

# Advocate General Opinions on Tax Autonomy of European Regions: From the *Basque Country Case* (1999) to the *Gibraltar Case* (2011)

**The author, in this article, explores the Advocate General Opinions in the *Basque Country*, *Azores*, *UGT-Rioja* and *Gibraltar* cases, with a focus on the issue of regional selectivity with respect to tax measures adopted by subnational authorities within Member States.**

## 1. Introduction

If there is a common element amongst the Opinions of Advocate General Saggio (1999),<sup>1</sup> Advocate General Geelhoed (2005),<sup>2</sup> Advocate General Kokott (2008)<sup>3</sup> and Advocate General Jääskinen (2011),<sup>4</sup> it is that all of them were delivered in cases regarding the complex and controversial topic of territorial selectivity with respect to tax measures adopted by subnational authorities within Member States. AG Geelhoed's and AG Kokott's Opinions, in the *Azores* (C-88/03)<sup>5</sup> and *UGT-Rioja* (C-428/06 to C-434/06)<sup>6</sup> cases, respectively, were fully endorsed by the ECJ in the related decisions and constituted the starting point of a new line of case law on this topic. At the time of writing this article, the decision in the *Gibraltar* cases (Cases C-106/09 P and C-107/09 P) had just been delivered.<sup>7</sup> Advocate General Jääskinen had proposed to the ECJ a completely independent non-binding

legal solution to the cases, which was rejected. However, with regard to the issue of regional selectivity, the line of reasoning in the *Azores* and *UGT-Rioja* cases was upheld.

This article outlines the criteria to be examined regarding regional selectivity and State aid regulations in the Treaty on the Functioning of the European Union (2007) (TFEU)<sup>8</sup> as interpreted in the Opinions of the Advocates General and ECJ case law, the Commission's approach to the issue, and the latest developments concerning the *Gibraltar* cases.

## 2. The Starting Point: AG Saggio's Opinion and the Basque Country Regime

On 1 July 1999, AG Saggio delivered his Opinion in the *Basque Country* cases (C-400/97, C-401/97 and C-402/97). The High Court of Justice of the Basque Country referred to the Court for a preliminary ruling the issue of the interpretation of articles 52 and 92 of the EC Treaty (now, articles 49 and 107 of the TFEU (2007)). The ECJ was asked to rule on the compatibility of certain provincial law provisions (*Normas Forales*)<sup>9</sup> with these TFEU articles, adopted by the three provincial authorities that belong to the Autonomous Community of the Basque Country in Spain, which regulated emergency fiscal measures to aid investment and stimulate economic activity.

For the purposes of this article, the focus is on the second part of the reference, which relates to whether corporate tax measures to encourage investment adopted by a region within a Member State, such as those adopted by the Basque provincial authorities, are compatible with the State aid provisions of the TFEU.

In deciding whether or not the measures adopted by the Basque authorities fell within the concept of State aid referred to in the TFEU, AG Saggio focused his assessment on three particular factors: (1) whether there was an appreciable advantage or benefit for companies obtained as a result of public measures; (2) whether the measures in question could be attributed to the Spanish State and (3) the selective nature of the State aid measures, in so far

\* Lawyer, Head of the Tax Policy Unit in the Tax Administration of Biscay (Basque Country-Spain). The author can be contacted at [gemma.martinez@bizkaia.net](mailto:gemma.martinez@bizkaia.net).

1. ES: Opinion of Advocate General Saggio, 1 July 1999, Joined Cases C-400/97, C-401/97 and C-402/97, *Administración General del Estado v. Juntas Generales de Guipúzcoa et Diputación Foral de Guipúzcoa* (referente for a preliminary ruling from the High Court of the Basque Country (*Tribunal Superior de Justicia de la Comunidad Autónoma del País Vasco*) (Basque Country cases)).
2. PT: Opinion of Advocate General Geelhoed, 20 Oct. 2005, Case C-88/03, *Portuguese Republic v. Commission of the European Communities* (action for annulment of State aid Decision 2003/442/EC) (*Azores*).
3. PT: Opinion of Advocate General Kokott, 8 May 2008, Joined Cases C-428/06 to C-434/06, *Unión General de Trabajadores de La Rioja (UGT-Rioja) and Others v. Juntas Generales del Territorio Histórico de Vizcaya and Others*, ECJ Case Law IBFD.
4. UK: Opinion of Advocate General Jääskinen, 7 Apr. 2011, Joined Cases C-106/09 P and C-107/09 P, *European Commission (C-106/09 P), Kingdom of Spain (C-107/09 P) versus Government of Gibraltar and United Kingdom*.
5. PT: ECJ, 6 Sept. 2006, Case C-88/03, *Portuguese Republic v. Commission of the European Communities (Azores)*.
6. PT: ECJ, 11 Sept. 2008, Joined Cases C-428/06 to C-434/06, *Unión General de Trabajadores de La Rioja (UGT-Rioja) and Others v. Juntas Generales del Territorio Histórico de Vizcaya and Others*, ECJ Case Law IBFD.
7. UK: ECJ, 15 Nov. 2011, Joined Cases C-106/09 P and C-107/09 P, *European Commission (C-106/09 P), Kingdom of Spain (C-107/09 P) versus Government of Gibraltar and United Kingdom*.

8. Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), EU Law IBFD.

9. These include regulations that are high-ranking (i.e. have priority over all other regulations), are of a general nature and are enacted by the General Assemblies of the Historical Territories, provinces, of the Basque Country.

as they were intended to favour certain undertakings or the production of certain goods.

The core of his analysis lies in the issue of regional specificity or selectivity.

AG Saggio held that there is no doubt that the measures adopted by the provincial authorities, by virtue of powers conferred by the Spanish legislation, constitute State aid in the form of fiscal advantages and are attributable to the state. Essentially, he concluded that *foral*<sup>10</sup> fiscal laws should be considered selective State aid because they are applicable only in part of the territory of the Spanish state, the Basque Country, and they contain provisions that are more advantageous than the general regime applicable in the rest of Spain. Therefore, they meet the requirement of regional selectivity.

Regarding the first requirement, AG Saggio, following settled ECJ case law,<sup>11</sup> readily concluded that the provincial laws at issue constitute aid. He relied on the decision in *Banco Exterior de España* (C-387/92),<sup>12</sup> wherein the ECJ stated that:

[...] a measure by which the public authorities grant to certain undertakings a tax exemption which, although not involving a transfer of State resources, places the persons to whom the tax exemption applies in a more favourable financial situation than other taxpayers constitutes State aid within the meaning of Article 92(1) of the Treaty.

From this sentence he concluded that the *Normas Forales* at issue constituted aid since they had the effect of mitigating the tax burden imposed on companies that fell within the scope of such laws.

With regard to whether or not measures adopted by regional authorities are attributable to the state, citing numerous ECJ decisions,<sup>13</sup> he concluded that the fact that the aid is adopted or granted by regional authorities does not prevent it from being attributable to the state for the purpose of EU State aid provisions and, therefore, the laws at issue in this case fall within the scope of the State aid concept in the TFEU.

