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The EU-UK Trade and Cooperation Agreement and UK Tax Subsidies: No Recovery after Brexit?

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After the initial relief that followed upon reaching a Trade and Cooperation Agreement between the European Union and the United Kingdom on Christmas Eve, we slowly see how this treaty is going to affect the tax domain. In this blog I will briefly focus on the area of fiscal state aid, i.e. the regulation of subsidies given to targeted businesses via the tax system.

Specific subsidies in the EU-UK Agreement

While the drafters of the new agreement tried to avoid any direct reference to the EU's 'state aid' framework, many of the definitions it rests upon have been copied into the new agreement. It provides quite some guidance on when tax measures will not be considered 'specific' (for those used to the EU state aid lingo: 'selective'), with explicit references to administrative manageability and ability to pay (Article 3.1, paragraph 2 of the Agreement). Having these principles stated here is rather helpful.

On the side of procedure the situation is quite different; if and when UK governments and public bodies will need to notify their subsidies in advance and wait for clearance by a new UK supervisor is still to be determined. The agreement brought us some further surprises that, combined, exclude UK taxation from effective state aid control for the most part.

If there would be a UK tax measure that would be clearly specific in nature and pose a risk to free and fair trade there seems to be a negligible risk of recovery. Recovery is the most important enforcement tool in the traditional 'state aid' arsenal, i.e. ordering companies to pay back illegal subsidies received.

Exclusion of Acts of Parliament from recovery

Even if an interested party (like an EU competitor) would challenge UK subsidies in its courts, in conformity with a new procedure yet to be announced, the EU-UK agreement explicitly states that recovery will not be required when a subsidy is based on an Act of Parliament (Article 3.11, paragraph 5). This would cover most (but not all) tax schemes. While, in return, the same will apply to tax benefits that might follow from an EU Regulation or the mandatory implementation of an EU Directive into national law, national tax laws adopted by EU Member State parliaments – who have still retained sovereignty in the domain of taxation for the most part – would not be treated alike. The latter would be subject to EU state aid supervision anyway, but the UK would

have direct recourse under the Agreement.

So, if an UK Act of Parliament would provide for a specific tax subsidy scheme that would affect trade or investment in the EU, recovery would be off the table even when an interested party would be able to challenge such act successfully. It is even doubtful whether UK Courts would be able to prohibit or suspend such Act for the future when called upon (Article 3.10, paragraph 3). However, if the UK government would be mandated to introduce statutory instruments to implement an Act and where such secondary legislation would cause a subsidy scheme to become 'specific' without being prompted by the initial Act, such actions do still seem potentially subject to recovery.

Private enforcement of prohibited tax ruling practices?

Individual subsidies (such as those in tax rulings or tax assessments, if not stemming from a larger subsidy scheme) might also be the subject of private enforcement in the UK courts. In the tax domain however, an interested party might have a hard time providing evidence of an individual subsidy being included in an often undisclosed tax assessment or tax ruling of another tax payer. The latter would be a prerequisite before we can even start discussing recovery. The question is whether the new UK supervising authority might offer some relief here by offering a complaints procedure or by starting ex officio investigations if private enforcement would be too problematic due to accessibility of information.

Excluding recovery of individual aid from arbitration

If either the EU or the UK themselves would like to challenge subsidies granted by the other Party, they can enter into consultations. If needed, remedial measures can be taken, if consultations do not resolve the dispute at hand. Such measures may then become the subject of arbitration. However, again there are important caveats. The arbitration panel has no jurisdiction with regard to individual subsidies (?!), with the exception of those subsidies that would normally run afoul of existing WTO rules anyway such as those contingent upon export or import substitution. (Albeit not when used to compensate for damages from disasters, which is probably a mistake in the redaction of Article 3.2, paragraph 1.)

