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To Admit, or Not to Admit, That Is the Question – The CJEU's Controversial Stance on the Admissibility of State Aid Questions in Preliminary Ruling Procedures

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The decisions of European Court of Justice (CJEU) in the *Vodafone* and *Tesco* cases[1] were eagerly awaited by many interested in EU tax law. It was expected that the CJEU would answer the question whether progressive turnover-based business taxes levied on certain sectors of the economy are compatible with EU law, more specifically with the fundamental freedoms and the State aid provisions of the Treaty on the Functioning of the European Union (TFEU). This question is particularly relevant these days when Member States are unilaterally introducing similarly designed digital services and advertisement taxes that raise the same concerns regarding their compatibility with EU law as the Hungarian turnover taxes at issue in *Vodafone* and *Tesco*. Unfortunately the judgements delivered in the beginning of March did not shed much light on the issues raised by the cases: the indirect discrimination test under the fundamental freedoms remained obscure and the State aid question was found to be inadmissible. This post deals with the latter point, i.e. the admissibility of State aid related questions in preliminary ruling procedures before the CJEU. The reluctance of the CJEU to provide substantive answers to State aid questions where the national proceedings are concerned with an individual tax notice is highly questionable both from the point of view of the objective of the State aid control and the objective of the preliminary ruling procedure.

The substantive State aid question in *Vodafone* and *Tesco* was whether the distinction between low-turnover and high-turnover enterprises – in terms of being subject to different effective tax rates due to the progressive rate structure of the tax – constitutes State aid granted to low-turnover enterprises.

However, the CJEU did not get to decide this question because it found the State aid question inadmissible from the outset. In examining the admissibility of the question, it highlighted the complementary competence of the Commission and the national courts in respect of the State aid control: the former is exclusively entitled to decide on the compatibility of an aid measure with the internal market (subject to the review of the CJEU), while the latter has to safeguard the rights of individuals affected by an aid that has been granted in breach of Article 108 (3) of TFEU ('standstill clause'), i.e. without the notification of the Commission of the aid or before the final decision of the Commission is made. This provision has direct effect.

However, the CJEU emphasized that the abovementioned obligation of the national courts vis-à-vis individuals is not without limitation. Especially, a tax exemption that is unlawful in light of the

State aid rules does not render the actual charging of the tax also unlawful in itself. Consequently, *"a person liable to pay that tax cannot rely on the argument that the exemption enjoyed by other persons constitutes State aid in order to avoid payment of that tax."* Therefore, when the main proceeding concerns an individual tax notice that is challenged on the grounds that the tax constitutes State aid to other taxpayers who are exempt or taxed less, the State aid question is usually not admissible. The rationale of this approach is that if a single taxpayer could successfully rely on the existence of incompatible State aid to claim reimbursement of the tax it has paid, it would just worsen the effect on competition, as the result would be the extension of the aid.

The CJEU acknowledges one exception to this main rule: the State aid question is admissible when the tax at issue forms an integral part of an aid measure. In particular, if the tax can be hypothecated to the aid measure, that is, the tax is allocated for the financing of the aid and it has a direct impact on the amount of aid (the level of tax revenue directly influences the amount of aid), the taxpayer can successfully claim back its tax payment in the main proceeding. From this it follows that if the national court has doubts about the State aid nature of the measure at issue (which is irrespective of the hypothecation question), it can refer a question for a preliminary ruling to the CJEU and this question will be admissible, as the taxpayer in the main proceeding has an interest in that question being answered since it can lead to the repayment of the tax that he was unlawfully charged.

The CJEU concluded that the abovementioned exception did not apply to the special sectoral taxes at issue, therefore the taxpayer could not rely on the fact that certain rules of the tax might constitute incompatible State aid in order to avoid payment of that tax or obtain repayment of already paid tax. As a result, it found the State aid question inadmissible.

Critical appraisal of the CJEU approach

Although the decisions in *Vodafone* and *Tesco* are in line with the settled case law of the CJEU on the admissibility of State aid questions in preliminary ruling cases, the approach followed by the CJEU in this regard is controversial for several reasons. .

