PEER-REVIEWED ARTICLE*

Revisiting the Dutch Interest Box under the EU State Aid Rules and the Code of Conduct: When a 'Disparity' Is Selective and Harmful

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In July 2009, the European Commission decided that the Dutch group interest box measure – a special beneficial tax regime for the taxation of intra-group interest – did not constitute State aid under EU law. This article critically analyses the Commission's decision and arrives at the opposite conclusion, that is, the measure grants selective advantage to group companies and specifically to multinational groups of companies. In the course of the analysis of the decision, a general analytical framework is proposed for examining fiscal measures suspect of being State aid. The question what options remain for the Member States after the decision to introduce tax measures attractive for multinational enterprises is discussed. Finally, the interest box measure is also examined in the light of the Code of Conduct criteria for harmful tax measures.

1. Introduction

In 2007, two high-profile State aid investigations were started by the European Commission (also referred to as the 'Commission') under Article 108(2) of the Treaty on the Functioning of the European Union (TFEU)[1] against two substantially similar tax regimes of two different Member States, namely the Dutch group interest box[2] and the Hungarian intra-group interest scheme.[3] Both of these regimes are special beneficial tax schemes for the taxation of intra-group interest, which are capable of attracting finance activities of multinational group of companies to the Member State concerned. Both State aid procedures have been followed by an exceptional interest from the public. First, because they raised novel, previously untouched legal issues, such as whether group taxation measures can be qualified as selective under the European Union (EU) State aid rules solely due to the fact that they only apply to companies being part of a group. Second, these investigations once again stirred up sensitive, political issues, such as to what extent the EU's regulatory system can limit the Member States tax policy choices as to how to exercise or not exercise their sovereign taxing powers in order to attract mobile capital and business. Ultimately, the questions that these two cases brought again to the forefront are where the boundaries of legitimate tax competition are within the EU and whether or not the EU State aid rules should be used for the purpose of adjusting those boundaries.

Both of these cases were decided in the second half of 2009. In its decision of 8 July 2009 (the 'Decision'),[4] the Commission, following an exceptionally long investigation, decided that the Dutch group interest box did not constitute State aid in the meaning of Article 107(1) TFEU. The State aid procedure concerning the Hungarian measure was closed on 28 October 2009.[5] The Commission found the Hungarian scheme to be existing State aid. The State aid qualification was based on certain limitations to the scope of the measure – certain types of taxpayers, such as financial institutions and small enterprises were excluded – and its optional character. The Commission considered that these features made the Hungarian scheme selective,

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1 See Consolidated versions of the TFEU, OJ C115 of 9 May 2008.

2 State aid: Commission opens in-depth investigation into one part of the proposed Dutch 'Groepsrentebox' tax break scheme and approves the other part, IP/07/154, Brussels, 7 Feb. 2007.

3 State aid: Commission opens in-depth investigation into Hungarian intra-group interest taxation, IP/07/375, Brussels, 21 Mar. 2007.

4 Commission Decision of 8 Jul. 2009 on the Groepsrentebox scheme no. C4/2007 (ex N 465/2006), which the Netherlands are planning to implement, Brussels, C(2009) 4511 final.

5 Commission Decision of 28 Oct. 2009 on State aid no. C10/2007 (ex NN13/2007) implemented by Hungary for tax deductions for intra-group interest, Brussels, C(2009) 8130 final.

thus, they warranted an opposite decision to the one in the Dutch interest box case. Being an existing aid, it did not, however, have to be recovered from the beneficiaries.[6] Besides the State aid procedures, both the Hungarian and the Dutch measures were discussed or addressed in the Code of Conduct Group.[7]

The main focus of this article is the Dutch group interest box measure. Specifically, the article aims at analysing the measure from the point of view of both the EU State aid rules and the criteria for harmful tax measures included in the Code of Conduct for business taxation ('Code of Conduct').[8]

First, we describe the detailed rules of the group interest box and provide some insights into its legislative history and the changes proposed to it during the State aid investigation (section 2). Then, we proceed to the State aid analysis of the measure, which is conducted through a critical review of the Commission's Decision (section 3). We scrutinize the Decision both from the point of view of the method of analysis applied by the Commission and the substantive arguments on the basis of which the Dutch group interest box was held not to constitute State aid. In this, we intend to go beyond the particularities of the concrete measure and the Decision by suggesting a systematic framework according to which fiscal measures should be examined under the EU State aid rules. The proposed framework aims at bringing about more clarity as to the elements of the State aid definition as applied to fiscal measures by building on the Commission's decision-making practice, the case law of the General Court (hereinafter 'Court' or 'CFI')[9] and the Court of Justice (hereinafter 'Court' or 'ECJ'),[10] and on academic theory. Following the State aid analysis, we continue with examining how the group interest box should be assessed under the Code of Conduct (section 4). In this part, we describe recent developments in the procedures of the Code of Conduct Group, which intend to lead to more predictability and certainty as to the conclusions of the Group on the harmful nature of various tax measures of the Member States. Finally, we discuss certain legislative developments in the Netherlands regarding the interest box following the 'no aid' decision of the Commission (section 5). The Hungarian scheme[11] will be discussed to the extent necessary for the analysis of the Dutch measure.

2. The Dutch Group Interest Box

As of 1 January 2007, the group interest box forms part of the Dutch Corporate Income Tax Act.[12] However, pending the result of the State aid review by the European Commission it could not enter into force. After the Commission's 'no aid' decision, the interest box is still on hold despite certain new developments in the legislative process, which we discuss in section 5 of this article.

In brief, the group interest box measure, in its original version, provides that following a joint request of all group companies taxable in the Netherlands, the so-called 'group interest balance' of the group company concerned is taxed at a rate of 5%. The group interest balance is defined as the balance of the interest paid and received on inter-company loans. For example, a Dutch parent company is taxed on the interest received from its Dutch subsidiary at a tax rate of 5%, and the latter can deduct the interest paid at the same tax rate. The parent has a positive balance of interest paid and received, while the subsidiary has a negative one. For reasons of legislative efficiency, the tax rate of 5% is applied by only including 5/25.5 of the group interest balance in the profit.[13] This profit is subsequently taxed at the regular tax rate of 25.5% so that the total group interest balance is effectively taxed at rate of 5%.[14]

The election for the group interest box regime is for a minimum period of three financial years. Inter-company loans are loan agreements, including economically similar agreements, such as financial lease and hire purchase, concluded between members of the same group.[15] It is important to note in this regard that interest formally payable to a third party but effectively to a group member is treated as group interest. According to the parliamentary history, this is for example the case in back-to-back arrangements and where a member of a group guarantees

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6 With a quite creative interpretation, the Commission concluded that due to the peculiarities of the case and the pre-accession context the Hungarian authorities had no reason to suspect at the time of the introduction of the measure that it could constitute State aid therefore, the omission of the notification of the measure has not resulted in illegal State aid.

7 The EU's Finance Ministers established the Code of Conduct Group (Business Taxation) at a Council meeting on 9 Mar. 1998 to assess the tax measures that may fall within the scope of the Code of Conduct for business taxation, see *infra*.

8 Conclusions of the ECOFIN Council Meeting on 1 Dec. 1997 concerning taxation policy – Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 Dec. 1997 on a code of conduct for business taxation – Taxation of saving, OJ C002 of 6 Jan. 1998, 1–6.

9 Before the entry into force of the Lisbon Treaty on 1 Dec. 2009, this court was called Court of First Instance (CFI).

10 Before the entry into force of the Lisbon Treaty on 1 Dec. 2009, this court was called European Court of Justice.

11 It is to be noted that the measure was repealed as of 1 Jan. 2010. Since that date, the intra-group interest regime has been replaced by a rule that provides for an exemption of 75% of foreign-source interest received by any Hungarian resident company. The 75% exemption was introduced as a unilateral double taxation relief applicable only to interest income.

12 Wet Werken aan Winst, *Staatsblad* 631 (2006).

13 With this design, the legislator avoids many tax-technical problems, such as the offset of losses across boxes.

14 Sometimes even less because of lower rate bands: for example, in 2009, the first EUR 200,000 of profit is taxed at 20%.

15 Section 12(6) under a, of the Wet op de Vennootschapsbelasting 1969 (Wet Vpb 1969 – Dutch Corporate Income Tax Act).

an external loan.[16] However, there is an escape route available where such a guarantee has been given. An external loan guaranteed by a group company is not considered an inter-company loan insofar as the loan amount could also have been borrowed independently.[17] In addition to group interest, the so-called acquisition funds are also covered by the group interest box. Proceeds from short-term investments held with a view to acquire participating interests are namely considered equivalent to group interest received.[18] Changes in value of inter-company loans, including foreign exchange results, are excluded from the scope of the box.

The term 'group' refers to a situation where a (joint) parent company holds an interest of more than 50% in a (sub)subsidiary or an (indirect) sister company. The term 'interest' – also referred to elsewhere in the 1969 Corporate Income Tax Act – is a substantive rather than formal concept that is widely understood to include economic as well as legal, that is, controlling, participation. The law offers two exceptions to the 50% criterion. Under the first exception, a cooperating group of non-affiliated entities may request to qualify as a group (opting in).[19] The Explanatory Memorandum gives the example of a situation in which entities are not linked through a common shareholder but through a management unit. Under the second exception, an independently operating division of the group can request to be excluded from the group (opting out).[20]

An important feature of the measure is that the positive group interest balance that falls to be taxed at the 5% tax rate is capped to a certain percentage of the average equity capital (capital and reserves).[21] This percentage corresponds to the interest rate payable on over- or underpaid tax applying to the last quarter of the relevant financial year.[22] The idea that underlies the cap is that the group interest box is intended for group financing activities funded with equity capital.[23] However, because no historic causal connection with the equity capital is required, funds drawn under a bank loan may be lent within the group. Bank interest is deductible at the normal rate of 25.5%, while group interest is only taxed at 5%. This tax leak has been the subject of intense debate in the Parliament. The debate was brought to an end when the Minister of Finance stated:[24]

> We do not need to know precisely what transactions are exactly implemented. As long as the cap has not been exceeded, it continues to be possible to use the remaining available space by concluding a loan here and lend it out elsewhere. I acknowledge that. However the solution is not to trace every loan made by the group's finance company and check whether it is funded by a loan or by equity capital. We will apply an integral, general maximum. (…) We do not want to create all sorts of links between loans in and out. The resulting administrative burden would be the final blow to the interest box.

It is to be noted that the limit only applies for the case where the group interest balance is positive. To the contrary, at all times any negative group interest balance is only deductible at a tax rate of 5%.[25]

Finally, the group interest box states two specific anti-abuse provisions. These concern: (i) a provision preventing the conversion of revenues normally taxed in the Netherlands into group interest and (ii) a provision aimed at preventing any inflation of the equity capital for tax purposes. Under the first-mentioned provision, a loan relating to the disposal of assets to a group company is excluded from the group interest box, unless it can be demonstrated that the loan and the disposal are based on commercial considerations.[26] For example, a situation in which a parent company sells an asset that has been leased to its foreign subsidiary to that subsidiary with the purchase price remaining due. In that case, normally taxed rent is converted into low-taxed group interest. The other anti-abuse provision prevents the obvious scheme in which a parent company takes out an external loan and contributes the funds acquired as capital to a subsidiary, after which the subsidiary loans the paid-up amount to group members. The paid-up capital increases the amount of the box for the subsidiary. However, under the

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16 Parliamentary Papers II 2005/06, no. 3, 52–54, and Parliamentary Papers II 2005/06, no. 8, 86–88.

17 A guarantee is given to get better terms and conditions – such as a lower interest rate – therefore does not qualify an external loan as an inter-company loan.