In reaching this conclusion, he referred to the ECJ decision in *Germany v. Commission* (248/84), where a system of aid set up by the Land of Nordrhein-Westfalen under a programme to improve the regional economic structure in favour of companies established in certain areas of its territory was attributed to the German Federal Republic. In assessing the legality of the Commission Decision, which found the regional aid programme to be incompatible with the common market, the ECJ stated first that:

[...] the fact that the aid programme was adopted by a State in a federation or by a regional authority, and not by the federal or central power, does not prevent the application of Article 92(1)

10. *Foral* fiscal laws belong to a group of public and political rights that are constitutionally protected and that, for historical reasons, the Historical Territories of the Basque Country benefit from.
11. ES: ECJ, 3 June 2010, Case C-387/92, *Banco Exterior de España*; IT: ECJ, 19 May 1999, Case C-6/97, *Italy v. Commission*; and DE: ECJ, 14 Oct. 1987, Case 248/84, *Germany v. Commission*.
12. *Banco Exterior de España* (C-387/92).
13. DE: ECJ, 14 Oct. 1987, Case 248/84, *Germany v. Commission*; BE: ECJ, 8 Mar. 1988, Joined Cases 62/87 and 72/87, *Glaverbel v. Commission*; and IT: ECJ, 11 July 1984, Case 130/83, *Commission v. Italy*.

of the Treaty if the relevant conditions are satisfied. In fact, this provision, in referring to any aid granted by a Member State through State resources in any form whatsoever, is directed at all aid financed from public resources. It follows that aid granted by regional and local bodies of the Member States, whatever their status and description, must be scrutinised to determine whether it complies with Article 92 of the Treaty.<sup>14</sup>

The debate over regional selectivity and whether measures constitute State aid was discussed in paragraphs 32 et seq. of the Opinion. As he points out, the focus of the analysis is on how to determine what is the general tax system of a state where tax powers are assigned not only to the central state but also to regional bodies. By definition, the general tax system is the system that is commonly applied to companies and, therefore, not subject to review at the EU level under the State aid rules but under other less rigorous provisions in the TFEU regarding harmonization of tax laws. In his understanding, general provisions of a legislative and regulatory nature are those applied generally within a particular Member State, while measures attributable to the state that favour certain economic sectors or certain operators over others are to be regarded as “aid” within the meaning of article 92 of the EC Treaty (now, article 112 of the TFEU (2007)). At the same time, he admitted that, up to that time (1999) the ECJ case law had not identified, with any certainty, a criterion of a general nature that could be used to clearly delineate between the two concepts. In fact, he accurately cited ECJ case law that had essentially examined the element of specificity of a measure by reference to the beneficiaries of the aid: specific sectors, a particular company, or even companies situated in a particular region.<sup>15</sup>

Nevertheless, after admitting that there was no settled case law on the identification of the general tax system of a Member State, he held that the tax laws adopted by the General Assemblies<sup>16</sup> did constitute State aid within the meaning of article 92 of the EC Treaty, and not general measures regarding economic policy. His exact words are as follows:

These measures are selective in nature, whether one takes into consideration the recipients of the aid or whether one applies the criterion of the legislative measure as a derogation from the general system. They are intended exclusively for companies situated in a particular region of the Member State in question and constitute for them an advantage which companies intending to carry out similar economic operations in other areas in the same State cannot enjoy.<sup>17</sup>

The Advocate General proposed an analysis based on a comparison of the *foral* system with the Spanish common system but overlooked a crucial element, that is, the Spanish common system is not applicable in the

14. *Germany v. Commission* (248/84).
15. IT: ECJ, 2 July 1974, Case 173/73, *Italy v. Commission*; NL: ECJ, 2 Feb. 1988, Joined Cases 67/85, 68/85 and 70/85, *Kwekerij Gebroeders van der Kooy BV and others v. Commission of the European Communities*; and *Germany v. Commission* (248/84).
16. General Assemblies are the most democratic institutions for citizens to participate in in the Historical Territories, provinces, of the Basque Country. Being parliamentary assemblies, they approve laws relating to matters within their competence, i.e. taxation, and control and supervise the activity and performance of the *Foral* Deputation.
17. AG Opinion in the *Basque Country* cases (C-400/97, C-401-97 and C-402-97), at para. 35.

Historical Territories, as the defendants and the Spanish government alleged, due to the particular allocation of competencies in matters of taxation between the central administration and the Basque Country, which stems from the Spanish constitutional framework and is implemented by virtue of the Economic Agreement Law.<sup>18</sup>

AG Saggio held that there was specificity or selectivity, as the fiscal benefits were granted exclusively to companies that met the conditions required in the *Normas Forales*, in essence, companies that were resident, for tax purposes, in the Basque Country. He also found that there was selectivity in the fact that the measure was an “exceptional” legislative measure in relation to the “general system”. However, the author believes he made a mistake in regard to either the concept or category when he considered that the tax system applicable in the territory of the Spanish State (outside the Historical Territories) is the general system. It could be argued, instead, that it is just the system applicable in the biggest part of the Spanish territory and to most taxpayers in Spain.

In response to the arguments jointly put forth by the defendants in the main proceedings and the Spanish state, that: (1) the factors used to assign tax competence either to the Historical Territories or to the Spanish state are no different from those used to distribute competencies between sovereign authorities of two Member States and (2) differences between sovereign systems cannot constitute State aid for the purpose of article 91 of the EC Treaty (instead any distortions caused to the market should be resolved through the adoption of measures to harmonize national laws), AG Saggio answered that the presumed tax sovereignty:

[...] is merely a matter of form, which is not sufficient to justify the preferential treatment reserved to companies which fall within the scope of the provincial laws. If this were not the case, the State could easily avoid the application, in part of its own territory, of provisions of Community law on State aid simply by making changes to the internal allocation of competence on certain matters, thus raising the “general” nature, for that territory, of the measure in question.<sup>19</sup>

As will be discussed in sections 3. and 5., the Commission later referred to AG Saggio’s Opinion to support its Decisions in the *Azores* and *Gibraltar* cases.

From the author’s point of view, AG Saggio’s approach to this question is somewhat superficial. It is difficult to believe that any Member State would fragment its tax system into several distinct systems for the sole purpose of being able to argue the general nature of the measures. It also seems unlikely that a state could “easily” change its constitutional framework, as the Advocate General suggests.

In addition, AG Saggio adds that the arguments in favour of the general nature of the Basque measures would be difficult to justify in view of ECJ case law, in particular,

.....

18. ES: Economic Agreement Law, Ley 12/2002, de 23 de mayo, por la que se aprueba el Concierto Económico con la Comunidad Autónoma del País Vasco (BOE 24 May 2002).  
 19. AG Opinion in the *Basque Country* cases (C-400/97, C-401/97 and C-402/97), at para. 37.

the *Republic of Italy v. Commission (Region of Sicily)* (Case 173/73),<sup>20</sup> which provides that:

[...] all the measures which involve a competitive advantage limited to companies which invest in a particular area of the Member State are attributable to the State in question and cannot therefore, by definition, in the scheme of the fiscal system of the State, be understood as measures of a general nature.

However, in regard to the Basque Country, the issue is not the distribution of competence within a single tax system but the existence of different systems, as the ECJ confirmed years later in the *UGT-Rioja* case, which is addressed in section 4.

The ECJ never decided this case and, therefore, the Opinion was never taken into account by the Court. By an order of 16 February 2000, the President of the ECJ decided to withdraw the cases from the Court register. On 8 February 2000, the High Court of the Basque Country informed the ECJ, in writing, that the preliminary ruling, referred by a writ of 30 July 1997, was being withdrawn.

As will be seen, AG Geelhoed’s Opinion in *Azores* in 2005 fully abandoned the legal reasoning introduced by AG Saggio and led to a new line of reasoning in regard to the assessment of regional selectivity.

### 3. The New Line of Reasoning: AG Geelhoed and the *Azores* Case

This case concerns the annulment of Commission Decision 2003/442/EC,<sup>21</sup> which found that reductions in the IRC rate for taxpayers domiciled in the Portuguese autonomous region of the Azores, insofar as they applied to the financial sector, constituted State aid that was incompatible with article 87(3)(a) of the EC Treaty (now, article 107(3)(a) of the TFEU) (i.e. regional aid), as well as other exceptions provided for in the EC Treaty.

