

# Designing Co-operative Compliance Programmes: Lessons from the EU State Aid Rules for Tax Administrations

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## Abstract

*Co-operative compliance programmes which are aimed at transforming the traditional adversarial relationship of the tax administration and the taxpayer to a trust-based relationship guided by transparency and certainty increasingly form part of the tax compliance strategies of different countries. These programmes could bring considerable benefits to both tax administrations and taxpayers. For tax administrations, the greatest benefit is that such programmes enable them to use their limited resources in a more efficient and more effective way. For taxpayers, participation in co-operative compliance programmes can result in a sizeable reduction in compliance costs. On the other hand, the fact that these programmes can usually be accessed only by certain—mainly large corporate—taxpayers, makes them inherently suspicious from the point of view of EU state aid rules, which prohibit the granting of selective advantageous tax treatment to certain undertakings. This article examines the conditions under which the EU Member States can introduce co-operative compliance regimes without the risk of providing illegal state aid to the taxpayers participating in them.*

## 1. Introduction

Co-operative compliance programmes, which aim to turn the relationship between the tax administration and the taxpayer from a contentious struggle into an amicable co-operation, are on the rise in Europe as well as worldwide. According to the OECD, co-operative compliance establishes “a relationship that favours collaboration over confrontation, and is anchored more on mutual trust than on enforceable obligations”.<sup>1</sup> The main objective of these programmes is to improve tax compliance in a way which brings advantages not only to governments but also to taxpayers thereby incentivising high levels of voluntary compliance. As these programmes are designed to reinforce compliance, it is curious that they have not received greater attention

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<sup>1</sup> OECD, *Study into the Role of Tax Intermediaries* (Paris: 2008), available at: <http://www.oecd.org/tax/administration/39882938.pdf> [Accessed 29 March 2017], 39.

in the framework of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project<sup>2</sup> or under similar EU initiatives. However, this may reflect the policy focus of the work to date. As the focus shifts to operational implementation, co-operative compliance programmes could have an important part to play in delivering better tax compliance outcomes.

Co-operative compliance programmes could bring considerable benefits to both tax administrations and taxpayers.<sup>3</sup> However, the fact that these programmes usually allow only certain types of taxpayers to enter into a co-operative compliance relationship with the tax administration raises the question whether these programmes lead to unequal treatment of taxpayers. Such unequal treatment may have legal relevance both under national law and EU law. From the point of view of national law, the limited scope of co-operative compliance programmes may conflict with constitutional principles, in particular, with the principle of equality.<sup>4</sup> From the point of view of EU law, selective co-operative compliance regimes which afford advantages to a specific group of undertakings may well infringe the prohibition of state aid laid down in Articles 107 to 108 of the Consolidated Version of the Treaty on the Functioning of the European Union (TFEU).<sup>5</sup>

Having regard to the fact that co-operative compliance programmes have a considerable potential to improve tax compliance while, on the other hand, they may conflict with some fundamental requirements of tax policy and law,<sup>6</sup> this article addresses the question whether co-operative compliance programmes are a legitimate element of countries' tax compliance strategies. In particular, it focuses on the question whether and, if so, how such programmes can be formulated in a way that they do not conflict with the prohibition of state aid under EU law. For this purpose, selected programmes of some EU Member States—in particular, those of the Netherlands, Ireland, Italy and Austria—are examined.

The authors begin with an explanation of the concept of co-operative compliance. Then an overview of co-operative compliance programmes which exist in the EU, with particular focus on the four selected national regimes, is provided. After describing the overall concept of state

<sup>2</sup> Some of the BEPS reports referred to co-operative compliance programmes in passing as an alternative tool to provide tax administrations with additional information on tax planning behaviour, see OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD Publishing, 2013), 22; OECD/G20 Base Erosion and Profit Shifting Project, *Mandatory Disclosure Rules, Action 12—2015 Final Report* (Paris: OECD Publishing, 2015), para.34.