18 Section 12(6) under a of the Wet Vpb 1969.

19 Section 12c(7) of the Wet Vpb 1969.

20 Section 12c(8) of the Wet Vpb 1969.

21 It concerns the average equity capital on 1 January and 31 December of a financial year.

22 As a rule, interest on over- or underpaid tax is the interest the tax authorities charge to a taxpayer if a tax assessment is imposed as soon as the tax debt arises. The interest rate payable on over- or underpaid tax was 5.45% in the last quarter of 2008. At this moment, the interest rate on over- or underpaid tax (third quarter of 2009) is 2.75%. An example for the calculation of the cap: suppose the average equity capital of a taxpayer is 100, the interest rate on over- or underpaid tax is 4% and the interest received from group companies is 10. The cap is 4, so 4 of the 10 interest income is taxed at the reduced rate of 5%. The surplus of 6 is tax at the normal rate of 25.5%.

23 Parliamentary Papers II 2005/06, 30572, no. 3, blz. 52–54.

24 Parliamentary Proceedings II 2006/07, no. 4, blz. 158–181.

25 Apparently, the Commission misunderstood this provision, as in its Decision it refers to the fact that the cap also applies to the deductibility of a negative group interest balance. See paras 22 and 118 of the Decision.

26 Section 12c(6) under c of the Wet Vpb 1969.

27 The anti-abuse provision ceases to be effective if the parent company is based abroad.

anti-abuse provision the external loan to the parent company is punitively qualified as an inter-company loan.[27]

From the above, it is rather clear that the measure is intended for the financing of foreign group companies in situations in which the interest is deductible abroad at a tax rate higher than 5%.[28] From a policy angle, the group interest box is the successor of the group financing regime (Concernfinancieringsactiviteiten (CFA)), which was introduced by the Netherlands in 1997. After the European Commission qualified the latter regime as State aid, understandably the fear of an exodus of mobile capital arose in the Netherlands. Not surprisingly, the objective of the group interest box has been unequivocally explained in the legislative history as a new weapon in the fight to preserve group financing activities for the Netherlands.[29] This is particularly obvious in the initially notified version of the group interest box according to which the scheme would be optional. Undoubtedly, (the Dutch part of) a group would only elect for the scheme if there are benefits to be gained. There is no benefit to be obtained from domestic financing arrangements because of the requirement that all Dutch group companies must 'co-sign' for the application of the regime.[30]

These features of the scheme could not have slipped the attention of the Commission, thus, it initiated a formal State aid investigation to verify whether the group interest box would not confer a selective advantage on certain companies.

It appears from the Commission's Decision that the Netherlands in the course of the formal investigation, on 18 December 2008, informed the European Commission that three amendments to the law would be implemented.[31] The most important amendment is the mandatory application of the group interest box. The second amendment concerns the definition of group. Under the new definition, a group exists if an entity directly or indirectly effectively controls the financing of another entity, or when a third-party entity or person effectively controls the financing of the two entities involved in the loan (sister companies).[32] The third amendment concerns an easing of Dutch company law, namely the repeal of the requirement for a BV (a limited liability company under Dutch law) to have a minimum capital of EUR 18,000.

3. The Commission's State Aid Decision

3.1. The Commission's Line of Reasoning

The Commission identified two potential points of selectivity inherent in the interest box measure: (i) only companies being part of a group can benefit from the lower taxation on intra-group interest to the exclusion of stand-alone companies and (ii) the interest box regime grants advantages to multinational groups of companies in comparison with purely domestic groups.[33] In the forthcoming analysis, first, we summarize the line of reasoning of the Commission (section 3.1). Then, we deal with the arguments related to point (i) (sections 3.2 and 3.3) and point (ii) (section 3.4), finally we discuss the Commission's arguments that were not touched upon previously (section 3.5).

The Commission first recalled the State aid definition included in Article 107(1) TFEU, namely an economic advantage granted through State resources, which favours certain undertakings or the production of certain goods and distorts competition as well as affects intra-EU trade.[34] However, it only focused on two of these elements, that is 'advantage' and 'selectivity' (i.e., the favouring of certain undertakings or the production of certain goods), as these are the elements that generally give rise to the most difficulties in answering the question whether or not a special tax regime that deviates from the general system of taxation constitutes State aid for the purposes of EU law.

For the Commission, the primary question was whether the interest box regime was selective, that is 'whether, within the context of a particular legal system, that measure constitutes an advantage for certain undertakings in comparison with others which are in a comparable legal and factual situation'.[35] In order to determine whether any advantages were conferred by the regime on certain undertakings, the Commission compared individual companies in the position of the creditor. When a group company provides an intra-group loan, it is taxed on the interest that falls within the box at a tax rate of 5% while a company or financial institution granting a loan to an unrelated third party is taxed on the interest received at the normal rate of corporate income tax, that is, 25.5%.[36] Thus, the measure produces an advantage for group companies providing

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28 See also S.A.W.J. Strik, 'Stroomlijning Antimisbruikbepalingen Renteaftrek en de Groepsrentebox' ['Streamlining Interest Relief Anti-abuse Provisions and the Group Interest Box'], MBB 7–8 (2006): 282.

29 See e.g., Parliamentary Papers II 2005/06, 30572, no. 3, blz. 6.

30 Besides some exceptions, for example when the debtor is in a loss situation or a deduction limit applies (thin capitalization).

31 Paragraphs 25–27 of the Decision.

32 Paragraph 26 of the Decision.

33 State aid no. C 4/2007 (ex N 465/2006) – The Netherlands Interest Group Box (Groepsrentebox), Brussels, 07.II.2007, C(2007)308, paras 19–21 ('opening decision').

34 Paragraph 72 of the Decision.

35 Paragraph 75 of the Decision.

36 Paragraph 102 of the Decision.

loan to a related company as compared to a bank or a stand-alone company granting loan to a third party.

The Commission considered that such advantage was not discriminatory, since a loan to a related company could not be compared with a loan to an unrelated company.[37] Thus, the fact that the financing arrangements between group companies are not comparable with those of stand-alone companies forms the basis of the conclusion that the interest box measure is not selective.

Throughout this reasoning, the Commission used 'selectivity' interchangeably with 'discrimination', merged the analysis of 'selectivity' with that of 'advantage', and did not distinguish between general measures, selective measures, and measures 'justified by the nature and general scheme of the system'. As these are the core concepts of fiscal State aid and the basic elements of a systematic analysis aimed at testing fiscal measures in the light of the State aid rules, we will primarily focus on these issues in the forthcoming discussion.

3.2. Advantage

3.2.1. *Derogation Approach versus Comparison Approach*

Admittedly, the meaning of selectivity of tax measures for the purposes of the State aid rules is everything but clear.[38] As pointed out in academic literature, the terms and descriptions used by the Commission and the Court for examining tax measures under the State aid rules differ to a considerable extent from one case to another.[39] One line of the decisions and case law represents the 'derogation approach' where the analysis focuses on the question whether the measure under scrutiny departs from the general or benchmark tax system.[40] Here the crucial point is the identification of the general system. The other line of case law, which is usually consider to originate from the *Adria-Wien Pipeline* case,[41] demonstrates the 'comparison approach' where the pivotal point is the comparison between undertakings excluded from the favourable measure and those benefitting from the measure.[42] If the two groups of undertakings are in an objectively comparable situation, the measure unjustifiably differentiates between them, thus, it should be regarded as selective State aid.[43]

3.2.2. *Merging the Criteria of Advantage and Selectivity*

The Decision in the interest box case appears to predominantly follow the path of the comparison approach. This is first and foremost reflected in the definition of a selective measure as being an advantage for certain undertakings in comparison with others that are in a comparable legal and factual situation. As we have seen, this is an adoption from the Court's *Adria-Wien Pipeline* line of case law.[44] The Commission also emphasized that differentiation between taxpayers may be justified by objective differences between them.[45] The limitation of the reduced tax rate to intra-group loans was considered to merely reflect objective differences and not to affect tax neutrality.[46] The Commission used several times the term 'discrimination' instead of selectivity, which shows the importance it attributed to the comparability aspect.[47] The final conclusion was that 'the measure does not provide an advantage in a discriminative manner to any undertaking in a similar situation'.[48]

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[37] Paragraph 103 of the Decision.

[38] See C. Pinto, *Tax Competition and EU Law* (The Hague: Kluwer Law International, EUCOTAX, 2003), 108; W. Schön, 'Taxation and State Aid Law in the European Union', *Common Market Law Review* 36, no. 5 (1999): 931; C. Micheau, 'Tax Selectivity in State Aid Review: A Debatable Case Practice', *EC Tax Review* 17, no. 6 (2008): 276.

[39] Micheau, *supra* n. 38, 278.

[40] ECJ, 2 Jul. 1974, Case 173/73, *Italy v. Commission* cited by Micheau. In our view, the cases on regional selectivity although they include the sentence characteristic to the comparison approach represent the derogation approach insofar as the crucial question in them is the determination of the general 'reference system' in relation to which the infra-state system does or does not qualify a deviation. See Case C-88/03, *Portugal v. Commission*; Joined Cases C-428/06 to C-434/06, *UGT-Rioja*; CFI, 18 Dec. 2008, Cases T-211/04 and T-215/04, *Government of Gibraltar v. Commission.*

[41] ECJ, 8 Nov. 2001, Case C-143/99, *Adria-Wien Pipeline*.

[42] Other cases cited by Micheau: ECJ, 26 Sep. 1996, Case C-241/94, *France v. Commission*; ECJ, 1 Dec. 1998, Case C-200/97, *Ecotrade.*

[43] Micheau proposes that despite the differing terminology of the various cases, we should not assume that two different tests exist but should rather seek for a reconciliatory approach. In particular, first on the basis of the 'derogation test' it should be determined whether a measure constitutes a departure from the benchmark system, then a comparison should be made between the beneficiaries of the measure and those excluded from the measure. If the comparison leads to the conclusion that the undertakings excluded from the measure are in an objectively similar situation, the measure indeed constitutes a derogation from the general rule. Thus, the comparison serves to reconfirm the result of the derogation test. See Micheau, *supra* n. 38, 278.

[44] Paragraph 75 of the Decision referring to ECJ, 22 Dec. 2008, Case C-487/06 P, *British Aggregates v. Commission*, para. 82; ECJ, 13 Feb. 2003, Case C-409/00, *Spain v. Commission*, para. 47; ECJ, 6 Sep. 2006, Case C-88/03, *Portugal v. Commission (Azores)*, para. 54; ECJ, 11 Sep. 2008, Joined Cases C-428/06, *UGT-Rioja and Others*, para. 46.

[45] Paragraph 76 of the Decision.

[46] Paragraph 104 of the Decision.

[47] Paragraph 83 of the Decision.

[48] Paragraph 124 of the Decision.

On the other hand, another line of reasoning in the Decision emphasized that the conditions for the application of the reduced rate of taxation on intra-group interest are objective conditions that can be satisfied by any company at all. Specifically, the Commission stated that 'the scheme … can be described as a reduced rate on a specific type of revenue (or cost) in the form of interests on a loan, when the transaction takes place between related companies'.[49] Hence, the Commission pointed to the type of the income that was treated in a favourable manner (revenue from intra-group loan) instead of the type of the beneficiary receiving the income (a group company financing with debt a related company).[50] According to this argument, any company may be in a situation of receiving interest on intra-group loans. To the same effect, the Commission emphasized the objective and horizontal nature of the condition that the lender must exercise control over the borrower company.[51] Along the same lines, the Commission considered highly important the abolishment of the minimal capital requirement for setting up a Dutch limited liability company, a change introduced by the Dutch authorities as a response to the investigation of the interest box measure. In the eye of the Commission, this amendment would make the interest box regime accessible for any company, as they can easily create a second company, thus, form a group and thereby become entitled to the application of the measure.[52] This reasoning also intends to highlight that the conditions for the interest box do not exclude anyone from its scope of application, thus the measure is general in nature. This would entail that the interest box measure is not an exception to or a derogation from the general system of taxation but is *part of the general system* or alternatively *it is the general system itself*, as it represents '… an adaptation of the general system to particular characteristics of certain undertakings'.[53]

With this parallel line of arguments, the Commission brought both the derogation approach and the comparison approach into the reasoning. In our view, the two approaches should characterize different steps of the State aid analysis. The derogation approach should be used for examining the presence of an advantage. In academic writing, Rossi-Maccanico emphasizes the importance of the distinction between 'selectivity' and 'advantage'. He points out that in the case of fiscal measures the notion of advantage is centred on derogation.[54] Applying the derogation approach to the interest box measure, we should ask whether it is indeed accessible to any and all undertakings, therefore, is not a derogation but the general system itself *or* the measure in fact grants an advantage only to a certain group of undertakings as an exception to the normal rules of taxation. In the latter case, the analysis should continue with the examination whether or not the derogation selectively benefits certain undertakings to the exclusion of others that are in an objectively comparable situation.