First, the purpose of State aid rules is to eliminate distortions of competition within the internal market. From this perspective, reimbursement and recovery are equally appropriate tools to re-establish the original competitive position in the market when aid is granted through the levying or non-levying of a tax. In fact, we can find a precedent in the CJEU's State aid jurisprudence where this view has been accepted. Namely, in the *Laboratoires Boiron* case,[2] the CJEU accepted that the consequence of not levying a tax on certain undertakings, which granted them a selective advantage, i.e. State aid, can be the reimbursement of the tax to those subjected to it. It is true that the CJEU formally decided this case as one in the line of the "hypothecated tax" cases, i.e. the only accepted exception to the rule of non-reimbursement of a tax the exemption from which constitutes State aid. However, it had to twist and bend the conditions under such case law in a rather artificial way in order to fit the tax at issue into the scope of this exception. The case concerned a special tax on the direct sales of medicines. There were two competing distribution channels to supply pharmacies with medicines: either by way of wholesale distributors or by way of laboratories that sold them directly. As wholesale distributors were obliged to discharge certain public services, while laboratories were not, the legislator imposed a flat rate tax on the direct sale made by laboratories with the explicit objective to compensate wholesale distributors and balance the previously distorted competition. The CJEU stated that a potential overcompensation in the form of the absence of tax liability could constitute State aid and in such a case, the aid is the tax itself.[3]

The CJEU carried out the analysis of integral part test with the conclusion that the tax and the aid measure (absence of tax liability) are inseparable, therefore the underlying tax forms an integral part of the aid as they are two elements of one and the same fiscal measure.[4] Consequently, upon the condition that the lack of tax liability amounts to State aid, the taxpayer could claim reimbursement of the tax paid. Thus, the CJEU confirmed the fulfillment of the integral part test, although it is obvious that the tax liability of the tax subjects did not directly influence the amount of the aid of wholesale distributors that were not liable tax. The aid rather depended directly on the wholesale distributors' achieved turnover on which the tax at issue was not imposed.

It is interesting to see how the CJEU makes a distinction between the absence of tax liability and the exemption from a tax. In the first case, it concluded that the tax itself constitutes aid and if it was proven that it constitutes incompatible State aid, then it would render the levying of the whole tax unlawful, while in the second case, the CJEU emphasized that an unlawful exemption regime did not call into question the validity of the tax itself. However, having a look at the nature of the lack of tax liability and that of exemption, no material difference can be explored: both result in the exoneration from the payment of any tax. In light of this, we can be excused for asking: why is the lack of tax liability of certain competitors capable of creating integral relationship between the tax and the aid, making the whole tax unlawful and thus enabling taxable persons to claim reimbursement of the tax (as opposed to the recovery obligation), while an exemption leading to the same fiscal effect both on the side of beneficiary and that of the competitors is not?

The *Laboratoires Boiron* judgement, teaches us two important lessons. First, the CJEU itself does not exclude the possibility that the adverse consequences of State aid, when it is granted through the imposition of a tax, might be rectified by way of reimbursement. Second, if reimbursement of a tax can be a consequence of State aid when the tax and the aid correlates only in a very broad sense, then insisting on a strict integral part test that is met only by hypothecated taxes in the narrow sense when it comes to admissibility of a State aid question in a preliminary ruling procedure is simply inconsistent.

Our claim that reimbursement of the tax and recovery/payment of the tax are equally appropriate and effective remedies of unlawful State aid when it is granted through the non-levying of a tax is also supported by the CJEU's judgement in the *Regione Sardegna* case. In this case both the violation of the freedom to provide services and the grant of incompatible State aid were established, and the CJEU left it to the national court to draw the appropriate conclusions of the judgement.[5] That is to decide if it applies the consequences of the breach of fundamental freedoms by way of reimbursing the tax at issue to all non-resident taxpayers who had been liable to pay it and eliminating the obstacle for cross-border operations or it applies the State aid consequences by way of claiming the recovery of the advantage from the beneficiaries who have not paid the tax, i.e. payment of the tax from which they were exempted.