<sup>3</sup> Although it has to be noted that recently in the Netherlands, the country which has the longest experience with such a programme, some doubts have come to the surface as to the actual extent of the benefits that the programme brings to the tax administration. See S. Hemels, "Netherlands Report" in M. Lang, J. Owens, P. Pistone, A. Rust, J. Schuch and C. Staringer (eds), *Improving Tax Compliance in a Globalized World*, forthcoming; J. Kleinnijenhuis and K. Kuijpers, "De Belastingdienst controleert steeds minder bedrijven", *Trouw*, 8 February 2017, available at: <https://www.trouw.nl/home/de-belastingdienst-controleert-steeds-minder-bedrijven-aca8e357/> [Accessed 29 March 2017]; K. Kuijpers and J. Kleinnijenhuis, "Horizontaal toezicht: nog net geen huwelijk tussen bedrijven en fiscus", *Trouw*, 8 February 2017, available at: <https://www.trouw.nl/home/horizontaal-toezicht-nog-net-geen-huwelijk-tussen-bedrijven-en-fiscus-a492b208/> [Accessed 29 March 2017].

<sup>4</sup> OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance* (OECD Publishing, 2013), 47; J. Freedman, "Responsive Regulation, Risk and Rules: Applying the Theory To Tax Practice" (2011) 44 *UBC Law* 649; J. Leigh Pemberton, A. Majdanska, "Can Cooperative Compliance Help Developing Countries Address the Challenges of OECD/G20 Base Erosion and Profit Shifting Initiative?" (2016) 70 *Bulletin for International Taxation* 595.

<sup>5</sup> Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326.

<sup>6</sup> For more details see: J. Freigang, "Is Responsive Regulation Compatible with the Rule of Law" (2002) 8 *European Public Law* 463; Freedman, above fn.4.

aid under Article 107(1) TFEU and the criteria which need to be fulfilled for a national measure to constitute state aid, the authors examine these criteria more closely and test the selected national co-operative compliance programmes against them. Finally, the authors conclude by summarising the legal requirements that co-operative compliance programmes need to fulfil in order to avoid the risk of being characterised as (unlawful) state aid.

## 2. Co-operative compliance: from blanket audits to tax risk management

Co-operative compliance is a relatively new concept. It is considered to draw substantially on the theory of responsive regulation.<sup>7</sup> Pursuant to this theory, regulators should be “responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is required”.<sup>8</sup>

Co-operative compliance arrived on the international scene in 2008 when the OECD published the *Study into the Role of Tax Intermediaries*.<sup>9</sup> At that point, it was referred to as “enhanced relationship”. Only several years later in the next OECD Report published in 2013 was it rebranded to “co-operative compliance”,<sup>10</sup> because of the negative connotations of the term “enhanced relationship” which suggested that through these programmes some extra benefits could be granted to certain taxpayers.<sup>11</sup>

The term “co-operative compliance” designates a special type of relationship between the tax administration and the taxpayer which is based on trust, transparency and mutual understanding. It represents a shift from a retrospective and primarily repressive control to a relationship based on ongoing discussion of tax treatment in real time, or even prospectively.<sup>12</sup> The essence of a co-operative compliance model is an exchange of transparency for certainty. The taxpayer is expected to offer full disclosure in respect of its tax position, whereas the tax administration should provide the taxpayer with advance certainty concerning its tax treatment. This should result in improved compliance by taxpayers and more efficient use by the tax administration of its (scarce) resources.<sup>13</sup> Implementing a compliance risk management strategy is of fundamental importance to the concept,<sup>14</sup> as usually only taxpayers which show a will to be compliant and to co-operate are allowed to enter a co-operative compliance relationship.

As the OECD described it, co-operative compliance is a model built on seven pillars.<sup>15</sup> These are transparency and disclosure which refer to what is expected from taxpayers; and commercial

<sup>7</sup>L. Osofsky, “Some Realism About Responsive Tax Administration” (2012) 66 *Tax Law Review* 301, 310; M. Burton, “Responsive Regulation and the Uncertainty of Tax Law - Time to Reconsider the Commissioner’s Model of Cooperative Compliance?” (2007) 5 *eJournal of Tax Research* 71.