In summary, in the Decision the mixing of the derogation and the comparison approaches, in effect, results in the simultaneous examination of 'advantage' and 'selectivity'. Although these two elements are strongly intertwined, in our opinion, their distinct examination in the context of the interest box scheme would have served methodological clarity better.

3.2.3. *Is the Interest Box Measure Open to Anyone?*

Apart from the Commission's method of merging the examination of 'advantage' and 'selectivity', the arguments regarding the general nature of the interest box and its openness to any company can also be criticized on substantive grounds.

First, regarding the 'de jure' condition for the interest box, that is, the requirement of control over another company, the Commission stated that it 'applies across the board to all companies regardless of size, sector or any other distinction'.[55] However, this argument seems quite artificial. The condition of control between the creditor and debtor is not a condition that can be satisfied by any undertaking in the course of its normal operation and everyday functioning. If the undertaking was established as a stand-alone company and it gained foot in the market as such, the condition of controlling another company presupposes the reorganization of the corporate and business structure. This reorganization normally does not take

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[49] Paragraph 81 of the Decision.

[50] Paragraphs 81, 83 and 84 of the Decision.

[51] Paragraph 104 of the Decision.

[52] Paragraph 127 of the Decision.

[53] Paragraph 75 of the Decision. The 'adaptation' argument mixes the derogation and comparison approaches, as actually it requires a comparison of the beneficiary undertakings that are in a specific situation with those that are not.

[54] P. Rossi-Maccanico, 'The Specificity Criterion in Fiscal Aid Review: Proposals for State Aid Control of Direct Business Tax Measures', *EC Tax Review* 16, no. 2 (2007): 95, where he explains that contrary to direct subsidies, fiscal aid is a negative form of intervention by the State, a non-application of or exemption from the general system of taxes and charges. Hence, an advantage presupposes an exception to the benchmark tax system. Similarly, P. Rossi-Maccanico, 'The Gibraltar Judgment and the Point on Selectivity in Fiscal Aids', *EC Tax Review* 18, no. 2 (2009): 71.

[55] Paragraph 104 of the Decision.

place unless there are sound business reasons that economically necessitate a group structure. In the light of this, it is quite absurd for the Commission to state that any company that would like to benefit from the interest box can do so by setting up another company – after the legislative amendment without any minimum statutory capital – and forming a group. The statement almost amounts to saying that anyone who wishes to abuse the rule can do so by setting up a second company, even if it lacks any economic substance, and creating a sham group structure.

It is true that in another case concerning the Irish participation exemption system a similar condition, namely the requirement of 5% shareholding for being entitled to dividends and capital gains exemption, was held to be a horizontal condition, which did not result in selectivity of the measure.[56] That case, however, concerned dividends and capital gains on shareholding, which income, by definition, can only be received by a shareholder in an existing ownership relationship. Therefore, the condition in the Irish participation exemption case is about the threshold of a shareholding that already exists and above which a beneficial tax treatment applies to the income flows related to the shareholding. On the contrary, the payment of interest does not presuppose any ownership relation between the creditor and the debtor; therefore, a requirement to that effect for a preferential tax treatment of the income may well result in a selective advantage for those who are in a position to satisfy that requirement. Therefore, the Irish participation exemption case should be distinguished from the interest box case.

In summary, it seems unequivocal that the interest box regime constitutes an exception to the general rules of taxation. Such exceptional regime, which consists of a reduced rate of tax on inter-company interest, is accessible only to companies that are members of a group and benefits only the latter when they provide loan to another group company. Hence, the question arises whether or not such exception to the benchmark system is selective for the purposes of the State aid rules.

3.3. Selectivity

3.3.1. *Lack of Selectivity in the Commission's Reasoning*

As we have seen above, the Commission found that related companies were not in a factual and legal situation, which was comparable to the situation of unrelated companies with respect to debt financing. According to the Commission, in the relationship of related companies the possibility of arbitrage between debt and equity financing exists. In a group of companies, the parent company controlling the other entities of the group decides on the means of financing of the latter on the basis of the interests of the group as a whole.[57] In this decision, the parent company is frequently influenced by fiscal considerations instead of economic ones.[58] The Commission accepted the argument of the Dutch authorities that the interest box measure by approximating the fiscal treatment of income from debt (interest) and income from equity (dividends) reduced this arbitrage.[59] Since the choice between debt and equity financing is not available for a third-party lender, such as a bank,[60] they are in an objectively different situation from group companies. Thus, the advantage of the reduced tax rate on intra-group interest does not have to be extended to them. Therefore, the Commission concluded that the interest box measure did not confer a selective advantage on a certain group of undertakings.

As to the method of analysis, the Commission's reasoning is not built on a clear and consistent concept of selectivity. There is a reference to the 'justification by the nature and general scheme of the system',[61] however, it does not turn out from the Decision whether or not this justification played a role in the finding that the interest box measures was not selective. Conceptually, the question that arises in this respect is in which stage of the State aid analysis the comparison between the beneficiaries of the measure and those who are excluded from the measure is to be made. In particular, should the comparison be made when deciding on the general-selective character of a measure or rather should the comparison form part of the examination of whether or not the selective measure is justified by the 'nature and general scheme of the system'? In the former case, a measure that applies only to undertakings being in a specific situation that is not comparable to the situation of other undertakings is a non-selective, in other words, general measure. In the latter case, such a measure is prima facie selective, however, justified by the 'nature and general scheme of the system'. Alternatively, we can ask whether selectivity is at all to be distinguished from the 'nature justification' or they are just two sides of the same coin. Some examples in the Court's case law, such as the British Aggregates Levy

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56 Commission Decision of 22 Sep. 2004 raising no objections, OJ C131 of 28 May 2005, 11.

57 Paragraph 89 of the Decision.

58 Paragraph 106 of the Decision.

59 Paragraph 86 of the Decision.

60 Paragraph 90 of the Decision.

61 Paragraph 76 of the Decision.

case[62] and the Dutch emission trading case,[63] clearly demonstrate the different methods of analysis. The Commission in the interest box Decision missed the opportunity to bring more clarity into these issues.

In the following part, we turn to the legal doctrine in order to see what answers academic commentators have given to these questions.

3.3.2. *Selectivity and Justification by the 'Nature and General Scheme of the System' in the Legal Doctrine*

Although an 'amorphous concept', as labelled by Advocate General Geelhoed,[64] the justification by the 'nature and general scheme of the tax system'[65] has a long history in the case law and the Commission's practice.[66] The Commission notice on the application of the State aid rules to measures relating to direct business taxation ('Commission Notice')[67] expressly recognizes that the selective nature of a measure may be justified by 'the nature or general scheme of the system'[68] and it purports to give an explanation to this justification. It states that an exception to the general tax system or differentiation within that system may be justified on this ground if 'they derive directly from the basic or guiding principles of the tax system'.[69] Further, 'measures whose economic rationale makes them necessary to the functioning and effectiveness of the tax system'[70] also fall under this justification.[71]

As regards selectivity, the Commission Notice is characterized by the derogation approach. It states that the main criterion in applying the State aid definition to a tax measure is that the measure provides for an exception to the application of the Member State's common tax system.[72] As it does not refer to the comparison test represented by the *Adria-Wien Pipeline* line of case law, it does not offer any guidance on the question whether the comparison test should be linked to the selectivity analysis or to the 'justification by the nature and general scheme of the system'.

In academic literature, Carlo Pinto points out that it is difficult to see what the difference is between the selectivity criterion and the 'nature' justification and the Commission Notice contributes little to answering this dilemma.[73] In order to distinguish the two, he proposes that under the selectivity analysis an objective assessment should be carried out in order to determine whether a tax measure objectively deviates from the general system. To the contrary, the examination of the 'nature' justification, which is the second step after the derogation from the benchmark system had been established, involves an assessment of the subjective policy goals of the tax measure.[74]

Another view expressed by Micheau is that the possibility to justify a selective fiscal measure is necessary due to the application of the strict derogation test in the assessment of the selectivity. As the derogation test implies that a very broad range of tax measures qualifies as selective in the first step, there is a need for a counterbalance, which is

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62 CFI, 13 Sep. 2006, T-210/02, *British Aggregates Association v. European Communities*. This case is special in the sense that it shows that the justification 'by the nature and general scheme of the measure' can be used to substantiate the material scope a special levy which is imposed only on certain goods or services. It concerned a specific environmental levy (AGL) imposed by the UK government on the extraction of certain aggregates while other types of aggregates were exempted. The applicants in the case claimed that a selective advantage accrued on those undertakings which engaged in the extraction of the exempted aggregates. The Commission did not raise objections against the levy (Commission Decision of 24 Apr. 2002, Aggregates levy N/863/2001), as it found that its scope was justified by the logic and nature of the tax system. The CFI maintained the Commission's decision, see paras 114–115, 134. Thus, the comparison and the nature justification can occur not only at the stage of examination of an 'advantage' or the 'selectivity' but at the verification of the scope of a specific charge or levy, on this see R. Luja, 'Presidente del Consiglio dei Ministri v Regione Sardegna, Judgment of the Court (Grand Chamber) of 17 Nov. 2009, Annotation', *European State Aid Law Quarterly* 1 (2010): 153. Note that the CFI's decision was set aside by the ECJ, see ECJ, 22 Dec. 2008, Case C-487/06 P, *British Aggregates Association v. Commission*. For a discussion and critical view of this case, see P. Rossi-Maccanico, 'The Notion of Indirect Selectivity in Fiscal Aids: A Reasoned Review of the Community Practice', *European State Aid Law Quarterly* 2 (2009): 171; J. Bousin & J. Piernas, 'Developments in the Notion of Selectivity', *European State Aid Law Quarterly* 4 (2008): 643.

63 CFI, 10 Apr. 2008, Case T-233/04, *Netherlands v. Commission*. In this case, the Commission characterized the issuance of emission trading certificates by the Netherlands to large polluters free of charge as a compatible aid (Commission Decision of 24 Jun. 2003, N 35/2003). The CFI annulled the Commission's Decision as it considered that the measure did not derogate from any general scheme, as the large polluters were not in a comparable situation to other small polluters. The CFI also added that even if the measure were considered to be selective, it would be justified by the nature and overall structure of the scheme of which it is part. Thus, the CFI made a distinction between the analysis of derogation/selectivity and the justification by the nature and general scheme and conducted the comparability test under the first leg of the analysis. For discussion of this case, see Rossi-Maccanico, *supra* n. 62, 172–173; Bousin & Piernas, *supra* n. 62, 639. Note that the CFI's decision was appealed by the Commission, pending Case C-279/08 P.

64 ECJ Case C-88/03, *Portugal v. Commission*, AG Opinion, 20 Oct. 2005, para. 62.

65 It is sometimes used in different term, such as 'justification by the nature or overall structure of the system' or 'justification by the inherent logic of the system'.

66 The justification first appeared in Case 173/73, *Italy v. Commission* in 1974 in an obiter dictum and it was revived in the ECJ's case law in the 1990s. See on this Micheau, *supra* n. 38, 278.