In its decision,<sup>22</sup> the ECJ, following AG Geelhoed’s Opinion,<sup>23</sup> stated that regional fiscal autonomy does not give rise to selectivity per se, thereby justifying the fiscal autonomy of regions within Europe.

Specifically, the ECJ held that:<sup>24</sup>

It is possible that an infra-State body enjoys a legal and factual status which makes it sufficiently autonomous in relation to the central government of a Member State, with the result that, by the measures it adopts, it is that body and not the central government which plays a fundamental role in the definition of the political and economic environment in which undertakings operate. In such a case it is the area in which the infra-State body responsible for the measure exercises its powers, and not the country as a whole, that constitutes the relevant context for the assessment of whether a measure adopted by such a body favours certain undertakings in comparison with others in a comparable legal and factual situation, having regard to the objective pursued by the measure or the legal system concerned.

.....

20. *Italy v. Commission* (173/73).  
 21. European Commission Decision 2003/442/EC of 11 December 2002 on the part of the scheme adapting the national tax system to the specific characteristics of the Autonomous Region of the Azores which concerns reductions in the rates of income and corporation tax, OJL 150 (2003), p. 52.  
 22. *Azores* (C-88/03).  
 23. AG Opinion in *Azores* (C-88/03).  
 24. *Azores* (C-88/03), at para.58.

The Commission's argument that such an analysis is rendered inadmissible by the wording of the Treaty and the well-established case-law in that field cannot be accepted.

This ECJ's approach to the territorial specificity criterion in regard to State aid derives from AG Geelhoed's Opinion, in which he clearly identified, from the outset, the relevant issue, which is in what circumstances variations in the national tax rate, adopted solely for a designated geographical area of a Member State, fall under the definition of State aid.

In order to better situate the AG's Opinion and the ECJ decision, the background of the case should be briefly outlined. In 2000, the Portuguese authorities gave notice to the Commission of a scheme adapting the national tax system to the specific characteristics of the Autonomous Region of the Azores. The measures, approved by the legislative body of the Azores Region, included, in particular, a reduction in the personal income tax rate of initially 15% (later 20%), and in the corporate tax rate of 30%, for taxpayers in the region.

Taking into account the State aid rules, the Commission viewed the tax reductions for residents of the Azores as State aid. After examining the scheme, in light of the guidelines on national regional aid, the Commission, however, considered that such aid met the conditions for being considered as compatible with the Common Market under the derogations of article 87(3)(a) of the EC Treaty, i.e. "aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious under-employment".

Nevertheless, the Commission Decision included a caveat that there should be a distinction between the financial and non-financial sectors. In fact, in respect of financial sector firms, the Commission stated that such corporate tax reductions were "not justified by their contribution to regional development" and, therefore, the tax reductions did not qualify as permitted regional aid under article 87(3)(a) of the EC Treaty or under any other derogation the Treaty provides for. The reasoning was that the existence of real regional handicaps has little relevance to mobile activities, such as financial services and firms that engage in "intra-group services" or act as "coordination centres". Accordingly, Portugal was ordered to recover the aid made available to firms carrying on financial or intra-group service activities. Since Portuguese law did not provide for any intra-group service regimes, it was financial institutions benefitting from the reduced rates that were most impacted by the decision.

Even though the Commission Decision only impacted financial firms with activities in the Azores, it could be said that the holding on regional selectivity limited future plans for future divergence between the tax system of mainland Portugal and the tax regimes in place in the two autonomous regions, namely the Azores and Madeira.

For the purpose of this article, what is most relevant concerning the Commission Decision is not the fact that the Commission found Portugal had unlawfully implemented the part of the scheme that adapted the national

tax system to the specific characteristics of the Azores (i.e. the individual and corporate tax rate reductions), contrary to article 88(3) of the EC Treaty (now article 108 of the TFEU (2007)), or even the fact that the Commission considered it met the conditions for being regarded as compatible with the common market under the derogations of article 87(3)(a) of the EC Treaty, with the exception of aid awarded to firms that carry on financial activities or "intra-group service" activities.

Indeed, its relevance lies in the fact that the Commission strongly supported the idea of regional selectivity:<sup>25</sup>

The Commission considers first that the element of selectivity in the concept of aid is based on a comparison between the advantageous treatment granted to certain firms and the treatment that applies to other firms in the same reference framework. [...] In this respect the text of the Treaty itself, which classifies measures intended 'to promote the economic development' of a particular region (Article 87(3)(a) and (c)) as State aid that may be considered to be compatible, indicates that benefits whose scope is limited to part of the territory of the State subject to the rules on aid may constitute selective benefits. [...] The settled practice of the Commission, confirmed by the Court of Justice, on the contrary consists of classifying as aid tax schemes applicable in particular regions or territories which are favourable in comparison to the general scheme of a Member State.

In fact, the Commission stated that:

[...] the Portuguese authorities' argument according to which benefits of limited territorial scope become general measures in the region concerned simply because they are established by the regional rather than by the central authority, and that they apply throughout the territory under the region's jurisdiction, cannot be reconciled with the concept of aid [...]. A distinction based solely on the body that decides the measure would remove all effectiveness from Article 87 of the Treaty, which seeks to cover the measures concerned exclusively according to their effects on competition and Community trade. Such aid therefore cannot be treated differently from measures which have the same objectives, use the same resources and have the same effects on trade and competition, according only to the formal criterion of the degree of autonomy of the infra-State authority that establishes it.<sup>26</sup>

In conclusion, the Commission pointed out that the use of a purely institutional criterion to differentiate "aid" from "general measures" would inevitably lead to differences in treatment in the application of the State aid rules to Member States according to whether they have adopted a centralized or decentralized model of allocating tax competence. It also considered that if measures that are completely identical in their objectives, technique and effects are not subject to the same rules it would be contrary to equal treatment and would create serious distortions in the functioning of the common market. The application of the rules on aid to regional tax benefits should be based on objective criteria and cannot depend on a purely institutional factor such as the application at a particular time of more or less extensive tax autonomy in favour of an infra-state authority of more or less broad territorial scope. If this technique were generalized, it would undermine equality in the application of State aid rules, making them ineffective.

25. Commission Decision 2003/442/EC, at para. 26.

26. Commission Decision 2003/442/EC, at para. 27.

Moreover, the Commission was not alone in its conclusions. It relied on the conclusions in AG Saggio's Opinion in the *Basque Country* cases to support its reasoning.

Portugal, challenged the Commission Decision on three grounds, the first being the relevant issue for the purposes of this discussion. The key argument was that the reduced rates were not selective but general measures, since the reference framework should have been the region and not the entire Portuguese territory. The Commission, on the other hand, submitted that the selectivity of a measure was to be determined by reference to the national framework and that the degree of autonomy of the Autonomous Region of the Azores was, in fact, limited.

AG Geelhoed's Opinion highlighted that since the ECJ had never addressed this specific question, namely the applicability of State aid rules to a regional autonomy, it was for the ECJ to set out the applicable principles and the parameters of application. For this purpose, the AG distinguished three different scenarios,<sup>27</sup> which depended on the decentralization model adopted by a particular state:

- firstly, if a central government of a Member State unilaterally decides that the national tax rate should be reduced within a defined geographic area, such a measure should clearly be regarded as selective;
- secondly, if all the local or regional authorities have the power to set the tax rate for their geographical jurisdiction, whether with or without reference to a "national" tax rate, the measure is non-selective within the meaning of the State aid provisions; and
- thirdly, where a tax rate lower than the national tax rate is decided upon by a local authority and applicable only within the territory of that local authority, the selective nature of the measure depends on whether or not the lower tax rate results from a decision taken by a local authority that is "truly" autonomous (i.e. institutionally, procedurally and economically autonomous) from the central government of the Member State. This last scenario is the relevant one to be addressed in the case.