This stance can also be traced in the State aid decision of the Commission in respect of the Hungarian advertisement tax, where the Commission stated that *"There would be no need for recovery if Hungary abolishes the tax system with retroactive effect as of the date of entry into force of the advertisement tax in 2014".**[6]*

Importantly, we are not arguing that extension of an aid to all competitors should be the general consequence of unlawful State aid instead of recovery of the advantage from the beneficiaries. Rather, the Member States should be given the opportunity, under certain circumstances, to choose between the main rule (recovery) and reimbursement of the tax paid by certain undertakings,

provided that the latter method also leads to the desired consequences of eliminating the distortion of the competition with a retroactive effect. More specifically, this should be the case where reimbursement seems to be an equivalent or better solution in terms of simplicity and feasibility. Especially, where the aid is granted in the form of the lack of tax payment obligation (certain taxpayers either not being liable to pay the tax at all or being exempt from the tax) and the measure constitutes a selective burden rather than a selective advantage for certain undertakings. This can be established in numeric terms, meaning that it is probable that a significantly higher number of taxpayers enjoy the advantage, i.e. are not liable for or exempt from the tax, than those who are subjected to it. In other words, the beneficiaries outnumber those who are excluded from the advantage. Furthermore, the financial interest of the Member State should also be taken into account and reimbursement can only be reasonable if it does not lead to dire consequences for the state budget. The consequence of allowing reimbursement of a tax as a State aid remedy would be that State aid questions would become admissible in preliminary ruling cases where the main proceedings concern an individual tax notice.

To add another point**,** a tax dispute on individual tax liability is in most cases the only chance of the taxpayers in domestic law to submit their doubts about the compatibility of the applicable tax with the EU State aid regime. Advocate General Kokott noted in her opinion in the *Vodafone* case that there is nothing to prevent these undertakings from initiating an abstract review of the challenged legislation before a national court separately and such a procedure might reach the CJEU in the form of a preliminary ruling request.[7] However, a preliminary ruling request can only be submitted in a judicial procedure pending before a national court and it is hard to imagine under what circumstances a business enterprise would be one of the parties to a tax litigation other than by way of challenging the tax authority's decisions related to its individual tax assessment. Under Hungarian law, a taxpayer cannot ask a national court in a non-contradictory procedure (in which the taxpayer has no legal interest or claim) to examine a piece of national legislation for its compatibility with EU law. In principle, the Hungarian Constitutional Court has competence for the abstract review of legislation in light of the Constitution and international law, which could include EU law. However, the Constitutional Court in a series of its decisions has excluded its own competence for reviewing the compatibility of national legislation with EU law. Therefore, the willingness of the CJEU to examine the conformity of national tax laws with the State aid rules would become even more important as there is no possibility to request the abstract review of fiscal legislation under Hungarian law. If the taxpayer were also precluded from doing so during a preliminary ruling procedure arising from the challenge of an individual tax assessment, it would raise serious concerns regarding the taxpayer's right to an effective legal remedy, a right so fundamental that it is enshrined in the Charter on the Fundamental Rights of the European Union.[8]

Lastly, it is important to highlight that the CJEU does not and cannot decide the domestic legal dispute. The objective of the preliminary ruling procedure is to ensure consistent and unified application and interpretation of EU law throughout the European Union. If the CJEU found that State aid questions were admissible also in cases where individual interests are at stake and it ruled on the merit of the case to the effect that the measure at issue constitutes State aid, it would not require the national court to order the reimbursement of the tax paid. Rather after the CJEU's judgement finding unlawful State aid, it would be the obligation of the national court to achieve the re-establishment of level playing field either by way of reimbursement or recovery. This would be much alike to the finding of a national tax measure discriminatory under the fundamental freedoms where it is also left to the national courts to draw the consequences of such finding.