<sup>8</sup>V. Braithwaite, “Responsive Regulation and Taxation: Introduction” (2007) 29(1) *Law & Policy* 3, 4; I. Ayres, J. Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate*, 1st edn (Oxford: OUP, 1992).

<sup>9</sup>OECD, above fn.1, 39.

<sup>10</sup>OECD, above fn.4.

<sup>11</sup>L. van der Hel - van Dijk and T. Poolen, “Horizontal Monitoring in the Netherlands: At the Crossroads” (2013) 67(12) *Bull. Intl. Taxn.* 675.

<sup>12</sup>J. Leigh-Pemberton and A. Majdanska, “Changing the Relationship between Tax Administrations and Taxpayers” (2016) 81 *Tax Notes International* 247, 253.

<sup>13</sup>L. van der Hel - van Dijk and M. Siglé, “Managing compliance risks of large businesses: A review of the underlying assumptions of co-operative compliance” (2015) 13 *eJournal of Tax Research* 760.

<sup>14</sup>OECD, above fn.4, 29.

<sup>15</sup>OECD, above fn.1, 39; OECD, above fn.4, 19.

awareness, impartiality, proportionality, openness and responsiveness which are required from tax administrations.

On the side of the taxpayer, disclosure and transparency are obligatory. It means that a taxpayer should be ready to discuss its tax position and disclose all facts relevant to the tax assessment. It should refrain from invoking legal privileges to avoid disclosure. The guarantee and precondition for adequate transparency and disclosure is a sufficiently robust system of internal control.<sup>16</sup> An internal control system makes it possible to validate the outputs the taxpayer provides to the tax administration. This system is known as the tax control framework. This framework should manage, control and monitor the correctness of reported tax positions and ensure that tax administrations can trust the information provided by the taxpayer. To put it simply, a tax control framework serves as an objective justification for the trust that is central to the co-operative compliance model.<sup>17</sup>

For the model to work, tax administrations also need to meet certain requirements. First of all, tax administrations should have a good understanding of the commercial drivers that are behind the transactions and activities undertaken by taxpayers as such an understanding is necessary for an understanding of the broader context. Secondly, tax administrations should be impartial both as far as decision-making and the conduct of audits are concerned. They should maintain a professional and critical attitude towards the taxpayers that they deal with and the information they obtain from them. They should act fairly and not primarily in a revenue-oriented manner.<sup>18</sup> Also the task of dispute resolution should be approached with a high level of consistency and objectivity. Further, actions of the tax administration have to be proportional and should show sufficient flexibility. This is particularly important when deciding on the allocation of resources and on the question of how to prioritise taxpayers or tax issues. Last but not least, openness and responsiveness should characterise the behaviour of tax administrations within the co-operative compliance relationship. These attributes are necessary to establish a constructive relationship with taxpayers and make it easier to handle tax issues with the taxpayer in real-time. Real-time working is the most effective way to achieve early certainty, which benefits both parties and is highly valued commercially.

To summarise, co-operative compliance is expected to offer a win-win situation for taxpayers and tax administrations.<sup>19</sup> The taxpayer receives earlier resolution of issues thanks to open discussions on tax positions on a regular basis. Overall, co-operative compliance should lead to reduced compliance costs for the taxpayers participating in it.<sup>20</sup> From the perspective of tax administrations, full disclosure and transparency by the taxpayer should result in fewer compliance checks and better targeted audits. For tax administrations the greatest benefit of the co-operative

<sup>16</sup> E. van der Enden and K. Bronzewska, "The Concept of Cooperative Compliance" (2014) 68 *Bull. Intl. Taxn.* 567, 568.

<sup>17</sup> Enden and Bronzewska, above fn. 16, 572.

<sup>18</sup> M.T. Soler Roch, "Tax Administration versus Taxpayer — A New Deal?" (2012) 4 *World Tax Journal* 282.