By institutional autonomy, the AG was referring to infra-state bodies with a constitutional, political and administrative status that is separate from that of the central government.

By procedurally autonomous, the AG was referring to the independence of the infra-state body in regard to the procedure for setting the tax rate and the lack of obligation on the part of the local authority to take the interests of the central state into account.

Finally, by economically autonomous, the AG was referring to whether or not the forgone tax revenue, through a tax reduction, is cross-subsidized or financed by the central government, so that the economic consequences of such tax reductions are not ultimately borne by the region itself.

The AG then concluded that when a local authority decides to institute a tax rate that is lower than the

27. AG Opinion in *Azores* (C-88/03), at para. 48 et seq.

national rate and exercises its tax autonomy institutionally, procedurally and economically, such decision cannot be qualified as "selective" for State aid purposes.

The ECJ decision in the case<sup>28</sup> fully followed AG Geelhoed's Opinion. For the purpose of examining a measure adopted by an infra-state body in their exercise of powers that are sufficiently autonomous vis-à-vis the central power, the ECJ referred to the AG's three scenarios. The ECJ found that the exercise of sufficiently autonomous powers requires constitutional autonomy (i.e. separate political and administrative status), procedural autonomy (i.e. no direct intervention by the central government) and financial autonomy (i.e. the cost of tax reductions must be borne by the autonomous region and not offset by aid or subsidies).<sup>29</sup>

The ECJ sets out the fundamental parameters of the new doctrine, i.e. that a measure conferring an advantage in only one part of the national territory is not selective on that ground alone for the purposes of article 87(1) of the EC Treaty. If an infra-state body enjoys a legal and factual status that makes it sufficiently autonomous in relation to the central government of a Member State, then what is relevant is the area in which the infra-state body responsible for the measure exercises its powers, and not the country as a whole, in assessing whether a measure adopted by such a body favours certain undertakings in comparison with others in a comparable legal and factual situation.<sup>30</sup>

It is noteworthy that the ECJ firmly rejected the Commission's interpretation of article 87 of the EC Treaty.<sup>31</sup>

In applying the principles laid down by the AG to the Azores scenario, the ECJ started by noting that the Azores islands have been designated an "autonomous region" and that this region has the power, in certain circumstances, to exercise its own fiscal competence including the right to adapt national fiscal provisions to regional specificities. Nevertheless, the ECJ also noted that the reduction in tax revenue resulting from the lower rates was offset by a financing mechanism in the form of compensatory financial transfers from the central state. In this regard, the ECJ considered that the decision of the government of the Autonomous Region of the Azores to exercise its power to reduce the rates was not economically autonomous in view of such transfers from the central government.

The ECJ considered that the relevant legal framework for determining the selectivity of the reduced tax rates was the whole of the Portuguese territory and those tax reductions were not justified by the nature or the overall structure of the Portuguese tax system.

In conclusion, a new framework for assessing the regional selectivity criterion was established by AG Geelhoed in the *Azores* case. The ECJ's decision, which endorsed this framework, definitively setting aside AG Saggio's approach, was the first decision on this issue.

28. *Azores* (C-88/03).

29. *Azores* (C-88/03), at para. 67.

30. *Azores* (C-88/03), at paras. 57 and 58.

31. *Azores* (C-88/03), at para. 60.

#### 4. Confirmation of the ECJ Doctrine in the Azores Case: AG Kokott and the UGT-Rioja Case

In 2005, the three Historical Territories of the Basque Country in Spain adopted, in their provincial laws (*Normas Forales*), certain corporate tax provisions, including, amongst others, a general tax rate of 32.5% and a series of tax credits. The general corporate tax rate in Spain was 35% and such tax credits were not available.

The new provisions were challenged in the High Court of the Basque Country by two Autonomous Communities, La Rioja and Castilla y Leon, and by a trade union (UGT). Given the High Court's concerns regarding the application of the *Azores* case, it referred the case to the ECJ for a preliminary ruling. The High Court asked the ECJ whether or not the *foral* tax measures were selective measures conferring an advantage to certain undertakings or in regard to the production of certain goods and, accordingly, constitute State aid that is incompatible with the common market on the sole ground that they do not apply to the whole territory of the Member State concerned.<sup>32</sup>

On 8 May 2008, AG Kokott delivered her Opinion,<sup>33</sup> wherein she states that the regional nature of the tax rules is the crucial point. She considered that these cases would give the ECJ a new opportunity to develop, in depth, the line of reasoning initiated in the *Azores* decision.

The difference in the procedural situation between the *Azores* case and the *UGT-Rioja* case should be pointed out. The *Azores* decision was given in an action for annulment brought by Portugal pursuant to article 230(1) of the EC Treaty (now, article 263 of the TFEU (2007)) against a Commission Decision. The Court, therefore, had to give the final decision on whether or not the Commission had proved that the contested measure constituted State aid. The *UGT-Rioja* case, on the other hand, involved a preliminary ruling under article 234 of the EC Treaty (now, article 267 of the TFEU (2007)), and, therefore, even though the ECJ considered the specific situation in the main proceedings, the referring national court was still responsible for assessing whether or not the contested rules of the Historical Territories were to be classified as selective measures and thus as State aid. In this case, AG Kokott provided complete legal reasons, which were endorsed by the ECJ in its decision, but it falls within the jurisdiction of the national court to determine whether or not the measures at issue are selective.

32. *UGT-Rioja* (C-428/06 to C-434/06), at para. 32: "Must Article 87(1) EC be construed as meaning that, by providing for a rate of tax lower than the basic rate set in Spanish State legislation and for deductions from the amount of tax payable which do not exist in State tax legislation, provisions in the field of taxation adopted by the Juntas Generales del Territorio Histórico de Vizcaya amending Articles 29(1)(a), 37 and 39 of the Provincial Law on Company Tax, which take effect in the jurisdiction of that infra-State autonomous body, must be regarded as selective and as covered by the definition of State aid enshrined in Article 87(1) EC and, accordingly, must be notified to the Commission pursuant to Article 88(3) EC?"

33. AG opinion in *UGT-Rioja* (C-428/06 to C-434/06).

AG Kokott's Opinion and the corresponding ECJ decision<sup>34</sup> not only confirmed every aspect of the *Azores* decision and the ECJ's approach towards regional selectivity, it also, in some respects, clarified and reinforced some elements of the decision.

In the proceedings, the Commission tried to force the ECJ to reinterpret the requirements set out in the three-part test in the *Azores* case for a region to be considered as sufficiently autonomous in light of the State aid policy and add a precondition for meeting the test. The argument was that, before examining the three-criteria test, it must be determined whether the authority "plays a fundamental role in the definition of the political and economic environment in which undertakings operate" (paragraph 58). AG Kokott, in applying the findings in *Azores* to the measures adopted by the Historical Territories, rejected this argument.

The Commission argued that the Historical Territories actually have very limited powers to define the environment for business, since they have powers to regulate tax law but hardly any competence to decide on the use of tax revenue in regard to expenses, which falls under the authority of either the Autonomous Community of the Basque Country or the state.

After first pointing out that, according to the EC Treaty, even Member States no longer possess full autonomy in regard to economic policy, AG Kokott, examining more closely the relevant paragraph of the *Azores* case, affirmed that the Court is concerned about autonomy in adopting the specific measures and not the general freedom to act in regard to economic policy<sup>35</sup> and, therefore, it is possible for an infra-state body to enjoy:

[...] a legal and factual status which makes it sufficiently autonomous in relation to the central government of a Member State, with the result that, by the measures it adopts, it is that body and not the central government which plays a fundamental role in the definition of the political and economic environment in which undertaking operates [...].