Moreover if the EU would like to challenge inadequate recovery by the UK in an individual case, in support of an interested party for instance, the arbitration panel has no jurisdiction either (Article 3.13, paragraph 2). So if there would be no or incomplete recovery, for reasons of political expediency perhaps, this would all be a matter for the interested party to deal with under the UK's upcoming domestic procedure.

Regulation 2016/1037 and upcoming EU Foreign Subsidies legislation as remedial measures?

Now, all of this would not be that worrisome from an EU perspective as the EU is working on new legislation that is to be introduced in 2021. It deals with subsidies granted by foreign governments to entities operating on the EU's internal market. While the UK is not its primary target, it will be subject to it anyway as a non-EU country. For instance, if the UK granted a tax benefit to a multinational's UK parent, the benefit of which would trickle down to its subsidiaries active in the EU, those subsidiaries might have to face the music.

Yet, it does seem that Article 3.12 of the EU-UK Agreement means to signal that this treaty is meant to act as tractatus/lex specialis, excluding other forms of recourse. It may well be that the new EU Foreign Subsidies legislation will be tailored to serve as a remedial measure that is

allowed under the new EU-UK Agreement, but this poses several challenges. The General Court and the Court of Justice of the EU would normally have a final say on any decision to be taken by the European Commission under the upcoming Foreign Subsidies legislation, but when that legislation would effectively qualify as a remedial measure – a term not defined in the EU-UK Agreement – the same decision might end up becoming the subject of (expedited) arbitration (Articles INST.14, INST.15 and INST.34B). This could bring about compliance issues in the end. To my knowledge, the CJEU has not been asked to provide an opinion on this matter (in accordance with Article 218, paragraph 11 TFEU). A similar problem would arise with respect to existing Regulation 2016/1037 that offers protection against subsidised imports from non-EU countries.

Rebalancing future tax policy

So, despite recovery being off the table for all but a few tax measures the UK may still have to sit through meetings with EU representatives to resolve issues of subsidies that negatively affect EU-UK trade and investment. It may even face challenges in domestic courts by interested parties to get rid of certain tax schemes, but the retroactive effect of recovery would still be lacking. Traditional trade sanctions might then be a last resort for the EU.

If, in future, the UK's domestic state aid regime were to become less stringent than the EU's current state aid regime, such divergence may have a material impact on trade and investment. As most changes to tax laws would be protected from the ultimate sanction of recovery, I would not be surprised to learn that efforts to curb tax subsidies may lessen over time. If the UK government still intends to create one of the most attractive tax systems at the EU's borders and decides to use targeted tax subsidies for that purpose (as an alternative to harmful tax regimes, which both the EU and the UK are committed to counter) then there is a possibility that by 2025 the EU might feel an urge to bring up so-called rebalancing measures in order to deal with this on a more structural level (Article 9.4).

Obviously, all that is written above also applies vice-versa to the EU but in light of the EU's continued commitment to maintaining strong state aid rules I do not expect that the UK has much to fear of increases in specific tax subsidies in the EU (if we ignore COVID-19 measures for the time being).

Still better than a no-deal?

The UK's effort to rid its tax system from effective state aid control seem to have succeeded. Trade sanctions are all that effectively remain in the tax domain, unless the soon to be introduced UK authority would be willing to actively involve itself with specific tax rulings and alike. While tax systems and subsidies can be used to drive investment post-Brexit, as P.M. Johnson recalled recently, the question is whether that statement only had generally applicable legislation in mind. Still both parties are better off than in a no-deal situation that would have resorted to the WTO Agreement on Subsidies and Countervailing measures, as the EU-UK Agreement also covers services, provides quite some examples of acceptable aid, and most likely leads to faster arbitration if needed. But maybe the latter is wishful thinking from my part.

One last thing. While the state aid paragraphs of the Agreement seem to have been one of the largest stumbling blocks during negotiations, we must keep in mind that the outcome is part of a package-deal and some degree of commitment to state aid control is still better than none at all.

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