<sup>19</sup> In contrast to "you win, I lose" as is the case under the traditional enforcement methods used by tax administrations. See J.P. Owens, "Tax Administrators, Taxpayers and Their Advisors: Can the Dynamics of the Relationship Be Changed?" (2012) 66 *Bull. Intl. Taxn.* 518.

<sup>20</sup> Some scholars have made studies measuring the impact of friendly tax administration on tax compliance costs. It was found that a customer-unfriendly administration increases the burden of complying with the tax law by about 27%. For more details see S. Eichfelder and C. Kegels, "Compliance costs caused by agency action? Empirical evidence and implications for tax compliance" (2014) 40 *Journal of Economic Psychology* 200.

compliance model is that it should enable more efficient and more effective use of limited resources.

### 3. Overview of co-operative compliance programmes in place in the EU

Co-operative compliance regimes have been adopted in one form or another in almost 30 jurisdictions worldwide.<sup>21</sup> In the EU 12 countries have introduced co-operative compliance models (Austria, Croatia, Denmark, France, Finland, Italy, Ireland, the Netherlands, Slovenia, Spain, Sweden and the UK), two of which are pilot programmes (Austria, France).<sup>22</sup>

Among the selected programmes examined in this article, the Dutch programme seems to be the best known. It is known as horizontal monitoring and was initiated—first as a pilot—in 2005. Since then the programme has been run under the motto “Flexible when possible, strict where necessary”.<sup>23</sup> The programme was designed not as a stand-alone operation but alongside regular vertical supervision.<sup>24</sup> It was intended to be an integral part of a balanced enforcement policy and as such it is but one of a broad range of supervisory instruments. The Irish programme also started in 2005 and thus has quite a long history too. The Italian programme on the other hand is the youngest of those analysed here. It is also unique, as it was implemented by way of adopting new legislation in 2015.<sup>25</sup> The formal programme was preceded by a pilot project on co-operative compliance. The last of the programmes examined, the Austrian one, is a pilot programme which started in 2011<sup>26</sup> and ran until the end of June 2016.<sup>27</sup> Based on the evaluation of the pilot project,

<sup>21</sup> E. van der Enden and K. Baisalbayaeva, “The relevance and sustainability of co-operative compliance models for tax in African countries”, paper presented at 1st Annual Congress, *Contemporary Tax Challenges for African Countries*, 2–4 September 2015, Cape Town, South Africa.

<sup>22</sup> Besides the formal co-operative compliance programmes mentioned here many countries have adopted only certain aspects of co-operative compliance programmes, e.g. Germany, Hungary, Portugal. In Germany in 2012 Lower Saxony introduced a co-operative approach for large businesses in cases of tax audits and in the same year Portugal established a Large Business Unit with the aim of enhancing the relationship with large business taxpayers, see more in: OECD, above fn.4, 23. Hungary implemented a client relationship management system based on staff dedicated to dealing with operational questions from large taxpayers and it started to examine the possibility of introducing a co-operative compliance programme. See more in: OECD, *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies* (Paris: OECD Publishing, 2015), 138. As at 2016, Hungary introduced under the Hungarian Law on Tax Procedures art.6/A a classification system of taxpayers based on past tax compliance (“trustworthy”, “average” and “risky” taxpayer categories) whereby various benefits are granted to trustworthy taxpayers (e.g. shorter tax audits, faster VAT refunds and lower penalties), while risky taxpayers are penalised (increased penalties, longer tax audits and slower VAT refunds). See more in: Deloitte, *Breaking Tax News: Tax law changes adopted for 2016* (2015), available at: <https://www2.deloitte.com/content/dam/Deloitte/hu/Documents/tax/hu-taxalert-20151221-en.pdf> [Accessed 29 March 2017]; B. Kolozs, “Hungary Report” in M. Lang, J. Owens, P. Pistone, A. Rust, J. Schuch and C. Staringer (eds), *Improving Tax Compliance in a Globalized World*, forthcoming.

