition to equity participations, exempt 1929 holding companies may hold public or private bonds, whether or not quoted on the regulated markets, and whether or not issued by the public sector. Exempt 1929 holding companies may also hold only bonds, independently of or in conjunction with participation management activities. It is thus possible for financial holding companies to broaden the circle of potential financing beneficiaries and in so doing to grant loans to all companies forming part of the group and hence to all companies sharing a common name which are at least 25 %-held by a common parent company.

- (79) Furthermore, certain activities are presumed to be equivalent to the acquisition of a participation, even if no shares are held by the exempt 1929 holding company in question. A holding company may thus hold patents and, although it may not exploit or negotiate them, it may grant exploitation licences to other companies either outside or within the group to which it belongs and hence collect a royalty without losing the benefit of exemption.
- (80) The activities which exempt 1929 holding companies are authorised to carry on also include the provision of advice on management and investment by investment funds. The purpose of this activity is to provide advice to collective investment undertakings on the management of the portfolio entrusted to them. It is normally carried on by consultancy firms which are in principle taxable under ordinary tax law. However, where certain specific conditions are met, it is possible for a consultancy firm to opt for 1929 holding company status ⁽²⁹⁾.
- (81) It follows from the above that the activities which a 1929 holding company may carry on are strictly limited by the Law of 31 July 1929, the pursuit of other activities being sanctioned by the withdrawal of tax-exempt status. The Commission considers that these restrictions confirm the selective nature of the exemption scheme for exempt 1929 holding companies. Moreover, as the Commission mentioned in its decision of 9 February 2006, it suffices to point out that several economic sectors cannot benefit from the advantages offered by the scheme. Thus, undertakings carrying on activities other than those authorised concerning participation value maximisation and activities falling

⁽²⁷⁾ See the judgment of the Court of Justice in Case C-409/00 *Spain v Commission* [2003] ECR I-1487, paragraph 52, the judgment of the Court of First Instance in Joined Cases T-92/00 and T-103/00 *Diputación Foral de Álava and Others v Commission* [2002] ECR II-1385, paragraph 60 and the case law cited.

⁽²⁸⁾ The granting of loans comes under the concept of the value maximisation of participations and is compatible with pure holding company status, but it must be an activity ancillary to the holding of a participation. The ancillary nature of the activity is not assessed by reference to the amount of the loan or to the purchase price or value of a participation. The authorities require, rather, that the exempt 1929 holding company should hold a substantial participation in the company being financed. A participation is deemed to be substantial where it amounts to 25 % of the capital of the company being financed. In the case of quoted companies, however, a lower level of shareholding does not rule out the granting of credit if a substantial part of the securities are available (floating) on the market. It should be noted that any financing must be terminated before or at the same time as the participation is disposed of.

⁽²⁹⁾ To qualify for 1929 holding company status, a consultancy firm must satisfy a series of requirements laid down by the tax authorities in Treasury Ministry Decision No 12.061 of 17 October 1968. In particular, it must have as its object the supervision and advising of a single open-ended or closed-ended investment company and it must invest at least 5 % of its capital in the company receiving its advice, with a minimum of EUR 50 000, the remainder being investable in other transferable securities of outside companies. The consultancy firm must have a company capital of at least EUR 76 000.

within several sectors, such as manufacturing, agriculture and commerce, are excluded from the benefit of the scheme.

- (82) The Commission considers that no objective explanation can justify such a tax treatment specifically reserved for exempt 1929 holding companies, seeking as it does, by thus limiting its application to certain undertakings, to place them at an advantage compared with their competitors.
- (83) The fact that the scheme in question is accessible only to Luxembourg undertakings carrying on a limited number of activities strengthens this assessment. In order to benefit from the exemption scheme in question, any undertaking wishing to maximise the value of its investments must set up a separate entity in Luxembourg for the purpose of carrying on exclusively the activities authorised by the 1929 legislation. The establishment of such a structure therefore entails investments on top of the normal costs of an investment activity. Only undertakings with a group structure and significant financial resources⁽³⁰⁾ of sufficient amount to establish in Luxembourg a structure devoted to the activities of managing and financing participations are able to benefit from the scheme. Such undertakings include, for example, exempt billionaire holding companies.