67 OJ C384 of 10 Dec. 1998.

68 Commission Notice, para. 12.

69 Commission Notice, para. 16.

70 Commission Notice, para. 23.

71 The Commission Notice mentions some examples of measures that may be justified on this ground, such as the progressive nature of an income tax scale, asset depreciation and stock valuation methods, arrangements for the collection of fiscal debts, etc. Commission Notice, para. 24.

72 Commission Notice, para. 16.

73 Pinto, *supra* n. 38, 144–145.

74 *Ibid*., 146.

the function of the 'nature justification'. According to this theory, the assessment of selectivity and that of justification differs in the sense that the former is an *in abstracto* analysis of the tax system as a whole whereas the latter is always an *in concreto* examination of the specific features of the measure, which is, by definition, conducted on a case-by-case basis.[75]

Finally, Rossi-Maccanico is of the view that selectivity is actually nothing else than the absence of 'justification by the nature and general scheme of the system'. When an exception to the general tax system is justified by the nature of the scheme, the tax advantage entailed by the exception is not selective but is rather the general rule for a specific situation.[76] His approach implies that the assessment of selectivity merges into the examination of justification. This simultaneous assessment includes the comparison taken from *Adria-Wien Pipeline*; however, it is complemented by a second test, namely that the 'differentiated treatment must be justified by its inherent coherence within the nature of the scheme'.[77] Thus, his two-prong test for determining whether a differentiation within a tax system is justified by the nature and general scheme of the system consists of the examination (i) whether the differentiation is based on different factual and legal situations and (ii) whether the differentiation is in accordance with the objectives of the system of reference and as such constitutes a coherent and inherently logical exception as a whole to the general taxation system.[78]

Other authors do not agree with the proposition that the 'nature' justification is nothing else than the application of the general (non-discrimination) principle, which lays down the rule that to different situations different treatments should be applied.[79] They argue that the 'nature' justification should rather be understood as requiring an objective (reasonable) justification for a difference in treatment of comparable situations.

We agree with the line of reasoning advocated by Rossi-Maccanico. A systematic analysis of the interest box measure along this line would start with the examination of the question whether or not the interest box regime grants an 'advantage' for certain undertakings in derogation from the benchmark tax system. As we have seen above, it does, thus the next step is the examination of selectivity. In the system of Rossi-Maccanico, this is analysed simultaneously with the 'justification by the nature and general scheme of the system'. This step partly consists of the comparison between a group company financing with debt another group company and a stand-alone company giving loan to an unrelated third party. Even if the two are not in a legally and factually comparable situation, the analysis may not stop here. Under the second part of the two-prong test suggested by Rossi-Maccanico, we should examine the coherence of the declared objective of the interest box measure, that is, the reduction of arbitrage between debt financing and equity financing in group situations, with the overall structure and nature of the scheme.

It appears that the objective of the measure is a key consideration under this approach. In this regard, it is legitimate to ask why the objective of the measure is at all relevant having regard to the settled principle that State aid measures should be analysed in light of their effects and not of their causes.[80] Pinto explains that this principle has limited application in the field of direct taxation.[81] In particular, an effect-based analysis is carried out only to determine whether the objective elements of the State aid definition are satisfied or not. However, when it comes to the question whether a measure that is prima facie State aid is justified or not by the 'nature and general scheme of the tax system' the issue of the underlying goals and policy objectives of the measure comes to the spotlight.[82] The fact that the objective of fiscal measures does have relevance in the evaluation of their selective nature is also confirmed by the *Adria-Wien Pipeline* comparison test. The test refers to 'undertakings which are in a legal and factual situation that is comparable *in the light of the objective pursued by the measure in question*'.[83]

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75 See Micheau, *supra* n. 38, 282.

76 Rossi-Maccanico, 'The Specificity Criterion in Fiscal Aid Review: Proposals for State Aid Control of Direct Business Tax Measures', *supra* n. 54, 96.

77 Rossi-Maccanico, 'The Gibraltar Judgment and the Point on Selectivity in Fiscal Aids', *supra* n. 54, 73.

78 Rossi-Maccanico illustrates this approach through the CFI's Case T-233/04, *Netherlands v. Commission*, *ibid.*

79 B. Kurcz & D. Vallindas, 'Can General Measures Be … Selective? Some Thoughts on the Interpretation of a State Aid Definition', *Common Market Law Review* 45, no. 1 (2008): 165.

80 'Accordingly, Article 92 [*now Article 107*] does not distinguish between the measures of state intervention concerned by reference to their causes or aims but defines them in relation to their effects', Case 173/73, *Italy v. Commission*, para.13. See also ECJ, 17 Jun. 1999, Case C-75/97, *Belgium v. Commission (Maribel bis/ter)*, para. 25; ECJ, 29 Feb. 1996, Case C-56/93, *Belgium v. Commission*, para. 79; Case 241/94, *France v. Commission*, para. 20; Case T-210/02, *British Aggregates*, para. 106.

81 Pinto, *supra* n. 38, 146.

82 Similarly, Bousin and Piernas emphasize that by means of the justification 'by the nature and overall structure of the system' the aims and causes of the measure can be taken into account despite the principle of effect-based objective analysis, see Bousin & Piernas, *supra* n. 62, 635. Similarly, the policy objectives of the measure are also important in the determination of whether or not the measure can be considered compatible with the Common Market in view of the derogations laid down in Arts 107(2) and (3) TFEU.

83 Case C-143/99, *Adria-Wien Pipeline*, para. 41. It is interesting to note that para. 75 of the Decision cites this sentence without the part referring to the objective of the measure.

The importance of the objective of a fiscal measure at the stage of justification is underlined by the Commission Notice, which says that '[a] distinction must be made between, on the one hand, the external objectives assigned to a particular tax scheme (in particular, social or regional objectives) and, on the other, the objectives which are inherent in the tax system itself'.[84] In the *Azores* case, the ECJ qualified this when it said that the distinction is between 'the objectives attributed to particular tax scheme which are extrinsic to it, and …, the mechanisms inherent in the tax system itself which are necessary for the achievement of such objectives'.[85] Although it is not entirely clear what the consequences are of the distinction between internal and external objectives,[86] it seems to be undoubted that a differential tax treatment that is inherent in the logic of the scheme, that is, follows an internal objective, is capable of being justified by the nature justification.

3.3.3. *Objective of the Interest Box Measure and Its Suitability and Proportionality in Relation to Its Objective*

We will now examine the Commission's assessment of the objective of the interest box measure.

Although the Commission discussed the objective of the interest box regime through several paragraphs, it did so merely to support the conclusion that arbitrage can only occur between related companies, thus unrelated companies are in a different situation from the point of view of financing. On the other hand, the Commission did not demonstrate that the objective of lessening arbitrage in intra-group financing is actually coherent with the nature or the general scheme of the system in which the interest box operates. In our view, the nature and general scheme of the system is capable of justifying an exception to the general system as long as the deviating measure pursues its objectives by appropriate and proportionate means. Therefore, a complete analysis of the selectivity of the interest box and its potentially justified nature should answer the question whether the means by which the regime intends to reduce arbitrage is appropriate and proportionate to the objective pursued.

The examination of the suitability and proportionality of the measure brings elements to the State aid analysis, which resemble to the 'rule of reason' test developed under the discrimination analysis concerning the fundamental freedoms.[87] Although it is not yet clear from the ECJ's State aid jurisprudence whether or not such a test should be performed in reviewing State aid measures, it seems to be logical that if a possibility for justifying selective advantages exists, the justification should not be allowed without limits.[88] Moreover, the principle of proportionality is a general principle of EU Law, the observance of which should be ensured also in the State aid field.[89]

There are indications in the Commission's practice in this direction. For example, the Commission decided in the case of Italian tax incentives in favour of newly listed companies[90] that the scheme that granted a tax rate reduction with respect to the future profits of Italian companies who obtained listing in the time period concerned was State aid not justified by the nature of the tax system. Specifically, the scheme was considered to be not proportionate to the aim pursued as the future profits of companies

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84 Commission Notice, para. 26.

85 Case C-88/03, *Portugal v. Commission*, para. 81.

86 Advocate General Geelhoed in the *Azores* case stated that the external objectives fall outside the scope of the justification by the 'nature and general scheme of a tax system' (Case C-88/03, *Portugal v. Commission*, AG Opinion, para. 76). However, there are some indications in the Commission's practice and in the case law to the contrary, i.e., external objectives, such as environmental protection, social and regional goals may, in principle, be taken into account when assessing whether a prima facie selective measure is justified by the nature and general scheme of the tax system. To this effect, see the *Adria-Wien Pipeline* case, which does not totally exclude ecological considerations from being taken into account. In this case, the ECJ rejected the ecological reasons on a different ground, namely that their application was not consistent with the scheme of the measure (Case C-143/99, *Adria-Wien Pipeline*, para. 52). Similarly, the Commission's Decision not to raise objections in the *British Aggregates* case shows that a differentiating tax measure can be justified by the nature of the scheme when it is based on environmental objectives. However, the decision and its approval by the CFI were eventually overturned by the ECJ, see *supra* n. 62. Although the *Maribel bis/ter* case concerned not a tax measure but a social security contribution, it is another example where external aim, i.e., the aim of the promotion of employment, could have justified the measure at issue on the basis of the nature and general scheme of the social security system. In that case, it was another factor, i.e., the sectorally selective application of the measure that rendered it State aid (Case C-75/97, *Belgium v. Commission*). In academic literature, Pinto is of the view that external objectives can be considered under the 'nature' justification, see Pinto, *supra* n. 38, 146, 148. As far as we understand, Micheau is of the opposite opinion, according to her the 'nature' justification encompasses only reasons intrinsic to the system itself, see Micheau, *supra* n. 38, 280. According to Rossi-Maccanico, it is the decision of the CFI in the British Aggregates case that confirms that 'fiscal specificity may be justified by general economic objectives being different from the inherent logic of the tax system', see Rossi-Maccanico, 'The Specificity Criterion in Fiscal Aid Review: Proposals for State Aid Control of Direct Business Tax Measures', *supra* n. 54, 98.

87 '[…] A restriction [*on the freedom of establishment*] is permissible only if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest. It is further necessary, in such a case, that its application be appropriate to ensuring the attainment of the objective thus pursued and not go beyond what is necessary to attain it' (see, to that effect, Case C-250/95, *Futura Participations and Singer* [1997] ECR I-2471, para. 26, and Case C-9/02, *De Lasteyrie du Saillant* [2004] ECR I-2409, para. 49), ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer*, para. 35. See on this point Pinto, *supra* n. 38, 148.

88 In Case 431/01P, *Bouygues SA and Bouygues Télécom SA v. Commission*, Advocate General Trstenjak observed that a possible interpretation of the 'justification based on the nature and general scheme of the system' is to see it as 'an application of a "rule of reason" in the field of national systems regulating the imposition of public financial burdens', para. 109.

89 Rossi-Maccanico, 'The Specificity Criterion in Fiscal Aid Review: Proposals for State Aid Control of Direct Business Tax Measures', *supra* n. 54, 97–98.

90 Commission Decision of 16 Mar. 2005 on aid scheme, C 8/2004 (ex NN 164/2003) implemented by Italy in favour of newly listed companies, OJ L94, 1 Apr. 2006, 42.

are not related to the fact of whether or not those companies had been admitted to stock markets.[91]

In the Decision, the Commission reached the conclusion that '… the measure at stake will have the effect of reducing this arbitrage (in a domestic situation) as the taxation of intra-group interests will approximate to the taxation of intra-group dividends, thus reinforcing the technical neutrality of the fiscal system'.[92] Curiously, the Commission limited its conclusion about the effect of the measure to domestic contexts. However, it is precisely in a domestic context where the risk of arbitrage does not exist. From the State's point of view, it is indifferent whether in a domestic context a resident affiliate pays interest or dividends to its resident parent. Both interest and dividend payments are taxed once; in the case of interest in the hands of the recipient and in the case of dividends in the hands of the payor.[93] As in a domestic context, both the payor and the recipient are resident in the same country, the right to tax the income once is guaranteed for the country of residence irrespective of the type of payment. From the taxpayer's point of view, the choice between debt and equity financing is also neutral, as it is taxed once in any case. In this constellation, it does not make any difference for the taxpayer whether it is taxed at 5% or 25% on the intra-group interest received if it can deduct the corresponding amount on the payor side.[94] Therefore, the approximation of the tax treatment of interest to that of dividends by reducing the rate of deduction/taxation will not have the effect of encouraging equity financing and dividend payments instead of interest payments in a purely domestic situation.