Overall, the reluctance of the CJEU to admit State aid questions in preliminary ruling procedures, which is the consequence of the overly rigorous stance on the form of State aid remedy, contravenes the very purpose of the preliminary ruling procedure. It perpetuates uncertainty as to the correct interpretation of EU law until the Commission initiates, if at all, a State aid investigation, and its decision potentially goes through all the stages of judicial review until it becomes final. This is definitely an undesirable outcome especially when the interpretation of EU law is of exceptional importance in order to ensure that new legislative trends in the Member States remain in accord with primary EU law. Finally, relaxation of the case law on admissibility of State aid questions would facilitate a more proactive participation of national courts in State aid scrutiny, the importance of which for the well-functioning State aid control regime has already been strongly emphasized by the Commission.[9]

[1] CJEU, 3 March 2020, Case C-75/18, *Vodafone Magyarország*, ECLI:EU:C:2020:139; CJEU, 3 March 2020, Case C-323/18, *Tesco-Global Áruházak*, ECLI:EU:C:2020:140.

[2] CJEU, 7 September 2006, C-526/04, *Laboratoires Boiron*, ECLI:EU:C:2006:528.

[3] CJEU, 7 September 2006, C-526/04, *Laboratoires Boiron*, ECLI:EU:C:2006:528 para. 39.

[4] CJEU, 7 September 2006, C-526/04, *Laboratoires Boiron*, ECLI:EU:C:2006:528, para. 45.

[5] CJEU, 17 November 2009, Case C-169/08, *Regione Sardegna*, ECLI:EU:C:2009:709, para. 65.

[6] Commission Decision (EU) 2017/329, (4 Nov. 2016) on the measure SA.39235 (2015/C) implemented by Hungary on the taxation of advertisement turnover, para. 96.

[7] Opinion of Advocate General Kokott, 13 June 2019, Case C-75/18, *Vodafone Magyarország*, ECLI:EU:C:2019:492, para. 146.

[8] CHARTER OF FUNDAMENTAL RIGHTS OF THE EUROPEAN UNION (2012/C 326/02), Article 47.

[9] Commission notice (2009/C 85/01) on the enforcement of State aid law by national courts

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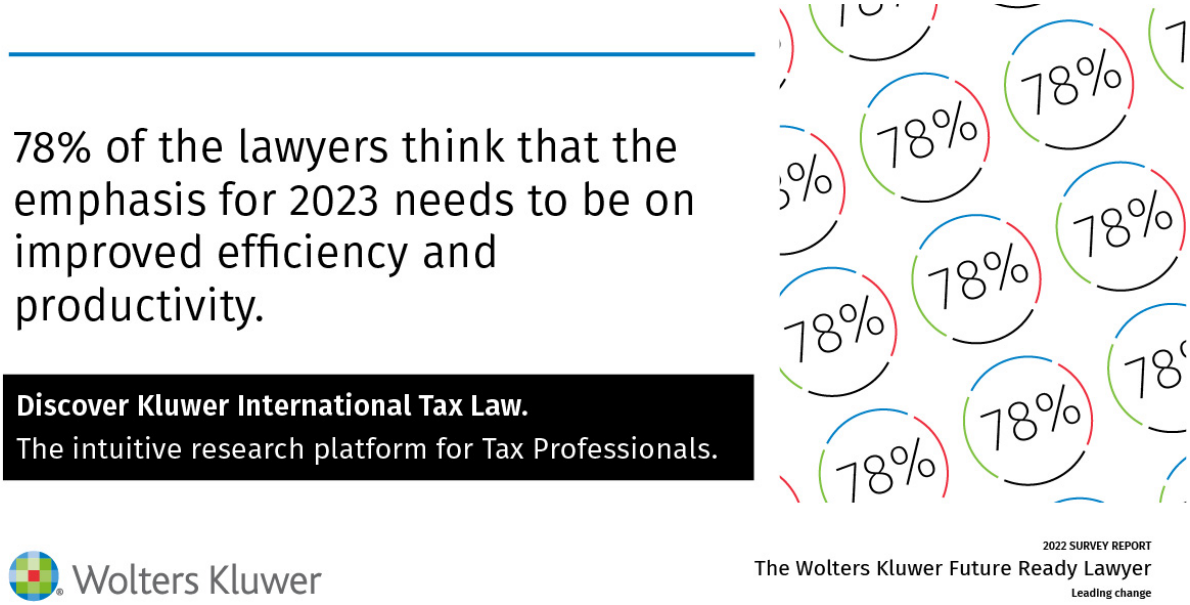

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