According to the Advocate General, if the Commission's interpretation of the *Azores* decision were correct, the Court would have had to reject autonomy in that case, as the regional competencies were restricted to adjusting the tax rate. Instead, it examined in detail whether, in the exercise of that competence, the region acted autonomously from an institutional, procedural and financial point of view.

Following this reasoning, the ECJ confirmed the lack of a precondition to the three-criteria test. It came to a completely different interpretation of paragraph 58 of the *Azores* decision in concluding that the fundamental role is a consequence of autonomy and not a precondition for that autonomy. Further, when an infra-state body is institutionally, procedurally and economically sufficiently autonomous, it necessarily plays a fundamental

34. *UGT-Rioja* (C-428/06 to C-434/06).

35. *Azores* (C-88/03), at para. 58.

role in the definition of the political and economic environment in which the undertakings operate.<sup>36</sup>

AG Kokott answered the question referred by the High Court of the Basque Country as follows:

Article 87(1) EC must be construed as meaning that the tax rules adopted by a local authority in a Member State, which apply in the same way to all undertakings subject to its fiscal sovereignty and which are more favourable than the general tax rules of that Member State, do not constitute an advantage for certain undertakings and the production of certain goods where the local authority has sufficient autonomy in the exercise of its legislative powers in the field of tax law. Such autonomy requires that:

- the local authority has institutional independence,
- the central State cannot have decisive influence in the procedure leading to the adoption of the local tax rules (procedural organisational autonomy),
- the local authority has sufficiently wide discretion in organizing its tax rules, which allow it to pursue independent finance policy aims (substantive organisational autonomy) and
- the local authority itself bears financial responsibility for shortfalls in tax revenue stemming from the rules which are more favourable than the general tax legislation (financial autonomy).

Therefore, in general, she adhered to the criteria set out in the *Azores* case with the result that the reference framework is the regional territory, herein the Basque Country, if the measures are adopted by infra-state bodies that are sufficiently autonomous from an institutional, procedural and financial point of view. However, she brought up a nuance to the concept of procedural autonomy when she differentiated between procedural organizational autonomy and substantive organizational autonomy.

In reaching her conclusions, she focused on procedural and financial autonomy since the institutional autonomy of the Historical Territories and their organs was not questioned by the referring High Court or any of the parties to the proceedings before the ECJ.

Regarding the “procedural autonomy” referred to in the *Azores* decision, AG Kokott coined it as “organizational autonomy” and split it into procedural and substantive organizational autonomy:<sup>37</sup>

Procedural organisational autonomy exists where the central State is not able to intervene directly in the procedure leading to the adoption of the tax rules, for example by approving the rules, lodging a veto against the adoption of the rules, or assuming competence for their adoption.

According to her reasoning, procedural organizational autonomy is not affected where the central state and the local authority inform and consult one another about legislative plans, at least where the local authority remains free to implement a plan regardless of whether or not the central government is opposed to it. She states, “substantive organisational autonomy means that the local legislator is able to decide freely on the structure of the tax rules”.<sup>38</sup> She remarks, however, that the legislators of Member States do not even have full autonomy due to constitutional and EU law limits.

In evaluating procedural autonomy, the Advocate General introduced another guideline for assessing regional autonomy, i.e. the role judicial review plays.

The High Court was concerned that the tax rules are subject to judicial review, which review can extend all the way to the central state court as a court of last instance. In addition, some parties to the main proceedings claimed that judicial review of the Basque Country tax laws has an effect on the procedural autonomy of the Historical Territories. Other parties contended, however, that that review is not relevant to the assessment of the autonomy criterion.

According to the AG’s Opinion, it is common for states that are based on the rule of law to make their legislation subject to judicial review and, as long as the examination does not extend to the expediency of the local tax laws, judicial review does not constitute an additional restriction on the autonomy of the local or regional authority. AG Kokott believed it was irrelevant, for the purpose of the case, that the Supreme Court, the highest central court in Spain, is competent to judicially review the Basque Country tax regulations.

After making this distinction and analysing the particular case of the Basque Country, the AG considered both elements of her “organizational autonomy” test, without prejudging the referring High Court’s final assessment.

In regard to the procedural condition, the ECJ upheld AG Kokott’s reasoning and conclusions, although it followed the concept and terminology set out in the *Azores* case, i.e. it gave no relevance to AG Kokott’s subcategories.

The ECJ assessed the relevance of judicial review prior to the three autonomy criteria and not as a part of the procedural criterion. However, its approach was in line with the AG’s Opinion.<sup>39</sup>

The purpose of reviewing the legality of acts is to enforce compliance with the pre-established limits on the areas of competence of the different State authorities, organs or bodies, not to determine those limits. As the Spanish Government stated at the hearing, the existence of judicial review is inherent in the existence of the rule of law. [...] However, the review decision is limited to interpreting the law establishing the limits of the areas of competence of such a body and cannot generally call into question the exercise of those powers within those limits. It follows that it is the applicable laws as interpreted by the national courts which determine the limits of the areas of competence of an infra-State body and which must be taken into account for the purpose of verifying whether that body has sufficient autonomy. Consequently, it cannot validly be found that an infra-State body lacks autonomy solely on the ground that the acts which it adopts are subject to judicial review.

According to the author, AG Kokott’s greatest contribution to regional autonomy concerns her assessment of the fiscal autonomy of the Basque Country.<sup>40</sup> She formulated this criterion following the *Azores* doctrine,<sup>41</sup> however, she pointed out that, in cases where financial relations with the state are complex, as in the case of the Basque

36. *UGT-Rioja* (C-428/06 to C-434/06), at paras. 54 and 55.

37. AG opinion in *UGT-Rioja* (C-428/06 to C-434/06), at para. 85.

38. AG opinion in *UGT-Rioja* (C-428/06 to C-434/06), at para. 89.

39. *UGT-Rioja* (C-428/06 to C-434/06), at paras. 73 to 83.

40. AG Opinion in *UGT-Rioja*, para. 106 et seq.

41. *Azores* (C-88/03), at para. 67.

Country, the application of the criterion raises considerable practical difficulties. Therefore, there is a need for a comprehensive assessment of financial relations between the central state and its subdivisions. In her opinion, the mere existence of a financial transfer from the central state to the local or regional authority does not prevent *per se* the financial autonomy criterion from being met by the infra-state body, since such a financial transfer can take place for a variety of reasons that have no connection with the local or regional tax rules. According to this reasoning, the element of cause-and-effect in the assessment of the financial autonomy criterion was introduced. In order to establish such a connection between financial transfers and the local tax legislation she considered that two requirements must be satisfied. First, the level of local tax revenue must be included as a parameter in determining any financial transfer. Secondly, a reduction in tax revenue must also lead to a corresponding compensatory adjustment in the transfer of funds between the state levels.

As the quota<sup>42</sup> (*cupo*) is the main instrument in financial relations between the central state and the Autonomous Community of the Basque Country, to which the national High Court and the parties in the proceedings before the ECJ referred, AG Kokott remarked that:

On the whole, the explanations given by the parties in their written statements and in response to a question asked by the Court at the hearing give the impression that the definition of the quota represents something of a political compromise and is not a direct consequence of the change to certain economic parameters, including the level of the tax revenue. [...] In any case, the Spanish Government takes the view that changes to the tax revenue of the Historical Territories do not influence the amount of the quota. If the referring court were to come to the same conclusion and no other compensatory mechanisms were to intervene, there would be sufficient financial autonomy on the part of the Historical Territories.<sup>43</sup>

With regard to the third condition, the ECJ stated, in particular, that it relates to both “economic and financial autonomy”:[...] Those three conditions are commonly considered to be the criteria of institutional, procedural, and economic and financial autonomy”.<sup>44</sup>

The ECJ’s evaluation of the economic and financial autonomy criterion in the *Basque Country* case also followed AG Kokott’s legal construction, focusing on the quota.<sup>45</sup> Concerning the attribution rate, which is essential in calculating the quota, it concluded that, although the rate is determined on the basis of economic data, it is set during the course of political negotiations between the Spanish state and the Autonomous Community of the Basque Country. Therefore, “a decision to reduce the tax rate thus does not necessarily have an impact on the level of that rate”.