State resources

- (84) With regard to the state origin of the advantages resulting from the application of the scheme in question, it should be pointed out that the concept of aid is more general than that of subsidy because it embraces not only positive benefits, such as subsidies themselves, but also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, therefore, without being subsidies in the strict sense of the word, are similar in character and have the same effect⁽³¹⁾. It follows that a scheme, such as the one at issue here, by which the public authorities grant to certain undertakings exemption from the tax normally due, which, although not involving a transfer of state resources, places beneficiaries in a more favourable financial situation than other taxpayers constitutes state aid within the meaning of Article 87(1) of the Treaty⁽³²⁾. In the present case, therefore, although the exemptions resulting from the application of the exempt 1929 holding companies scheme do not constitute transfers of state resources, it cannot be denied that they lead to a loss of tax revenue and hence constitute state financing.

⁽³⁰⁾ See the judgment of the Court of First Instance in Joined Cases T-92/00 and T-103/00, cited above in footnote 27, paragraphs 38-40.

⁽³¹⁾ See *inter alia* the judgments of the Court of Justice in Cases C-143/99 *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke* [2001] ECR I-8365, paragraph 38; C-501/00 *Spain v Commission* [2004] ECR I-6717, paragraph 90 and the case law cited; Case C-66/02 *Italy v Commission*, not yet reported, paragraph 77; and Case C-222/04, referred to above in footnote 19, paragraph 131, and the case law cited.

⁽³²⁾ See, for example, the judgment of the Court of Justice in Case C-387/92 *Banco Exterior de España* [1994] ECR I-887, paragraph 14.

Distortion of competition and effect on trade between Member States

- (85) According to Luxembourg, the exempt 1929 holding companies scheme is not capable of distorting competition and trade within the Community because the beneficiary holding companies are exclusively passive recipients of income and are not in situations comparable to those of other operators acting as independent service providers. Nor, according to Luxembourg, has the Commission proved that the scheme has the effect of strengthening the position of exempt 1929 holding companies compared with that of other holding companies.
- (86) The Commission would point out that, under the settled case law of the Court of Justice of the European Communities, for a measure to distort competition it is sufficient that the recipient of the aid competes with other undertakings on markets open to competition⁽³³⁾ and that a measure affects intra-Community trade when state financial aid strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade⁽³⁴⁾.
- (87) The Commission considers that exempt 1929 holding companies are active in the financial sector, where they perform specific activities such as providing loans to other group members, issuing bonds, performing invoice discounting and managing cash deposits on behalf of both directly and indirectly controlled companies and other companies in a group to which an exempt 1929 holding company belongs, or providing advice on the management of investment funds. As indicated above, exempt financial holding companies and exempt billionaire holding companies enjoy increased operational flexibility under the 1929 legislation in the pursuit of such financing activities. Exempt 1929 holding companies are also active in purchasing, managing and licensing patents on behalf of directly and indirectly owned subsidiaries, or for other companies in the group.
- (88) In accordance with the process of deregulation which has characterised the Community market in financial services, competition in this sector is based primarily on the elimination of any institutional restrictions to the pursuit of financing activities in the common market and on transparency and equality of conditions in the pursuit of such activities where they are comparable. Competition is distorted, however, by the scheme in question inasmuch as exempt 1929 holding companies enjoy complete exemption from the direct taxes normally applicable in Luxembourg to the income from such activities, despite

⁽³³⁾ Judgment of the Court of First Instance in Case T-214/95 *Het Vlaamse Gewest v Commission* [1998] ECR II-717.

⁽³⁴⁾ Judgment in Case 730/79 *Philip Morris v Commission* [1980] ECR 2671, paragraph 11.

the fact that those activities are taxable where they are carried on by independent service providers or service providers who do not take the specific form of an exempt 1929 holding company.

- (89) Moreover, in view of the fact that the legal form of exempt 1929 holding company is frequently chosen by groups having an international dimension or whose activities cover various sectors, including the trading sector, trade between Member States is affected because of the tax advantages awarded to trading multinationals availing themselves of the services of exempt 1929 holding companies. Furthermore, exempt 1929 holding companies provide intra-group services and can, within certain limits, take part in the industrial and commercial activities of participated companies — which, as the Court of Justice confirmed in its recent judgment in *Fondazione Cassa di Risparmio di Firenze* ⁽³⁵⁾, constitutes a fully fledged economic activity. For all these reasons, and because of the commercial activities carried on by the groups to which exempt 1929 holding companies belong, the effect on trade and the distortion of competition are also present at the level of those groups.
- (90) These conclusions are strengthened by the finding of the considerable impact which the tax exemptions in question have on the choice of Luxembourg as a preferred financial centre. In this connection, the Commission considers it appropriate to refer to articles that have appeared in the press ⁽³⁶⁾, according to which the Luxembourg financial system is founded on the holding companies tax exemption scheme. This is evidence that financial multinationals use the structure of holding companies, including exempt 1929 holding companies, in Luxembourg to minimise their tax burden. According to these press articles, there are getting on for 15 000 exempt 1929 holding companies registered in Luxembourg.
- (91) Despite the lack of data from the Luxembourg authorities making it possible to establish the aggregate turnover achieved by exempt 1929 holding companies, the Commission considers there can be no denying how important the scheme is to the financial sector in Luxembourg or how substantial are the resulting distortions of competition and trade.