In a cross-border context, on the other hand, the situation is different. If we take a foreign parent company with a Dutch affiliate where the parent has the choice between providing equity and granting a loan, the measure that allows the interest to be deducted only at a rate of 5% is likely to discourage financing by means of loan if the interest is taxed in the country of residence of the parent at the full rate of the corporate income tax, as this would lead to double taxation.[95] Thus, the reduced rate for the deduction of intra-group interest has the proclaimed effect of reducing arbitrage between debt and equity financing; however, contrary to the Commission's finding, it has this effect only in a cross-border context and only where the Dutch resident company is the debtor. This situation is irrelevant from the point of view of the State aid analysis, as the part of the interest box measure that is tested under the State aid rules is not the reduced rate for the deduction but the reduced rate for the taxation of intra-group interest received by a Dutch creditor. This follows from the starting point that the only situation where an advantage is present is where the Dutch company provides a loan to a related company.[96]

Taking this latter situation, that is, when the Dutch company is in the position of a creditor and it gives a loan to a foreign affiliate, the interest box measure, instead of reducing, even increases the arbitrage between debt and equity financing. However, in the Commission's opinion this effect resulted not from the interest box measure itself but from the interaction of the different tax systems of the Member States.

Thus, we conclude from the above that a thorough analysis of the appropriateness and proportionality of the interest box measure in relation to its objective should have revealed that the measure is not able to achieve the reduction of arbitrage between a domestic financing company and a domestic financed affiliate. Thus, the interest box measure is unrelated to the objective it pursues. In addition, due to the fact that in a cross-border scenario it can even increase the scope for arbitrage (Dutch creditor-foreign debtor) it is disproportionate to the aim pursued.

3.3.4. *Proposed Analytical Framework*

In conclusion to the above critical remarks, we intend to outline an analytical framework, which could be used, beyond the analysis of the interest box measure, in a general way for reviewing fiscal measures of the Member States under the EU State aid rules.

The proposed framework focuses on the examination of the 'advantage' and 'selectivity' elements of the State aid definition.

The first step of the analysis is aimed at identifying an *advantage* that 'favours certain undertakings or the production of certain goods'. The main question to be

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91 See para. 27 '… nor can this exception to the normal tax rules be justified by the nature of the Italian tax system, since it does not address any fundamental tax distinctions between the situations of listed as opposed to non-listed companies. In particular, since the scheme provides for a reduction in the tax rate applicable to future profits earned by its beneficiaries, it cannot be deemed proportionate because such profits are unrelated to the fact that the beneficiaries are admitted to listing, to their capital structures and to other characteristics associated with listing'.

92 Paragraph 86 of the Decision.

93 Assuming that a participation exemption regime applies in order to relieve economic double taxation of distributed profits.

94 Apart from the case where the payor is in a loss position.

95 The Dutch authorities emphasized exactly the cross-border effect of the interest box. They specifically referred to the interest box measure as a disincentive for the inflow of debt financing into the Netherlands with an effect similar to thin capitalization rules, i.e., preventing the erosion of the Dutch tax base. Paragraph 57 of the Decision.

96 The Dutch authorities argued that this aspect of the interest box is also aimed at giving an incentive to maintain capital in the Netherlands, as it offers the reduced rate for intra-group interest received *provided that it is financed with equity capital*. See para. 57 of the Decision. However, this argument is rather unconvincing, see in this respect s. 2 where we pointed out that the rules of the interest box require no historic casual connection between the intra-group loan on which interest is received and equity capital from which it is assumed to be financed.

answered here is whether there is a recognizable benefit that the measure confers on certain undertakings in derogation from the general system of taxation. If a benefit is entailed by the measure but it is generally available to any undertaking upon the meeting of equally applicable and objectively defined conditions, then there is no derogation from or exception to the general system. An example of such a general measure would be participation exemption for dividends received by shareholders having more than 5% shareholding in the distributing company.

If a measure does qualify as a derogation from the general tax system, the next question is whether the favoured undertakings are in a legally and factually comparable situation with those who are excluded from the measure, in the light of the objective of the measure. This second step is aimed at examining the *selectivity* of the measure. By qualifying a measure as selective or not, we also answer the question whether it is *justified by the nature and general scheme of the system* or not. Thus, in the proposed framework the examination of selectivity is not detached from the examination of the 'nature' justification. The aggregate analysis of these two elements requires a comparison to be made between the beneficiaries of the measure and those who are excluded from it. If a measure applies only to a certain group of undertakings that are in a specific situation that cannot be compared to the situation of others, the measure is justified by the nature and general scheme of the system. It follows that such measure is not selective. An example of a derogation from the common system that is justified by the nature of the system, thus, is non-selective is a tax credit for R&D activities or innovation. Undertakings who invest in R&D are not in a comparable situation to those who do not invest in that.

In addition, the examination of whether the measure is justified by the nature of the system has to have regard to the objective that the measure pursues. Thus, the selectivity/justification analysis, on the one hand, involves a comparison, on the other hand an assessment of the objective of the measure and its suitability and proportionality in relation to that objective.

This analytical framework shows substantial similarities to the approach that we use under the fundamental freedoms in order to determine whether a national measure constitutes a discrimination or restriction on the freedoms.[97] Both under the State aid analysis and the discrimination/restriction approach, the comparability test has a key role. Both a selective advantage and a discrimination consist of a measure that treats comparable situations differently. Under both approaches, we take into account the objective of the measure and its suitability and proportionality. However, under the discrimination approach the comparability test is distinct and separated from 'rule of reason' test (legitimate aim, imperative public interest, suitability, and proportionality). The rule of reason test is part of the justification stage of the analysis, which is a step separate from the examination of the comparability of the situations. Therefore, if a measure differentiates between objectively different situations, it is not discriminatory, thus there is no need to justify it. The analysis stops before the rule of reason test comes into play. Consequently, the suitability and proportionality of such measure cannot be reviewed. In contrast, the selectivity analysis in our proposed framework combines the comparability test and the justification into one step. Therefore, even if a measure differentiates between objectively different situations, it still has to comply with the suitability and proportionality criteria in order to be considered justified by the nature of the system and thus escape selectivity.

3.4. Disparity

The Commission, contrary to us, concluded that the 'de jure' condition for the interest box regime, that is, application only to group companies, did not lead to a selective advantage for its beneficiaries. The Commission examined another aspect of the scheme, namely the advantage that it confers on multinational groups of companies as compared to domestic groups.[98]

Although by virtue of its legal conditions the interest box regime is not limited to multinational groups, 'de facto' these taxpayers would be the real beneficiaries of the measure.[99] In a cross-border context where a company established in the Netherlands provides loan to an affiliate abroad, the regime entails that the financing company is entitled to the reduced rate on the interest received on the intra-group loan, while, at the same time, the debtor has the right to full deduction of the interest paid in its country of residence. The Commission held that this 'de facto' selective advantage conferred by the measure on multinational groups of companies could not be imputed to the Netherlands.[100] Any such advantage is a consequence

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97 Bousin & Piernas, *supra* n. 62, 643.

98 The Commission has already investigated and found to be State aid a large number of national tax regimes specifically designed for multinational company groups. For a list and summary of these regimes, see R.H.C. Luja, 'De Groepsrenteboxbeschikking: Onbedoeld te Gunstig', *Weekblad Fiscaal Recht* no. 6825 (2009):1067–1068 and P. Rossi-Maccanico, 'A Review of State Aid in Multinational Tax Regimes', *Tax Notes International* 46, no. 9 (28 May 2007). As Luja points out, contrary to the interest box, these regimes contained an express condition for the group having a foreign headquarter or being in foreign ownership or having operations in a certain number of countries and/or continents, thus they were 'de jure' selective.

99 Regarding de facto advantages, the CFI already held that '[…] What matters, […], for a measure to be found to be State aid, is that the recipient undertakings belong to a specific category determined by the application, *in law or in fact*, of the criterion established by the measure in question', CFI, 1 Jul. 2004, Case T-308/00, *Salzgitter*, para. 38.

100 Paragraph 115 of the Decision.

of disparities between different tax jurisdictions, which falls outside the scope of the State aid rules.[101] Hence, the Decision became the first precedent in the Commission's State aid practice where the disparity argument is utilized as the main, substantive ground on the basis of which a tax advantage accruing to a specific group of undertakings is excluded from the scope of the State aid rules.[102]

The notion of disparity finds its roots in the ECJ's jurisprudence concerning the fundamental freedoms laid down in the TFEU. In that context, it describes an obstacle to the internal market, which results from the interplay of differing rules of various jurisdictions as opposed to a discrimination or a restriction that is caused by the rules of one single jurisdiction. In the direct tax field, it was the *Schempp* case[103] where the ECJ first spelled out that disparities between the tax legislation of various Member States may result in a disadvantage for the taxpayer exercising the right to free movement, which is a disadvantage that cannot be remedied by having recourse to the fundamental freedoms.[104] Although such disparities create an obstacle to the free movement within the internal market, they fall outside the scope of the fundamental freedoms.[105] The question arises whether or not it is legitimate to rely on the notion of disparity in the field of State aid in a similar manner as in the field of the fundamental freedoms to the effect that a Member State cannot be held responsible under the State aid rules for certain tax advantages following from the interaction of its tax legislation with the different tax rules of another Member State. In the case of the fundamental freedoms, a disparity results in a disadvantage for the taxpayer who makes use of its rights guaranteed by the freedoms, whereas in the case of a suspected State aid a disparity results in an advantage for a specific group of taxpayers. The possible favourable effect of a disparity for taxpayers was expressly pointed out by Advocate General Geelhoed in his opinion in the *ACT IV* case.[106] In his words, '[…] at issue here are distortions of economic activity resulting from the fact that different legal systems must exist side by side. In certain cases, these distortions provide disadvantages for economic actors; in other cases, advantages. While in the first case they are "restrictive", in the second case they stimulate cross-border establishment activity'.[107] Besides the fact that disparities that are advantageous for the taxpayer stimulate cross-border transactions, they may impair the functioning of the internal market just as disparities, which disadvantage the cross-border activity of taxpayers. While the latter disparity impedes the free movement of persons, services, or capital, the former distorts competition as long as it favours only a certain category of taxpayers. Although both types of disparities have a detrimental effect on the internal market, it seems to be correct to exclude them from the scope of primary EU law entailing obligatory legal effects for the Member States, as it is impossible to determine which Member State should be forced to change its rules in order to eliminate the disparity. Moreover, the concept of selectivity for the purposes of the State aid rules is parallel with the concept of discrimination in the field of the fundamental freedoms. Thus, it is justified to carve out disparities from the domain of selectivity just as disparities are distinguished from discrimination.

Therefore, in our view, the concept of disparity and its consequence, namely, that not all specific tax advantages that distort competition in the internal market can be imputed to a Member State, should indeed be acknowledged in the field of the State aid rules.

However, the question still remains whether in the case of the interest box measure it is indeed a genuine disparity that benefits multinational groups of companies engaging in cross-border intra-group debt financing (Dutch creditor-foreign debtor). The advantage for the latter category of taxpayers results from the fact that the Netherlands intends to introduce a special scheme for intra-group interest under which the creditor is taxed at a substantially lower rate than under the normal tax rules, while other Member States did not introduce such derogation from their general tax rules. From this perspective, the finding of the Commission that '… any advantage obtained in a cross-border context […] is not the result of a lower Dutch rate for intra-group interest received but

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101 Paragraph 117 of the Decision.