<sup>23</sup> Committee Horizontal Monitoring Tax and Customs Administration, *Tax supervision — Made to measure: Flexible when possible, strict where necessary* (June 2012), available at: [https://download.belastingdienst.nl/belastingdienst/docs/tax\\_supervision\\_made\\_to\\_measure\\_tz0151z1fdeng.pdf](https://download.belastingdienst.nl/belastingdienst/docs/tax_supervision_made_to_measure_tz0151z1fdeng.pdf). [Accessed 29 March 2017].

<sup>24</sup> OECD, above fn.4, 94.

<sup>25</sup> Legislative Decree No.128 of August 5, 2015, Provisions on Legal Certainty in the Relationship Between the Treasury and the Taxpayer, Pursuant to Articles 5, 6 and 8 (2), of Law No. 23 of March 11, 2014. Pubblicato in Gazzetta Ufficiale n. 190 del 18 agosto 2015.

<sup>26</sup> Bundesministerium für Finanzen, *Geschäftsbericht 2011 der österreichischen Steuer- und Zollverwaltung* (2012) 17, available at: [https://www.bmf.gv.at/services/publikationen/BMF-Geschaefisbericht\\_2011\\_der\\_oesterreichischen\\_Steuer-\\_und\\_.pdf?56sdb4](https://www.bmf.gv.at/services/publikationen/BMF-Geschaefisbericht_2011_der_oesterreichischen_Steuer-_und_.pdf?56sdb4) [Accessed 29 March 2017].

<sup>27</sup> E.M. Schrittwieser and H. Woischitzschlagger, “Kooperation statt Ex-post-Prüfung” (2014) 8 *CFO aktuell: Zeitschrift für Finance & Controlling* 62; K. Mölzer-Metz, K. Hofbauer and B. Polster-Grüll, “Horizontal Monitoring — Laufende

a decision will be taken as to whether or not the programme should be continued on a permanent basis.<sup>28</sup>

As regards the means of introduction of co-operative compliance programmes, most countries have formulated their programmes through administrative practice instead of by way of changing their laws and regulations. A few countries, such as the UK, have issued general administrative guidance which sets out a detailed framework for co-operative compliance.<sup>29</sup> A notable exception, as mentioned above, is Italy where co-operative compliance was brought about by legislative means.<sup>30</sup> Where legislation or general administrative guidance on co-operative compliance programmes are not available, an instrument is usually adopted through which a concrete relationship is established between the taxpayer and the tax administration or in which the conditions for entering into a relationship of co-operative compliance are laid down. The OECD distinguishes between three main mechanisms: a unilateral statement or declaration; a charter; and a formal or informal agreement.<sup>31</sup>

A common feature of co-operative compliance programmes is that they are not open to everyone and their personal scope is limited to certain taxpayers, normally, large corporate taxpayers. This is mainly due to the fact that the concept of co-operative compliance was developed to address aggressive tax planning. As indicated by the OECD, large corporate taxpayers, in addition to high-net-worth individuals, represent the greatest risk in relation to aggressive tax planning.<sup>32</sup> It was expected that aggressive tax planning would become less attractive to large corporate taxpayers and that the demand for those types of services would be reduced, once the new type of co-operation, based on trust, mutual understanding and

Kontrolle statt Betriebsprüfung im Nachhinein” in Hans Zöchling (ed), *Tax Controlling in der Praxis*, 1st edn (Linde, 2012), 93–109.

<sup>28</sup> Schrittwieser and Woischitzschlägerm, above fn.27; Mölzer-Metz, Hofbauer and Polster-Grüll, above fn.27. The evaluation of the Austrian pilot was published in October 2016. The evaluation revealed that the pilot had achieved its goals. However, no public communication about introducing a permanent programme on co-operative compliance has so far been issued. The evaluation reads: “If the above mentioned conditions are met, the goals of the programme can be achieved and the implementation of a permanent programme can be recommended.” (Authors’ translation.) See: Bundesministerium für Finanzen, *Horizontal monitoring: Evaluationsbericht* (October 2016), available at: [https://www.bmf.gv.at/services/publikationen/BMF\\_Evaluationsbericht\\_Horizontal\\_Monitoring.pdf?5q2vv7](https://www.bmf.gv.at/services/publikationen/BMF_Evaluationsbericht_Horizontal_Monitoring.pdf?5q2vv7) [Accessed 29 March 2017], 11.