Concerning the undervaluation of the attribution rate and the minor contribution to the state budget by the

42. This is the amount the Basque Country must pay to the state in order to finance competencies that have not effectively been delegated to or assumed by it.  
43. AG Opinion in *UGT-Rioja*, paras. 115 and 116.  
44. *UGT-Rioja* (C-428/06 to C-434/06), at para. 51.  
45. *UGT-Rioja* (C-428/06 to C-434/06), at para. 123 et seq.

Basque Country alleged by the Commission and by some of the parties to the main proceedings, the ECJ reiterated that its jurisdiction in regard to the preliminary ruling was restricted to the interpretation of article 87(1) of the EC Treaty. It had no role in deciding, in the main proceedings, whether or not the attribution rate calculated on the quota was correctly calculated from an economic perspective, or whether it was undervalued. It added that such alleged undervaluation was only one indicator of the lack of economic autonomy of the Historical Territories. According to the ECJ, “[t]here must be compensation, namely, a causal relationship between a tax measure adopted by the *foral* authorities and the amounts assumed by the Spanish State”<sup>46</sup> and the national High Court has the jurisdiction to examine and determine whether or not, “the setting of the attribution rate and, more generally, the calculation of the quota may have the effect of causing the Spanish State to compensate the consequences of a tax measure adopted by the *foral* authorities”.<sup>47</sup>

In concluding its analysis of economic and financial autonomy it tackled the issue of certain financial transfers between the Basque Country and the Spanish state. In keeping with the AG’s Opinion and contrary to what the Commission claimed, it reiterated that in order for the economic and financial autonomy criterion not to be met, the cause-and-effect element must be satisfied in regard to the financial transfer.<sup>48</sup>

[...] the mere fact that it appears from a general examination of the financial relations between the central State and its infra-State bodies that there are financial transfers between the former and the latter, cannot, in itself, suffice to demonstrate that those bodies do not assume the financial consequences of the tax measures which they adopt and, accordingly, that they do not enjoy financial autonomy, since such transfers may take place for reasons unconnected with the tax measures.

## 5. An Opportunity for ECJ Doctrine on Tax Autonomy of European Regions To Be Consolidated: AG Jääskinen and the *Gibraltar* Case

The Court of First Instance’s decision in the *Gibraltar* case (Joined Cases T-211/04 and T-215/04)<sup>49</sup> overturned Commission Decision 2005/261/EC of 30 March 2004,<sup>50</sup> which prohibited Gibraltar from enacting new tax legislation that would provide for an attractive offshore location for mobile business activities. Indeed, the *Azores* and *Basque Country* decisions, as well as AG Kokott’s approach to territorial selectivity were taken into account by the CFI in analysing the appeals, even though there is no specific reference in the decision to the latter (only the *Azores* case is referred to). A closer look at the dates would lead us to presume the CFI was actually waiting

46. *UGT-Rioja* (C-428/06 to C-434/06), at para. 129.

47. *UGT-Rioja* (C-428/06 to C-434/06), at para. 131.

48. *UGT-Rioja* (C-428/06 to C-434/06), at para. 135.

49. UK: ECJ, 18 Dec. 2008, Joined Cases T-211/04 and T-215/04, *Government of Gibraltar and United Kingdom v. Commission*.

50. European Commission Decision 2005/261/EC of 30 March 2004 on the aid scheme which the United Kingdom is planning to implement as regards the Government of Gibraltar Corporation Tax Reform, OJ L85 (2005).

for the ECJ to deliver its decision in the *UGT-Rioja* case<sup>51</sup> in order to verify whether the *Azores* doctrine would be confirmed or whether a new approach to regional selectivity would be developed by the ECJ, which could have included variations on the precondition element, which the Commission argued should be applied prior to the three-part test (see section 4.).

According to Gibraltar’s planned reform, which the United Kingdom notified the Commission of on its behalf, companies domiciled in Gibraltar would have been subject to a yearly payroll tax (per employee) and to a business property occupation tax. As such, every employer in Gibraltar would have been required to pay payroll tax for each of its full-time and part-time employees employed in Gibraltar plus a business property occupation tax at a rate equivalent to a percentage of their liability for general property tax in Gibraltar. One interesting and controversial point of the reform was that the liability for payroll tax, together with business property occupation tax, would have been capped at 15% of profits. The project included other features, such as a registration fee applicable to all Gibraltar companies and an additional top-up or surtax on profits generated from certain designated activities.

The *Gibraltar* case, similar to the *Azores* and *UGT-Rioja* cases, raised the issue of the conditions needed for regional tax powers to be in line with the State aid policy of the European Union. However, in this case, an additional issue was raised, i.e. the existence of the material selectivity element of State aid in Gibraltar’s proposed corporate tax regime.

In scrutinizing the reform plans, the Commission considered that a number of its features would likely confer an advantage on Gibraltar companies. The first ground of dispute was regional selectivity, i.e. the concern that the proposed system would grant an advantage to Gibraltar companies compared with UK companies. The proposal was to set the basic corporate tax rate in Gibraltar at 15%, rather than the United Kingdom’s 30% statutory corporate tax rate.

The Commission’s view is that the difference in rates amounts to a selective advantage for companies active in Gibraltar. According to the Commission, a distinction based solely on the body that decides the measure would eliminate the effectiveness of article 87 of the EC Treaty (now, article 107 of the TFEU), which is intended to cover such measures due to their effect on competition and Community trade. The Commission, in making its point on regional selectivity, even referred to the controversial position outlined in AG Saggio’s Opinion in the *Basque Country* cases (see section 2.). Following his reasoning, the Commission stated that measures adopted by regional authorities, with exclusive competence under national law, are merely a matter of form, which is not sufficient to justify the preferential treatment reserved to

companies that fall under the provincial laws. If this were not the case, the State could easily avoid the application, in part of its own territory, of provisions of EU law on State aid simply by making changes to the internal allocation of competence over certain matters, thus raising the “general” nature, for that territory, of the measure in question.<sup>52</sup>

Even if they were to apply automatically and equally to all economic operators liable for tax in Gibraltar, without introducing any difference in treatment in favour of one or more sectors of activity, which is not the case here, the abovementioned tax reductions “are intended exclusively for companies situated in a particular region of the Member State in question and constitute for them an advantage which companies intending to carry out similar economic operations in other areas in the same State cannot enjoy”.<sup>53</sup> In this case the abovementioned tax reductions do in fact favour firms taxed in Gibraltar, in comparison with all firms active in the United Kingdom.<sup>54</sup>

In addition, the Commission pointed out that the use of a purely institutional criterion to differentiate aid from general measures would inevitably lead to differences in treatment in the application of the State aid rules to Member States, according to whether they had adopted a centralized or decentralized model of allocating tax competence.

The governments of Gibraltar and the United Kingdom brought actions for annulment against the Commission Decision and, as a result, the CFI overturned the Decision, delivering detailed reasons wherein they concluded that the reference framework corresponded exclusively to the geographical limits of the territory of Gibraltar, meaning that no comparison can be made between the tax regime applicable to companies established in Gibraltar and that applicable to companies established in the United Kingdom for the purpose of establishing a selective advantage favouring the former.<sup>55</sup>

As mentioned in section 2., the ECJ decision in *UGT-Rioja* had a clear impact on the reasons in *Gibraltar*, in particular, the rejection of the fourth condition or precondition prior to the three-criteria *Azores* test analysed in section 4. The Court found there was no support for that argument in the decision in *Azores* or in the AG’s Opinion in that case.