102 The Commission referred to another State aid case in which the CFI brought up arguments regarding legislative and regulatory disparities between the Member States (para. 115 of the Decision). However, those arguments were not used to deny the State aid character of certain advantageous tax situations but rather to establish the correct reference framework as compared to which the selectivity of a national tax measure can be determined. See Case T-308/00, *Salzgitter*.

103 ECJ, 12 Jul. 2005, Case C-403/03, *Schempp*.

104 '… The Court has already held that the Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in which he previously resided will be neutral as regards taxation. Given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen's advantage in terms of indirect taxation or not, according to circumstances' (see, to that effect, Case C365/02, *Lindfors* [2004] ECR I7183, para. 34). Case C-403/03, *Schempp*, para. 45.

105 On the concept of disparity, see B. J.M. Terra & P.J. Wattel, *European Tax Law*, 5th edn (Deventer: Kluwer, 2008), s. 3.2.7. Wattel suggests that in order to determine whether a disadvantageous tax effect derives from a disparity between two tax systems or from the unilateral discrimination/restriction of a Member State, we have to look at what would happen if both Member States had the same tax rules. If the disadvantage disappears, it was caused by a disparity. See *supra* n. 47.

106 ECJ, 12 Dec. 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*.

107 Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*, AG Opinion, 23 Feb. 2006, para. 38. The Advocate General categorizes disparities as 'quasi-restrictions' falling outside the scope of Art. 43 EC Treaty along with other two categories of obstacles, namely, cumulative administrative compliance burdens and dislocation of the tax base.

the result of unlimited deduction for intra-group interest paid abroad'[108] can hardly be substantiated. Even if one takes the view that the advantage is not imputable to the Netherlands, why would it be unilaterally caused by the other Member State, which simply applies its standard, general rules of taxation of interest income[109]? If the advantage stems from a genuine disparity, no one single Member State can be blamed for it, as the advantage is caused by the juxtaposition of the differing rules of two Member States. However, in our opinion, not even this latter description stands for the case of the interest box measure.

We submit that the advantage obtained by multinational groups of companies in cross-border intra-group interest transactions with tax jurisdictions with a corporate tax rate higher than 5% is not a result of a genuine disparity. In our opinion, only the difference between the general corporate tax rates of the Member States may be qualified as a genuine disparity. That difference in itself can result in an arbitrage for taxpayers engaged in debt financing where interest is paid from a high-tax jurisdiction to a low-tax one. The lack of harmonization of the corporate tax rates within the EU cannot, however, be assimilated to the case where a Member State introduces a specific scheme in derogation of the general tax rules that provides a preferential rate for intra-group interest and thereby intentionally increases the disparity between the tax systems of the Member States.[110] Due to the interest box, the gap between the tax rate at which intra-group interest is taxed and at which it is deducted is widened. The normal arbitrage that exists due to the difference of the general tax rates of the Member States is even enhanced.

In summary, in our view, two factors have to be taken into account in assessing the interest box regime. First, the Netherlands is about to introduce the interest box regime as an exception to the general tax system, as the lower taxation provided by the measure is limited to intra-group interest income. This benefits a certain intra-group activity, the provision of loan to other group entities. Second, the Netherlands by introducing the regime increases the disparities between the tax systems of the Member States. These two factors on their own may not be sufficient to engage the State aid rules. Derogating rules for the taxation of intra-group interest alone may not be selective because it is possible to argue that the situation of group companies is different from the situation of unrelated companies, thus, the provision of loan between them and the income derived from those loans can be taxed differently.[111] An existing disparity between the tax rates of the Member States that is favourable to certain taxpayers is also out of the scope of the State aid rules. Even an increase of that disparity by, for example, reducing the corporate income tax rate generally across the board for all taxpayers in a Member State is irrelevant from the point of view of the State aid rules. However, the introduction of a special regime in deviation from the general tax system combined with the effect of increasing the disparity between the Member State tax systems with the result of creating a possibility for multinational company groups to specifically benefit from those increased differences is an intervention by the Member State that should fall under the State aid rules and should be qualified as State aid. Consequently, it is the combination of the two factors that should result in the qualification of the interest box as State aid imputable to the Netherlands.

3.5. The Compulsory Nature of the Interest Box

Another factor that was decisive in the Commission's conclusion that the interest box did not grant selective advantages to any category of undertakings was the fact that the interest box was made compulsory after an amendment made to the original measure. According to the Commission, the compulsory nature of the measure rules out the possibility of opting out and opting in the regime depending on what is more beneficial for the group.[112] This, indeed, lowers the chance that various groups of companies will be taxed differently. It is also true that due to the compulsory nature of the interest box there could be situations where the regime results in a disadvantage for the group, namely when a foreign parent company finances its Dutch subsidiary by debt. In this case, the Dutch subsidiary will only be able to deduct the interest paid on the debt at 5%, while the interest will be taxed in the hands of the parent at the full corporate income tax rate. However, the existence of possible unfavourable consequences of the measure does not cancel out the advantages that are obtained by certain other economic players

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108 Paragraph 113 of the Decision.

109 This latter point is also emphasized by the Commission a few paragraphs later '…in the country concerned, the deduction at the normal rate will only stem from the application of the normal tax system (and not from a derogatory measure)', para. 116 of the Decision.

110 Raymond Luja also points out that the interest box broadens the difference in tax treatment already existing between the Member States by introducing a new tax incentive. However, he concludes that this still remains within the ambit of disparity, as if a regime similar to the Dutch interest box were in place in the other Member States the cross-borer advantage would disappear, see R. Luja, 'Commission Decision on Dutch Group Interest Box Scheme', H&I 2009/9.24.

111 Setting aside the question whether or not such tax rules can be justified by the nature and general scheme of the tax system taking into account the appropriateness and proportionality of the rules in relation to the objective pursued by them.

112 Paragraph 108 of the Decision.

in a reverse position. Moreover, taxpayers reinforced by their mighty tax advisors usually find the way how not to apply the measure where it would have disadvantageous consequences for them. As we will see below, the latest draft bill on the new version of the interest box would allow in certain circumstances a Dutch subsidiary of a foreign parent to deduct intra-group interest at the normal rate of 25.5%. In conclusion, in our view, turning the interest box into a compulsory measure may have lessened its selectivity; however, it did not fundamentally change its original character.

In conclusion, we submit that the interest box regime grants selective advantage to both group companies as compared to stand-alone companies and to multinational groups engaging in cross-border intra-group debt financing as compared to purely domestic groups. As this opinion was not shared by the Commission, the question remains whether there is any instrument available in the EU regulatory regime, which could prevent the implementation by a Member State of a tax measure that, although distortive on competition, cannot be tackled under the State aid rules. An obvious answer is the stand-still mechanism in the Code of Conduct Group for the prevention of introduction of new harmful tax measures.

4. The Dutch Group Interest Box in the Light of the Code of Conduct on Harmful Tax Competition

4.1. Introduction

Now we turn to the question whether the group interest box qualifies as a harmful tax measure according to the criteria of the Code of Conduct. In 2007, the Code of Conduct Group[113] reported to the Council that it would keep its powder dry pending the State aid investigation into the group interest box.[114] The report states: 'The Group discussed the description of the Netherlands Interest Box. The Group agreed that the measure should be assessed against the Code Criteria when the current State Aid proceedings were complete'.

Unlike State aid rules, the Code of Conduct is 'merely' a political commitment and therefore considered part of European 'soft law'. Although the latest developments indicate that there may be water in the engine (see below), we can conclude that the Code of Conduct Group has been successful in rolling back existing harmful tax measures and preventing the introduction of new such measures. So far, the Group has investigated over 400 tax measures, a 100 of which were found to be harmful. Those have been repealed or amended by the Member States.[115] Unfortunately, the work of the Code of Conduct Group is not always visible enough to the outside world. Apart from the Report, which was presented to the Council in November 1999 and which contained 271 tax measures of which 66 were considered harmful ('Primarolo Report'),[116] no public documents of the deliberations of the Code of Conduct Group on potentially harmful tax measures are distributed in a normal course of action.[117] The apparent reason for this is that according to the Member States negotiations should not be conducted in the public domain but kept within the Council.[118]

4.2. The Three-Step Process of the Code of Conduct

The Code of Conduct uses a three-step process to determine whether a certain measure has to be considered a harmful tax measure. The first question is whether the Code of Conduct applies to the measure at all. This is the case if it concerns a profit tax measure, including administrative measures and administrative practices, which substantially affects or may affect the location of business activities within the Community.[119] If activities are performed within a group of companies, the Code of Conduct deems those to be business activities without further examination. Not covered by the Code of Conduct are other tax measures, such as wage and income tax imposed on natural persons.

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113 As from the date of the establishment of the Code of Conduct Group until 16 Oct. 2007, the group was chaired by the UK Paymaster General Dawn Primarolo. She was succeeded by Jane Kennedy. Since 5 Feb. 2009, the Group is chaired by the Director-General of the Austrian Ministry of Finance, Wolfgang Nolz. He has been appointed for a period of two years.

114 Code of Conduct Group (Business Taxation), Report to the ECOFIN Council, SN 15545/1/07 REV 1, 29 Dec. 2007, para. 13.

115 See *Promoting Good Governance in Tax Matters*, SN 9281/09, 29 Apr. 2009, 4.

116 Code of Conduct Group, Report on Code of Conduct (Business Taxation), SN 4901/99, 23 Nov. 1999, also published in V-N 2000/6.6. For detailed analysis, see Pinto, *supra* n. 38, 208–214.

117 Apart from some exceptions, see the Council's website <www.consilium.europe.eu> on which some minutes have been published. The Council decides on what is published: see para. H of the Code of Conduct.

118 R.C. de Smit & K.M.H.J. Theunissen, *Verslag of the Rondetafelbijeenkomst 'Het fiscale Concern Binnen het EG-Recht'* (Report on the Round Table Meeting 'The Tax Grouping under EC Law'), WFR 2008/6788, 1287–1292.

119 See para. A of the Code of Conduct.

The second question is whether the measure is potentially harmful.[120] In this respect, it is essential whether or not the measure results in a significantly lower effective level of taxation than those levels that generally apply in the relevant Member State. This lower taxation may be caused by a different nominal rate, an adjusted tax base, or other factors. There is nothing wrong with a competitive tax system as such, an example of which is the Irish corporate income tax system with a general rate of (only) 12.5%, applicable since 1 January 2003.

The third and also last question is many times perceived as the most complicated. It concerns the question whether the potentially harmful tax measure is actually harmful. According to the Code of Conduct, the following criteria must be considered when answering this question:[121]

(1) Are the benefits solely granted to non-residents or granted for transactions with non-residents (also know as 'ring-fencing 1')?

(2) Are the benefits fully separated from the domestic economy so that they do not have any consequences for the national tax base (also known as 'ring-fencing 2')?

(3) Are the benefits also granted in the absence of any real economic activity or substantial economic presence in the Member State offering these tax benefits?

(4) Do the rules for the calculation of the profit from domestic activities of a multinational group of companies differ from the internationally accepted principles, in particular the Organization for Economic Cooperation and Development (OECD) approved rules?

(5) Are the tax measures insufficiently transparent, also when legal regulations at the administrative level are applied in a less strict and obscure manner?