Compatibility

- (92) The Commission considers that the state aid granted to exempt 1929 holding companies cannot be considered compatible with the common market. The Luxembourg authorities have advanced no arguments to show that any of the exceptions provided for in Article 87(2) and (3) of the Treaty are applicable in this case.

- (93) The exceptions 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, clearly do not apply in this case.
- (94) The same goes for the exception provided in Article 87(3) (a) of the Treaty, which 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. Likewise, the scheme cannot be considered a project of common European interest or a remedy to a serious disturbance in the economy of Luxembourg, as provided for by Article 87(3)(b) of the Treaty. Nor does it have as its object the promotion of culture and heritage conservation as provided for by Article 87(3)(d) of the Treaty.
- (95) As regards lastly Article 87(3)(c) of the Treaty, which permits 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 contrary to the common interest, the Commission would point out that the tax advantages granted to exempt 1929 holding companies are not linked to investment, job creation or specific projects. They simply consist in a mitigation of the charges which should normally be borne by the companies concerned in the course of their business and must therefore be considered to be operating aid. In line with established Commission practice, such aid cannot be considered compatible with the common market if it does not facilitate the development of certain activities or of certain economic areas and if it is not limited in time, degressive or proportionate to what is necessary to remedy specific economic handicaps.
- (96) The Commission would observe that the mere fact that the tax advantages in question are exclusively reserved for companies registered in Luxembourg as exempt 1929 holding companies seems to contravene the freedom of establishment of business entities established in Luxembourg as well as being formed in other Member States ⁽³⁷⁾.

- (97) The Commission would point out in this connection that only companies established in company form in Luxembourg can benefit from the advantages afforded by the Luxembourg tax scheme to exempt 1929 holding companies and that this cannot be justified by the nature of the scheme. It would appear that a foreign undertaking carrying on activities comparable to those of an exempt 1929 holding company, including through a permanent establishment, an agency or a branch of a foreign company

⁽³⁵⁾ Case C-222/04, cited above in footnote 19, not yet reported, paragraph 112.

⁽³⁶⁾ See the interview with Carlo Thelen, a member of the Luxembourg Chamber of Commerce, published in the *International Herald Tribune* on 9 February 2006.

⁽³⁷⁾ Judgment of the Court of Justice in Case C-307/97 *Saint-Gobain* [1999] ECR I-6161.

within the meaning of Article 43 of the Treaty, cannot benefit from the advantages afforded by the exempt 1929 holding companies scheme. Against this background, the Commission cannot accept the Luxembourg authorities' commitment not to oppose the extension of exemption status under the Law of 31 July 1929 to include permanent establishments in Luxembourg of foreign companies which satisfy the conditions laid down in that Law. Article 87(1) of the Treaty makes no distinction according to the causes or aims of state aid, but defines it in terms of its effects⁽³⁸⁾. The Commission therefore confirms its preliminary assessment that the scheme in question places, first and foremost, foreign undertakings operating in Luxembourg which do not take the form of a Luxembourg company at a disadvantage compared with holding companies which do take the form of a Luxembourg company. This discrimination may therefore constitute a barrier to the freedom of establishment of foreign companies in Luxembourg contrary to the Treaty and hence incompatible with the common market.

- (98) The Commission would also point out in this connection that the procedure provided for in Article 88 of the Treaty must never produce a result which is contrary to other specific provisions of the Treaty. State aid, certain conditions of which contravene other provisions of the Treaty, cannot therefore be declared by the Commission to be compatible with the common market⁽³⁹⁾. In the present case, as already indicated, it would appear that the scheme in question would not benefit a foreign company operating in Luxembourg through a secondary establishment taking the form of a permanent establishment, an agency or a branch, within the meaning of Article 43 of the Treaty, taxable in Luxembourg. If a Member State grants, even indirectly, a tax advantage to undertakings having their registered office in its territory, while refusing to allow undertakings having their registered office in another Member State to benefit from that advantage, then the difference in treatment between these two categories of beneficiary is in principle prohibited by the Treaty, provided that there is no objective difference in situation between them.
- (99) In the light of all the above considerations, the Commission considers that the scheme in question cannot be considered compatible with the common market.