In overturning the Commission’s Decision, the Court found that the main question was whether or not Gibraltar fulfilled the three-criteria *Azores* test, followed by AG Kokott and the ECJ in the *UGT-Rioja* case, for determining whether or not the autonomy of an infra-state body is sufficient to consider that tax measures adopted by it stem from a jurisdiction that is independent from that of the Member State.

Prior to addressing this issue the Court stated that EU law relating to State aid granted by Member States does apply to Gibraltar and, therefore, State aid “favouring certain

51. The decision in *UGT-Rioja* (C-428/06 to C-434/06) was issued on 11 Sept. 2008 and the Court of First Instance ruling in *Gibraltar* (T-211/04 and T-215/04) was issued on 18 Dec. 2008, a year and a half after the hearing.

52. Commission Decision 2005/261/EC, at para. 105.  
 53. AG Opinion in the *Basque Country* cases (C-400/97, C-401/97 and C-402/97).  
 54. Commission Decision 2005/261/EC, at para. 102.  
 55. *Gibraltar* (T-211/04 and T-215/04), at para. 115.

undertakings or the production of certain goods”, i.e. aid that is selective, is prohibited.

The Court then examined whether, in accordance with the three-criteria test, it is the United Kingdom or Gibraltar that constitutes the appropriate reference point for assessing whether the tax reform at issue is regionally selective.

As regards the institutional autonomy laid down in the *Azores* decision, the Court found that the competent Gibraltar authorities that had devised the tax reform have, from a constitutional point of view, a political and administrative status that is separate from that of the UK central government.<sup>56</sup>

As far as procedural autonomy is concerned, the Court noted that this condition is met if the tax reform is devised without the UK central government being able to intervene directly as regards its content. It found, in this regard, that the United Kingdom’s residual power to legislate for Gibraltar and the various powers granted to the Governor of Gibraltar must be interpreted as enabling the United Kingdom to assume its responsibilities towards the population of Gibraltar and to meet its obligations under international law, and not as granting it an ability to intervene directly as regards the content of a tax measure adopted by the Gibraltar authorities, in particular since those residual powers have never been exercised in matters of taxation.<sup>57</sup>

The third condition, i.e. the comprehensive assessment of financial relations between the state and its subdivisions or dependent territories and the cause-and-effect element that must be examined in assessing the financial autonomy criterion, which was proposed by AG Kokott and followed by the ECJ in *UGT-Rioja*, was clearly applied by the CFI.<sup>58</sup>

According to the Commission, in determining whether or not this condition has been met, all sources of financing from the central government must be considered, given that money is fungible and that a payment that relieves one head of public expenditure by Gibraltar allows it to apply more money elsewhere or to levy lower taxes. In light of its interpretation, the Commission disputed that the third condition was met in the present scenario. It alleged that financial assistance was being granted by the United Kingdom to Gibraltar, including the financing of the Gibraltar Social Insurance Fund in order for Gibraltar to be able to pay certain pensions, the development aid granted by the United Kingdom to Gibraltar on various occasions, as well as the subsidization of the operation of Gibraltar’s airport by the United Kingdom’s Ministry of Defence.

However, the CFI did not uphold the Commission’s reasoning on the basis of the cause-and-effect interpretation. It pointed out that the ECJ used the verb “offset” in paragraph 67 of *Azores*, which implies, as stated in *UGT-Rioja*,

56. *Gibraltar* (T-211/04 and T-215/04), at para. 87.

57. *Gibraltar* (T-211/04 and T-215/04), at paras. 90 to 100.

58. *Gibraltar* (T-211/04 and T-215/04), at paras. 106 to 113.

that a causal link must exist between the tax measure at issue adopted by the infra-state body and the financial support from other regions or the central government of the Member State concerned. According to the CFI:

The interpretation proposed by the Commission would make the third condition set out in the judgment on the tax regime in the *Azores* a dead letter, since it would be very difficult to conceive of an infra-State body which does not receive any financial support, in whatever form, from central government.

In the absence of evidence to the contrary adduced by the Commission, the Court determined that none of the financial transfers referred to served to offset any financial consequences that the tax reform would entail for Gibraltar and consequently that the third part of the test had been satisfied.

Since the three-criteria *Azores* test had been met, the Court concluded that the reference point for assessing whether or not the tax reform at issue was regionally selective corresponded exclusively to Gibraltar and, accordingly, no comparison could be made between the tax system applicable to companies established in Gibraltar and that applicable to companies established in the United Kingdom for the purpose of establishing a selective advantage favouring the former.

As pointed out in paragraph 3 of this section, the material selectivity element of State aid, which is beyond the scope of this article, was also challenged in this case. The Court held that the Commission had not established the existence of selective advantages stemming from the three aspects of the tax reform that were at issue and, as a result, overturned the Commission Decision in its entirety.

The Commission and Spain appealed the decision. The Commission appealed solely on the issue of material selectivity, whereas Spain appealed on the basis of both regional and material selectivity. This gave the ECJ an opportunity to review the *Azores* doctrine and the criteria that should be examined in deciding the issue of tax autonomy and European regions.

On 7 April 2011, AG Jääskinen delivered his Opinion in the case.<sup>59</sup> As regards regional selectivity, he applied the existing case law, that is, the *Azores* doctrine, as referred to in *UGT-Rioja*, and proposed that the ECJ dismiss the appeal.

He first tackled the issue of the reference framework. The CFI had first looked at whether or not it was appropriate to consider, as the Commission had, that the United Kingdom and Gibraltar formed a unit, or whether Gibraltar was the appropriate point of reference.

Referring to the *Azores* decision, he recalled that the fundamental question was whether the tax reductions at issue could be regarded as measures of general application in the *Azores* or whether they were selective measures that conferred an advantage solely on operators established in the *Azores* as compared with those operating in Portugal.

59. AG Opinion in the *Gibraltar* cases (C-106/09 P and C-107/09 P).

He then summed up the main features of the *Azores* case as follows:<sup>60</sup>

As proposed by Advocate General Geelhoed, the region must be autonomous in an institutional, procedural and economic sense in order for it to be possible to consider that the measure is not of a selective nature. Indeed, in the *Azores* judgment, the Court took the view that in order for a decision to be capable of being regarded as having been adopted in the exercise of sufficiently autonomous powers, it must have been taken by a regional or local authority which has, from a constitutional point of view, a political and administrative status separate from that of the central government. Next, it must have been adopted without the central government being able to intervene directly as regards its content. Finally, the financial consequences of a reduction of the national tax rate for undertakings in the region must not be offset by aid or subsidies from other regions or central government. The Court reiterated those principles, with certain clarifications, in the *UGT-Rioja* case.

In his view, the importance of the *Azores* decision lies in the fact that, even though it did not concern a federal state (where fiscal powers are symmetrically distributed), the Court did not hold that the reference framework necessarily has to correspond to the totality of the territory of a Member State. By contrast, the Court conceded that the reference point for tax rules of a regional authority could correspond to its own territory where that entity was sufficiently autonomous from the central government of the Member State concerned. Consequently, AG Jääskinen agreed with the CFI decision and rejected the possibility that the reference framework was the United Kingdom instead of Gibraltar.

In analysing regional selectivity, Spain contended that the CFI had erred in regard to the issues of non-discrimination and the existence of a fourth condition in the *Azores* decision.