These criteria, which are not exhaustive, partially overlap each other and basically address the question whether a tax measure deviates from the national tax system *in a harmful manner.*[122] Naturally, it is not required in this respect that all criteria are complied with. Incidentally, the fifth criterion is the odd one out here, as the lack of transparency in itself does not make a measure harmful. This does not alter the fact of course that it could be an important clue.[123]

While assessing the harmful nature of the measure, the effect of the tax measure on the other Member States should also be taken into account, '*inter alia* in the light of how the activities concerned are effectively taxed throughout the Community'.[124] Pursuant to this economic criterion, the average rate at which the activity is taxed in the EU seems to be of crucial importance.[125] It seems that a potentially harmful measure is only considered harmful on the basis of this criterion if the relevant measure results in a tax burden that is a significantly lower than the average in the EU. Finally, the Code of Conduct seems not to bother with harmful tax measures promoting the economic development of certain regions.[126]

4.3. Is the Group Interest Box Harmful?

It is not questionable that the group interest box as a profit tax measure falls within the scope of the Code of Conduct as it might influence the location of the group financing activities. As earlier mentioned, the Code of Conduct Group – and ultimately the Council – must arrive at a final political verdict on the group interest box. Our conclusion is that the Code of Conduct provides a sufficient base for a positive assessment, as the group interest box has the unmistakable characteristics of a harmful tax measure.[127]

In any case, it seems that the group interest box already fulfils three of the five criteria listed in the Code of Conduct. It can be argued that the 5% rate for group interest de facto solely applies to inter-company loans granted to a foreign group company outside the Netherlands (ring-fencing 1). After all, there are no benefits to be gained in a domestic financing arrangement.[128] It also implies that the benefits are not in any way related to the domestic economy and therefore have no consequences for the national tax base (ring-fencing 2). Furthermore, no substance requirements are imposed for the application of the

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120 See para. B of the Code of Conduct.

121 See paras B and H of the Code of Conduct.

122 Compare Pinto, *supra* n. 38, 201–204.

123 See B.J. Kiekebeld, *Harmful Tax Competition in the European Union, Code of Conduct, Countermeasures and EU Law* (Deventer: Kluwer, Foundation for European Fiscal Studies, 2004), 26.

124 See para. G of the Code of Conduct.

125 See Kiekebeld, *supra* n. 123, 25.

126 Paragraph G of the Code of Conduct.

127 See also M.F. Nouwen, 'De Verplichte Groepsrentebox: Geen verboden Staatssteun, wel Schadelijke Belastingconcurrentie?' ['The Mandatory Group Interest Box: No Prohibited State Aid but Harmful Tax Competition?'], *Weekblad* (2009): 1164 and M.F. Nouwen, *Groepsrentebox als Alternatief voor het Afgeschafte Concernfinancierings Regime* [*Group Interest Box as Alternative to the Repealed Group Financing Regime*] (Deventer: Kluwer, 2009), 76–100.

128 Besides some exceptions, such as in the event of losses.

5% rate other than that the group company lending the money is a resident of the Netherlands for tax purposes.[129] In addition to these three criteria, it is doubtful whether the group interest box is in line with internationally accepted principles. Although the Code of Conduct refers to arms-length establishment of transfer prices, which are compliant with OECD standards, the criterion does not seem to be limited to it. A delicate detail in this connection is the fact that the Netherlands boldly applies an anti-abuse provision that prevents the erosion of the tax base, through interest deductions within the same group.[130] If the interest income is subject to an effective tax rate abroad that is lower than 10%, abuse is even assumed.[131] In other words, the Netherlands would not accept other Member States to introduce a look-alike group interest box. As far as the last criterion, non-transparent application, is concerned, it is observed that the 5% rate of the group interest box has clearly been laid down in the law. The tax benefit therefore has nothing to do with any obscure application of a tax provision by the Dutch tax authorities. The fact that the group interest box contains a delegation clause on the basis of which some aspects may be worked out in a ministerial regulation does not alter this in our view.

It should be observed that in the system of the Code of Conduct, the group interest box can only be assessed against these criteria if it qualifies as a *potentially* harmful measure. That is only the case if the group interest box can be considered an exception to the general Dutch tax system in that it results in a significantly lower level of taxation on intra-group interest than that generally applicable to interest. It seems to us that precisely this question will become decisive. Unfortunately, it is unclear how it must be assessed, whether a tax measure is part of or diverges from the Dutch 'benchmark tax structure'. The assessment resembles to a certain extent to the selectivity test as applied in connection with the State aid control. For example, based on the 'derogation approach', a measure is selective if it deviates from the universally applied tax system. It is true that in its final decision the European Commission followed the so-called 'comparison approach' and ruled that no selective benefit existed in comparison with the taxation of bank interest or other interest between unrelated parties because group interest and the latter type of interest are not comparable. Following from the above, the European Commission emphasized the general nature of the scheme by pointing out that the group interest box is available to all businesses subject to corporate income tax and receiving and/or paying group interest, regardless of their size, their branch of activity, or any other distinction. It seems therefore that the European Commission is of the opinion that the group interest box is a general measure for a specific situation (in this case, group financing). The benefit to be gained in cross-border situations is a consequence of disparity according to the Commission. As argued above, that decision could have been very different. It is not impossible that the Code of Conduct Group contrary to the Commission does consider the group interest box as an exception. The fact that the advantage is due to a (pumped-up) disparity does not exclude the characterization as an exception.

It is noteworthy that in the new work programme that the Code of Conduct Group adopted[132] and the Council approved on 2 December 2008[133] the establishment of a sub-group is indicated, which will investigate disparities between tax systems, such as they exist with hybrid entities and profit sharing loans. It seems to be suggested that disparities should be addressed in the framework of the coordination exercise.[134] The relevant investigation will take place within the framework of paragraph K of the Code of Conduct in which Member States are called to fully cooperate in the fight against tax evasion. This paragraph of the Code of Conduct is generally seen as the odd one out. The fight against tax evasion in itself has nothing to do with harmful tax competition. Nevertheless, the Code of Conduct Group intends to set guidelines to fight abuse in connection with disparities. From all these, it can be inferred that the Code of Conduct Group is of the opinion that a disparity cannot result in one Member State being blamed for engaging in harmful tax competition.

4.4. Hungarian Group Interest Box as Precedent?

During the parliamentary debate of the group interest box, the Minister of Finance observed the following about the probability for the interest box to survive the scrutiny by the Code of Conduct Group:[135]

> Nothing is reported by the Code of Conduct Group, the Primarolo group until the national decision-making process has been completed. (…) Equal Treatment is of course an important basic premise for the Netherlands.

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[129] Or if a company carries on a business in the Netherlands through a permanent establishment to which a group receivable can be attributed.

[130] Reference is made to s. 10a of the Wet Vpb 1969.

[131] Possible to furnish evidence to the contrary but very difficult.

[132] Code of Conduct Group (Business Taxation), Report to the ECOFIN Council (including future work package), 20 Nov. 2008, no. 16084/08, 1–14.

[133] See Code of Conduct Group (Business Taxation), no. 11967/09, 20 Jul. 2009, 1.

[134] Code of Conduct Group (Business Taxation), no. 10200/1/09, 29 Jun. 2009, 8.

[135] Parliamentary Proceedings I, 21 Nov. 2006, no. 9, 375.

> We are of the opinion that there are precedents in other countries on which we can rely and which we can extremely well defend in the Primarolo group. Obviously I do not know how the other group members will react to this, but for a blockade in the Primarolo group to be effective, they would absolutely unanimously have to be against the Netherlands.

Although the State Secretary is not listing the precedents, his trump card seems to be the Hungarian intra-group interest regime. Under this regime, which was in force in Hungary from 1 January 2003 till 31 December 2009 (see footnote 11), a Hungarian resident company could deduct from its tax base 50% of the positive balance between interest received from and interest paid to its related companies.[136] At the same time, if the balance of interest received from and paid to related companies was negative for a Hungarian company, it could only deduct 50% of the interest paid to related companies from its tax base.[137] The measure only applied to interest paid between related companies. It was optional, opting in and opting out was possible on a yearly basis.

The Code of Conduct Group had not been able to reach a consensus on the Hungarian counterpart of the interest box in 2005.[138] Although a majority of seventeen Member States qualified the Hungarian measure as harmful, Belgium, Luxemburg, Lithuania, Poland, the Netherlands, and Hungary of course were of a different opinion.[139] The Netherlands, Lithuania, and Poland, for example, were of the opinion that there was no objective justification for the designation 'harmful', because a (not further specified) comparable royalty regime had not been considered harmful by the group in 2003. Belgium and Luxemburg did not consider the Hungarian measure harmful. They felt it was similar to a French royalty regime, which was not further specified either. That regime was not considered harmful by the group in 2002. In the documents that were released, Belgium observes: 'What has been allowed for France must be allowed for Hungary'. This gave rise to discussion in the group about whether one could still talk of 'the group' and/or a 'large majority'.

In the meantime, the Code of Conduct Group adopted the new work package for the future.[140] One of the objectives of the new work package is to steer discussions on precedents in the right direction through a number of guidelines. The Dutch State Secretary for Finance informed the Dutch Parliament that he considered the new work package 'a success for the Netherlands since many Dutch requirements were acceded to'.[141] The greatest novelty is the table included in the appendix to the work package, which lists factors for each element of the Code of Conduct on the basis of which the degree of equality of a measure can be assessed. For example, to assess whether a measure comparably affects the location of economic activities in the Community, one could take into consideration the type of enterprise or revenues for which the measure was designed.

It is furthermore stated in the work package that the Code of Conduct Group – notwithstanding the formal requirement of unanimity[142] – continues to strive for a 'broad consensus' so that it can continue to report to the Council on behalf of the Member States. The term 'the group' and 'broad consensus' will be used where all Member States (except for the Member State 'charged') share the same opinion and in all other cases in which Member States although they are of a different opinion do not object against the use of the words 'the group' and 'broad consensus'. If despite a further, more political discussion, no broad consensus can be reached, the group will nonetheless report to the Council. The report will then anonymously list the number of 'votes against' in order to keep the deliberations in the Council pure.

The question rises whether the new guidelines will help the Netherlands to successfully invoke precedents. We stress that the Code of Conduct Group was divided and eventually did not agree on the (non-)harmful character of the Hungarian regime. That makes this regime not a very strong case on which a claim for equal treatment could be built on. Of course, this would have been different if the Code of Conduct Group had unanimously qualified the Hungarian regime as a non-harmful measure. Furthermore, Lithuania, Poland, Belgium, and Luxemburg considered the Hungarian intra-group interest scheme comparable to a non-harmful royalty regime. It seems that this precedent cannot also be invoked in the case of the Dutch group interest box. The 'comparability table' explicitly refers to the types of income covered by the regime under examination. This suggests that from a Code of Conduct perspective measures concerning royalty income are not (or no longer) comparable to measures concerning interest income, although both are mobile types

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136 Section 7(1)(k) of Act LXXXI of 1996 a Társasági Adóról és az Osztalákadóról (TAO – Corporate Income Tax Act).

137 Section 8(1)(k) TAO.

138 See Report from the Chair of the Code of Conduct (Business Taxation) to the ECOFIN Council, 6 Dec. 2005, no. 15434/05, 1–7.

139 Two Member States, namely Malta and Estonia, thought that more information was required in order to arrive at a decision.

140 See *supra* s. 4.3.

141 Parliamentary Proceedings II, 2007–2008, 21 501-07, no. 595.

142 See para. 14 of the Council conclusions concerning the establishment of the Code of Conduct of 9 Mar. 1999, 98/C99.01.

of income. All in all, we consider the Dutch interest box as a new opportunity for the Code of Conduct Group to fully discuss the effects of national measures that provide for the favourable tax treatment of group interest.

5. New Developments in the Netherlands Regarding the Group Interest Box

Even before the European Commission approved the group interest box, the Dutch State Secretary for Finance published a new draft bill on possible amendments to the Corporate Income Tax Act, including a new group interest box. The draft bill has been subject to a public consultation procedure that started on 14 June 2009.[143] The consultation ended on 1 August 2009.