VI. CONCLUSIONS

- (100) The Commission finds that the tax scheme applicable to exempt 1929 holding companies constitutes state aid within the meaning of Article 87(1) of the Treaty and that none of the exceptions provided for in Article 87(2) or (3) of the Treaty applies. It also finds that, in spite of the amendments to the exempt 1929 holding companies scheme introduced by the Law of 21 June 2005, the

scheme still affords all the tax advantages in question, and this despite the fact that the circle of beneficiaries under the scheme is restricted to holding companies receiving less than 5 % of their dividends from foreign companies subject to less than 11 % corporation tax and to holding companies receiving dividends from foreign companies subject to at least 11 % corporation tax or from Luxembourg companies. The Commission concludes from this that the exempt 1929 holding companies scheme, as amended by the Law of 21 June 2005, constitutes state aid within the meaning of Article 87(1) of the Treaty and that none of the exceptions provided for in Article 87(2) or (3) of the Treaty applies.

- (101) The Commission notes that the exemption granted by the 1929 legislation has not been fundamentally modified since the Treaty entered into force. It considers, therefore, that the scheme in question constitutes existing aid within the meaning of point (b)(i) of Article 1 of Regulation (EC) No 659/1999. The amendments to the exempt 1929 holding companies scheme provided for by the Law of 21 June 2005 do not, in its view, introduce any new aid elements and do not increase the number of beneficiaries; the measure accordingly retains its nature as existing aid.
- (102) The Luxembourg authorities have argued that the Commission approved the amendments introduced by the Law of 21 June 2005 within the Council's Code of Conduct Group devoted to scrutinising harmful tax measures in the light of the Code of Conduct for Business Taxation⁽⁴⁰⁾ and that, as a result, the exempt 1929 holding companies scheme is in conformity with the Treaty. In response to this, the Commission would point out firstly that Article 87 does not exclude from its scope tax measures of any description. Secondly, neither the Law of 31 July 1929 nor any of its amendments, including those introduced by the Law of 21 June 2005, were notified to the Commission in accordance with Article 88(3) of the Treaty. Consequently, the Commission has not had occasion to decide on the compatibility of the scheme in question with the state aid rules.
- (103) No conclusions can therefore be drawn from the fact that the Commission took part in the proceedings of the Code of Conduct Group, the aim of which was to examine the harmful character of the tax measures in question. Suffice it to say that the procedure for examining tax schemes from a state aid point of view is legally independent of the work of the Code of Conduct Group. Moreover, the scope of the examination of the exempt 1929 holding companies scheme by the Code of Conduct Group was narrower than that of the present examination inasmuch as the Group focused solely on the exemption of dividends received by such companies.

⁽³⁸⁾ Judgment of the Court of Justice in Case C-159/01 *Netherlands v Commission*, not yet reported, paragraph 51 and the case law cited.

⁽³⁹⁾ Judgment of the Court of Justice in Case C-156/98 *Germany v Commission* [2000] ECR I-6857.

⁽⁴⁰⁾ See footnote 2.