Concerning the first issue, Spain contended that the CFI infringed the principle of non-discrimination by applying the *Azores* decision to the Gibraltar case, which involves an entirely different situation. They argued that the Court should not have applied the criteria laid down in the *Azores* decision, which are intended to apply to a region of a Member State, to Gibraltar, which has the status of a colony. Second, the *Azores* case related only to a reduction of the corporate tax rate, not the introduction of a complete corporate tax system.

According to the AG Opinion, in regard to territories and regions with special links to certain Member States a two-stage reasoning should be applied. First, it is necessary to examine whether the EC Treaty applies to such a territory. If so, and regardless of whether an infra-state body, an autonomous territory or a territory outside the territory of a Member State is at issue, the second stage consists in identifying the appropriate reference framework in light of the *Azores* decision. He found that the CFI, after establishing the status of Gibraltar under the EC Treaty, rightfully applied the criteria laid down by the

ECJ in *Azores* and, therefore, did not breach the non-discrimination principle.<sup>61</sup>

In addition, he held that it would be inconsistent with the purpose of the EC Treaty to require the United Kingdom to apply its own tax system to the territory of Gibraltar. In contrast, since the EC Treaty and the Treaty on European Union do not contain any derogations concerning the application of the State aid rules in the territory in question, it is logical that the conditions concerning regional selectivity should be appraised in accordance with the same principles as those applicable to other infra-state bodies having their own taxation powers.

Moreover, the fact that the ECJ has never had to consider a case involving a territory, the relations of which a Member State is responsible for, is not sufficient to exclude the applicability of the *Azores* decision in relation to Gibraltar.

He concluded that the CFI was entitled to apply that case law to Gibraltar and that that approach did not amount to an infringement of any of the criteria inherent in the concept of State aid for the purposes of article 87(1) of the EC Treaty.

The AG then turned to Spain's argument that the CFI had misinterpreted the *Azores* decision by failing to apply a fourth condition (i.e. a precondition to the three-criteria *Azores* test). The AG pointed out that in the *UGT-Rioja* case, the ECJ rejected the existence of a fourth condition:

[...] the only conditions which must be satisfied in order for the territory falling within the competence of an infra-State body to be the relevant framework in order to assess whether a decision adopted by that body is selective in nature are the conditions of institutional autonomy, procedural autonomy and economic and financial autonomy as set out in paragraph 67 of Portugal v Commission.

Consequently, he concluded that the ECJ had never endorsed a fourth condition.

The AG's approach to regional selectivity is exactly in line with the *Azores* and *UGT-Rioja* decisions. His finding that the Gibraltar regime is not territorially selective and his proposal to the Court of Justice to dismiss the appeals gave it a new opportunity to endorse the settled case law, reinforcing the position of regions with tax competence within the European Union.

Six months after the Opinion was delivered, the ECJ gave its decision.<sup>62</sup> It ruled that the CFI erred in law in finding that the proposed tax reform did not confer selective advantages on offshore companies and upheld the Commission's Decision not to authorize the United Kingdom to implement the Gibraltar corporate tax reform proposed in 2002.

As mentioned, two separate issues regarding the regulation and interpretation of State aid in the EC Treaty were before the Court of Justice.

60. AG Opinion in the *Gibraltar* cases (C-106/09 P and C-107/09 P), at para. 57.

61. AG Opinion in the *Gibraltar* cases (C-106/09 P and C-107/09 P), at paras. 77 to 90.

62. *Gibraltar* cases (C-106/09 P and C-107/09 P).

The first of these issues focused on the material selectivity element. In this respect, the Court concluded that:

[...] the fact that offshore companies are not taxed is not a random consequence of the regime at issue, but the inevitable consequence of the fact that the bases of assessment are specifically designed so that offshore companies, which by their nature have no employees and do not occupy business premises, have no tax base under the bases of assessment adopted in the proposed tax reform.<sup>63</sup>

Thus, the fact that offshore companies can avoid taxation precisely because of their characteristic features leads to the conclusion that they enjoy selective advantages.

As it is beyond the scope of this article, this aspect of the AG Opinion is not discussed. However, it should be mentioned at least that his Opinion, which is non-binding, was not upheld by the Court.

Briefly his thesis on material selectivity was based on two pillars. First, AG Jääskinen considered that the State aid rules should not divert from their objective so as to be used to combat the phenomenon of harmful tax competition between Member States, which falls within the field of direct tax policy. In this connection, he noted that the provisions of EU law that relate to State aid only seek to remedy distortions of competition deriving from the desire of a Member State to grant, in derogation from its general policy guidelines, a particular advantage to certain undertakings or goods. On the contrary, where a tax measure is of a general character, it constitutes an adjustment to general fiscal policy and not State aid.

Second, he considered that the CFI was correct in rejecting the Commission’s novel<sup>64</sup> approach under which any “inherently discriminatory” tax system must be classified as State aid. According to his views, in its Decision on the Gibraltar tax reform, the Commission failed to identify a common or “normal” tax regime in relation to which certain elements of Gibraltar’s tax system constituted derogations, and were, therefore, selective. In contrast, the Commission found, in its Decision, that Gibraltar’s tax system, based on its structure, conferred an advantage on a category of undertakings due to the inclusion of specific

63. *Gibraltar cases* (C-106/09 P and C-107/09 P), at para. 106.  
 64. The Commission did not follow the derogation-based approach advocated in its Notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384 (1998), p. 3.

criteria under the allegedly “normal” taxation system. It, accordingly, concluded that Gibraltar’s tax system, as a whole, was “inherently discriminatory”, which was equivalent, in its view, to the existence of a selective advantage and, therefore, to the existence of State aid.

The second issue that was before the ECJ was “regional selectivity”. In its decision, the Court decided that it was not relevant or necessary to even consider this issue because the case before it could be decided on the basis of the material selectivity issue alone.<sup>65</sup> Thus, the attempt, made only by Spain, since the Commission did not appeal on this ground, to use this appeal to have the ECJ rule that Gibraltar does not have the right to have its own tax system and rates on the basis of regional selectivity, failed.

## 6. Conclusions

In 2005, AG Geelhoed introduced a new line of reasoning, which allowed for the recognition, subject to certain requirements, of the compatibility of regional tax powers with the State aid provisions in the TFEU.

Since then, European regions that are “truly” autonomous are protected by a safe harbour in regard to the territorial selectivity element of the State aid provisions.

Following the ECJ decision in the *Gibraltar* case, which focused on material selectivity and did not consider the territoriality issue, case law regarding regional selectivity remains as it stood; namely, the principles settled in the *Azores* and *UGT-Rioja* cases continue to apply, which upheld AG Geelhoed’s and AG Kokott’s Opinions, respectively, and which were endorsed by the CFI and AG Jääskinen in the *Gibraltar* case. Consequently, the initial approach put forward by AG Saggio in 1999, followed later by the Commission in the abovementioned cases, is no longer under consideration.

65. *Gibraltar cases* (C-106/09 P and C-107/09 P), at paras. 110 and 183 to 188.

## Cumulative Index

[continued from page 154]		
<b>Luxembourg</b> Oliver R. Hoor: Classification of Foreign Entities for Luxembourg Tax Purposes: Methodology and Tax Consequences	135	
<b>Portugal</b> Sérgio Vasques: The Madeira Free Trade Zone: Compliance and Control Issues	149	
<b>Spain</b> Florentino Carreño: Understanding How Trusts Are Analysed in Spain: A Comment from a Spanish Legislative Perspective	103	
<b>Sweden/European Union</b> Cécile Brokelind: Risk Capital Incentives, a Risky Business?	11	
		<b>Switzerland</b> Kathrin Egli Arginelli, LL.M.: Judicial System and Legal Remedies in Switzerland
		29
		<b>United Kingdom</b> Paul Smith: The Long Road to Corporate Tax Reform
		176
		[continued on page 186]