Two of the three amendments the Netherlands undertook to implement in connection with the State aid proceedings have been incorporated in this new group interest box. These are the mandatory application of the box and the change to the group criterion. According to the explanatory notes to the consultation document, the mandatory application kills two birds with one stone. The mandatory group interest box not only intends to keep finance companies in the Netherlands instead of moving to low-tax jurisdictions, but it also serves as an instrument to protect against the erosion of the Dutch tax base by limiting the deduction of group interest.[144] The new definition for group corresponds with the criteria on the basis of which it is mandatory for a group of companies to prepare consolidated annual accounts.[145] Key in this definition is having the power to set the financial and operational policies (control). Other than the proposed group interest box, the new group interest box does not provide the opportunity to opt in or opt out. The third amendment concerns an easing of company law, which obviously has not been incorporated in the group interest box itself.[146]

It is striking that the new group interest box – besides incorporating the two amendments discussed above – departs on many other points from the group interest box that was submitted to the Commission and that was the basis for its final State aid Decision. This may be problematic from the perspective of the State aid procedure, insofar as these differences are not purely tax-technical in nature.[147] For example, the box is deliberately enlarged to include other items. Unlike the proposed group interest box, the new group interest box also includes: (1) changes in value of and foreign exchange results on inter-company loans/acquisition funds; (2) hedging and interest proceeds connected with inter-company loans and acquisition funds; and (3) the finance element in compensations for making tangible fixed assets available within the group (operational lease). Especially with regard to foreign exchange results, it can be wondered whether their inclusion in the box indeed reduces any arbitration between intra-group debt and equity financing, which is the declared objective of the group interest box. Unlike interest, foreign exchange results are unpredictable; therefore, they do not leave much scope for deliberate tax planning.

The most salient change, however, is the fact that the cap on the amount of group interest eligible for the reduced rate has been dropped. The group interest received (on balance) is always taxed at a rate of 5% and not only up to a certain percentage of the equity capital. Undoubtedly, this change relates to the mandatory nature of the box. After all, maintaining the cap could result in double taxation in domestic financing arrangements. If the limit were to be exceeded, group interest would be taxed at 25.5% in the hands of the group company lending the money, whereas the interest paid by the borrowing group company can only be deducted at 5%. Naturally, this would have an undesirable effect, for this reason the cap has been abandoned. However, if no cap applies, this could entail an unlimited scope for abuse of the measure (see paragraph 2.1 in this respect). This risk has been addressed and restricted by the introduction of a new specific anti-abuse provision in the new group interest box.[148] Insofar as an external loan is used to generate group interest box revenues, the external loan is treated in the same way as an inter-company loan. That actually means that when a taxpayer takes out an external loan and subsequently extends internal credit, the external interest paid is only deductible at the box rate of 5%. On balance, only the spread is taxed at 5%.

Nevertheless, the removal of the cap raises the question whether the Commission's assessment of the group interest box would remain the same in view of this change. It has to be recalled that the Commission attributed high importance to the cap in finding that the non-exclusion of

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143 Parliamentary Papers II 2008/09, 31 369, no. 6, 1–33.

144 Parliamentary Papers II 2008/09, 31 369, no. 6, 10.

145 Specifically IAS 27 and IAS 31.

146 The easing of the company law – more specifically the repeal of the minimum capital requirement for BVs – is currently under consideration by the House of Parliament, see Parliamentary Papers II 2008/09, 31 058, no. 8. Intended entry into force also on 1 Jan. 2010.

147 Rather than applying the 5% rate to the 'group interest balance' instead of separately to the group interest paid and received seems such an irrelevant tax-technical deviation.

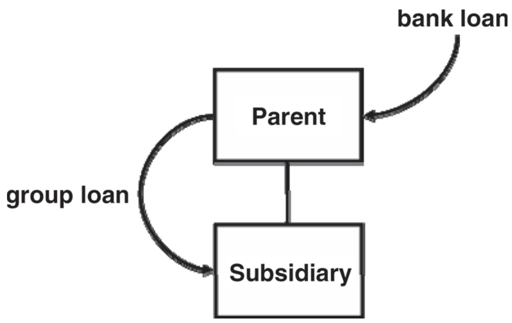
148 Section 12c(6) of the draft bill amending Wet Vpb 1969.

the financial sector from the scope of the measure does not afford a specific advantage to group companies in that sector in breach of the State aid prohibition. The cap was perceived by the Commission as a guarantee against the abuse of the group interest box by the financial sector whose main activity consists of lending, thus, it can easily benefit from the measure more than other sectors.[149]

In the example shown in Figure 1, the Parent borrows from a bank and uses the money to provide a loan to its Subsidiary. The interest paid by the parent company to the bank is only deductible at a rate of 5%, while the interest the Parent receives from the Subsidiary is taxed at the same rate.

The anti-abuse provision provides for a mirror image rule that is aimed at making an interest on an external bank loan eventually deductible at a normal rate of 25.5%.[150] This concerns a 'transparency provision' on the basis of which an inter-company loan taken out (interest deductions at 5%) is classified as an external loan (interest deductions at 25.5%). For this conversion, it is required that the inter-company loan is (ultimately) financed externally by the group. In the example, the group interest paid by the Subsidiary to the Parent falls outside the box and is deductible at 25.5%. According to the explanatory notes, there must be a parallel and historic connection between the inter-company loan and the external loan.[151] That connection is mainly assessed on the basis of the term, repayment, interest rate, amount, and the date on which the loan was taken out. Clearly, the *transparency* provision operates as an escape route from the interest box.[152] This escape route appears to be mainly a solution for foreign multinationals, seeing that they are hit the hardest by the mandatory group interest box. Their Dutch subsidiaries may only deduct any group interest payable at 5%, whereas the interest received is taxed at the regular rate abroad. It can be wondered, however, whether such alteration of the measure would not change the Commission's assessment. In a nutshell, the Commission accepted the mandatory group interest box because it narrows the tax arbitrage between equity and debt financing. The existence of the arbitrage is, in our view, independent of the fact that the inter-company loan is (ultimately) financed externally by the group. For instance, in the example shown in Figure 1, the Parent does have the choice to pass on the money borrowed from the bank to its Subsidiary through a loan or equity. It looks like the transparency provision diminishes the mandatory character of the group interest box, which was a crucial element of the Commission's approval.

Figure 1. Anti-abuse Provision – Re-qualification of External Loan into Group Loan



Moreover, the new interest box provides for an additional escape. Unlike the version submitted to the Commission (see section 2), a bank loan guaranteed by a group member is not considered an inter-company loan,[153] even if the taxpayer could not have taken out the bank loan without a guarantee. This change gives foreign multinationals, for example, the possibility to refinance their Dutch activities with a bank loan guaranteed by the foreign parent company.[154]

Eventually, the Secretary of State announced on 5 December 2009 to refrain from introducing the mandatory group interest box.[155] The main reason is not surprising. It was concluded that the 'reasonable interests' of foreign investors within a mandatory interest box cannot be safeguarded. Undoubtedly, with this formulation the Secretary of State refers to the limited possibilities under a mandatory group interest box to deduct group interest (see above). He expressed his worries about losing foreign investments in the Netherlands. He thinks that it would be irresponsible from a policy perspective to relax the mandatory group interest box for foreign investors, for example by the *transparency provision* as discussed above. If the provisions were relaxed, it would always be questionable whether they are in accordance with the Commission's Decision. As a mere palliative, the Secretary of State asked a recently established committee to find a solution for the arbitrage between equity and debt.

Notes

149 Paragraph 118 of the Decision.

150 Section 12c(5) of the draft bill amending the Wet Vpb 1969.

151 Parliamentary Papers II 2008/2009, 6, 12.

152 We acknowledge that this is a rather heavy burden of proof. A group in which many funds flow criss-cross must demonstrate that the external bank loan has been forwarded as a loan directly to a group company.

153 Parliamentary Papers II 2008/2009, 6, 10.

154 See F.A. Engelen, H. Vordering & S. van Weeghel, 'Eenvoud, Evenwicht en een a Lager Tarief Vennootschapsbelasting: Waar Staan We een Jaar Later?' ['Simplicity, Balance and a Lower Corporate Income Tax Rate, Where Are We Compared to a Year Ago', *Weekblad Fiscaal Recht*, no. 6822 (2009): 957.

155 Parliamentary Papers 2009–2010, 31 369, no. 9.

That solution does not in any way have to be similar to a mandatory group interest box. Perhaps even a notional interest deduction on equity like Belgium has could be an option.[156]

6. Conclusion

In summary, in this article we analysed the Dutch interest box measure under two parallel regulatory regimes of EU law, that is, the State aid rules and the rules relating to harmful tax measures. We found that the measure is both State aid within the meaning of Article 107(1) TFEU and harmful tax measure in the light of the criteria set out in the Code of Conduct. In the analysis of the measure, we followed a dual approach in the sense that we discussed, on the one hand, general methodological and conceptual issues regarding the State aid review of fiscal measures and, on the other hand, concrete substantive arguments regarding the question whether or not the interest box measure grants selective advantages either to (i) group companies as compared to stand-alone companies or (ii) multinational groups as compared to purely domestic groups. In addition to these legal-technical issues, we also touched upon questions of tax policy when we followed through the legislative developments of the interest box in the Netherlands.

As regard the general methodological and conceptual issues of fiscal State aid, the critical analysis of the Commission's Decision helped us recognize that there is a need for a consistent and generally applicable analytical framework for the purpose reviewing fiscal measures under the EU State aid rules. This framework should ultimately be developed by the Court; however, the Commission's decision-making practice could play an important guiding role in this. Unfortunately, the Commission's Decision in the Dutch interest box case does not contribute much to the development of a systematic approach to fiscal State aid. Having regard to this, we attempted to set up an analytical framework that could apply, in a general way, to the State aid analysis of fiscal measures.

In terms of this analytical framework, the interest box measure grants an advantage for group companies involved in intra-group loan transactions in derogation from the general tax system. Such derogation is selective unless it can be justified by the nature and general scheme of the system. To be justified on this ground, first, it must be established that a differentiated tax treatment applies to companies that are in a legally and factually different situation. This condition is met by the interest box, as the situation of group companies is not comparable to stand-alone companies with regard to their financing decisions. However, in addition it is also necessary that the objective of the differentiated tax treatment, that is, the lessening of arbitrage in group financing, be coherent with the nature and overall structure of the system. Such coherence presupposes that the measure is appropriate to achieve its objective and is proportionate to the latter. This is the part of the test where the interest box fails.

As regards substantive arguments, the main point where we disagreed with the Commission is the issue of disparity. We argued that the advantage that the interest box scheme confers on multinational groups of companies as compared to purely national groups is not a consequence of disparity between the various tax systems of the Member States. It rather results from the introduction of a special reduced tax rate for intra-group interest, which deliberately enlarges the gap between the rates at which intra-group interest is deducted and that at which it is taxed. We concluded that the State aid rules should prevent Member States from benefitting such pumped-up disparities especially when the effect on other Member States may be detrimental (for example, erosion of their tax bases).

Finally, as regards the tax policy perspective, the so far unsuccessful attempts by the Dutch legislature to introduce a measure that is both attractive to multinational groups of companies and is compliant with the State aid rules – as interpreted in the Commission's Decision – demonstrate that the Decision did not leave substantial manoeuvring room for the Member States. The form in which the interest box was authorized is not a real choice for the national legislatures due to its potential unwanted consequences on inbound investments. The remaining choice is devising general measures that apply across the board to any and all companies but at the same time are capable of attracting multinational enterprises that make location decisions with a view to favourable taxation environment. An example of this is the Belgian notional interest deduction or, possibly, the Hungarian provision replacing the intra-group interest scheme, which generally exempts three-fourth of foreign-source interest by way of a unilateral relief for double taxation. These limited tax policy options available for the Member States help us assess the real consequences of the Dutch interest box Decision, which prove to be less far-reaching than originally predicted.

Note

156 The committee, under the chairmanship of Prof. Dr Stef van Weeghel, published the study on 7 Apr. 2010 (Studiecommissie Belastingstelsel, 'Continuïteit en vernieuwing: een visie op het belastingstelsel').The Committee indeed proposes the introduction of a notional interest deduction on equity..