- (104) It follows from this that the Group's examination cannot prevent the Commission from carrying out the present assessment or call into question the Commission's finding that the exempt 1929 holding companies scheme governed by the Law of 31 July 1929, as amended by the Law of 21 June 2005, constitutes state aid incompatible with the common market within the meaning of Article 87(1) of the Treaty.
- (105) The Commission considers that it is necessary to put an end to the granting of the various advantages conferred by the tax exemption scheme applicable to exempt 1929 holding companies either by abolishing them or by modifying them so as to make them compatible with the common market. As from the date of notification of this Decision, the advantages conferred by the scheme or its constituent parts may no longer be granted to new beneficiary companies registered in the form of exempt 1929 holding companies. To that end, the Luxembourg authorities will amend their legislation by 31 December 2006 at the latest.
- (106) With regard to existing exempt 1929 holding companies which currently enjoy tax exemption under the scheme described in this Decision, the Commission acknowledges that the existing aid nature of the scheme prevents any aid granted before the date of this Decision from being recovered.
- (107) The Commission takes note of the fact that interested third parties did not submit any comments or other information relevant to determining whether there is, on the part of beneficiaries of the scheme in question, a legitimate expectation such as might justify the adoption of individual transitional measures before the aid scheme is abolished. It has examined the information submitted by the Luxembourg authorities on 1929 holding companies' financing activities and the other arguments presented by those authorities concerning the legitimate expectations of current beneficiaries. The thrust of these is that the said beneficiaries should be allowed to continue enjoying the scheme's effects during a transitional period before it is abolished altogether.
- (108) In this respect the Commission would point out firstly that, in the light of the judgment of the Court of Justice of 22 June 2006 ⁽⁴¹⁾, neither Luxembourg nor the beneficiaries under the scheme can claim a legitimate expectation in the maintenance of the exempt 1929 holding companies scheme during the transitional period laid down by the Council (in the context of the work of the Code of Conduct Group) for dismantling those parts of the scheme that are deemed to be harmful. The state aid regime based on Articles 87-89 of the Treaty which is the subject matter of this proceeding is distinct from the Council's activities as part of the above-mentioned work.
- (109) The Commission would point out secondly that, although the exempt 1929 holding companies scheme is a permanent scheme, beneficiaries cannot in principle claim a legitimate expectation in its continued existence beyond the tax year to which the exemption applies. In particular, the scheme is not conditional on the carrying out of specific investments by beneficiaries, but is instead limited to exempting the income received by exempt 1929 holding companies during the tax period concerned.
- (110) Admittedly, however, the exempt 1929 holding companies scheme is still governed by the Law of 31 July 1929, which has not been significantly modified since it was promulgated. Although such longevity (76 years) is no guarantee of the scheme's permanence or of its compliance with the state aid rules, it may have given beneficiaries the impression that a tax scheme closely bound up with their activities would not be terminated all of a sudden and that they could reasonably expect those activities to continue. The business of 1929 holding companies consists, moreover, in the provision of medium- and long-term financing. This business is distinct from that of short-term financial trading and cannot be carried on outside of a lasting stable environment.
- (111) It is true that existing 1929 financial holding companies have invested heavily in the multinational groups to which they belong. This investment is aimed among other things at setting up and developing those multinational groups' infrastructure so as to coordinate and promote the growth of their business activities. Any questioning of their status would therefore lead to difficult and complex reorganisation operations which would take some time to complete.
- (112) Similarly, medium- and long-term commitments have been entered into towards staff and outside service providers so as to enable holding companies to perform the activities related to the international groups to which they belong. According to the Luxembourg authorities, there are almost 13 000 exempt 1929 holding companies currently active in Luxembourg; these contribute to the country's attractiveness as an international financial centre, the active population of which consists in any case of no more than 110 000 workers. The Commission must therefore be mindful of the relatively serious consequences that a decision to immediately abolish the exempt 1929 holding companies scheme might have for employment and economic growth in Luxembourg.
- (113) In view of the above, the Commission considers it reasonable to grant a transitional period to exempt holding companies existing on the date of this Decision. This transitional period will end on 31 December 2010. However, those companies which continue to benefit from the exemption scheme until 31 December 2010 will not be able to form the subject matter of any total or partial transfer for consideration of their capital throughout the duration of this transitional arrangement, the reason being

⁽⁴¹⁾ Joined Cases C-182/03 and C-217/03 *Kingdom of Belgium and Forum 187 asbl v Commission*, not yet reported, paragraphs 150-154.

that, in view of their nature as holding companies, when their parts are disposed of they can no longer have any legitimate expectation of continuation of the tax exemption scheme. In the case of income exemption on and after 1 January 2011, application of the exempt 1929 holding companies scheme will therefore be unlawful and may give rise to recovery of any advantage granted.

HAS ADOPTED THIS DECISION:

Article 1

The tax scheme currently in force in Luxembourg in favour of holding companies exempted on the basis of the Law of 31 July 1929 (hereinafter called 'exempt 1929 holding companies') is a state aid scheme incompatible with the common market.

Article 2

Luxembourg shall abolish the aid scheme referred to in Article 1 or amend it to make it compatible with the common market by 31 December 2006 at the latest.

As from the date of notification of this Decision, the advantages of the scheme or of its component parts may no longer be conferred on new beneficiaries.

In the case of exempt 1929 holding companies benefiting under the scheme referred to in Article 1 on the date of this Decision, the scheme's effects may be prolonged until 31 December 2010 at the latest. However, those companies which continue to benefit under the scheme referred to in Article 1 until 31 December 2010 may not form the subject matter of any total or partial transfer for consideration of their capital throughout the duration of this transitional exemption arrangement.

Article 3

Within two months of notification of this Decision, Luxembourg shall inform the Commission of the measures it has taken to comply with it.

Article 4

This Decision is addressed to the Grand Duchy of Luxembourg.

Done at Brussels, 19 July 2006.

For the Commission

Neelie KROES

Member of the Commission