<sup>29</sup> The UK approach to the co-operative compliance concept was set out in the programme called Large Business strategy with a Customer Relationship Manager assisting large corporate taxpayers. The details of the programme were published in the guidance HMRC, *Large Businesses: customer relationship management model* (15 December 2014) on HMRC’s website, available at: <https://www.gov.uk/government/publications/large-businesses-customer-relationship-management-model/large-businesses-customer-relationship-management-model> [Accessed 29 March 2017]. The UK’s programme has recently been amended and supplemented by the Framework for Co-operative Compliance which was included as Annex B to the consultation response document to the Finance Bill 2016. Its soft launch took place in April 2016. The new framework sets out principles for how HMRC and large businesses should work together, which will influence HMRC’s approach to risk management. The continued compliance with the framework serves as a list of indicators of lower risk behaviour and non-compliance with the framework as an indicator of higher risk behaviour. See more details in HMRC, *Improving large business tax compliance* (9 December 2015), available at: <https://www.gov.uk/government/consultations/improving-large-business-tax-compliance> [Accessed 29 March 2017].

<sup>30</sup> Nonetheless, it seems that recently more countries have started to introduce co-operative compliance via legislative means, e.g. Russia and Croatia.

<sup>31</sup> OECD, above fn.1, 43.

<sup>32</sup> OECD, above fn.1, 11.

transparency, between the tax administration and the large corporate taxpayer was promoted.<sup>33</sup> In addition, the OECD underlines that the needs of large corporate taxpayers are different from those of small and medium enterprises.<sup>34</sup> It is reflected even in the relative complexity and scale of affairs of the two groups of taxpayers. Most small and medium-sized enterprises do not need to have direct or frequent contact with the revenue body. Also because of the large number of small and medium-sized enterprises it would be very difficult to set up co-operative compliance programmes which would extend to them.<sup>35</sup> Therefore, the focus of co-operative compliance on large corporate taxpayers was also due to considerations of practicability and feasibility.

This is precisely the reason why co-operative compliance programmes need to be scrutinised under the EU state aid rules which preclude all sorts of selective advantages from being granted in any form whatsoever, including through tax measures, to certain taxpayers or groups of taxpayers.

#### 4. State aid rules as applied to national tax measures

The state aid rules, as part of EU competition law, are, together with the provisions on the free movement of goods, persons, services and capital, the foundations of the EU's internal market. They are aimed at ensuring equal conditions of competition for all market players in the internal market by precluding undue support from being granted by national governments to specific undertakings which would improve the financial position of the recipient vis-à-vis other undertakings. The prohibition of state aid is laid down in Article 107(1) TFEU.

Article 107(1) TFEU provides that:

“Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”

On the basis of this provision, a Member State measure constitutes state aid if the following cumulative conditions are met: 1. the measure confers an advantage on the recipient, which is 2. financed by the state or through state resources and 3. it favours certain undertakings or the production of certain goods, that is, it is selective whilst it 4. distorts competition and affects intra-Union trade. These are considered to be the four elements of the concept of state aid.<sup>36</sup>

<sup>33</sup> OECD, above fn.1, 11.

<sup>34</sup> OECD, above fn.4, 47.

<sup>35</sup> OECD, above fn.4, 47.

<sup>36</sup> C. Quigley, *European State Aid Law and Policy*, 3rd edn (Oxford: Hart/Bloomsbury, 2015), 4; M. Lang, “State Aid and Taxation: Recent Trends in the Case Law of the ECJ” (2012) 11(2) *EStAL* 411, 411; R. Lyal, “Transfer Pricing Rules and State Aid” (2015) 38 *Fordham Law Journal* 1028. On the other hand, the EU Courts in their case law often define the four elements differently, in particular, by not mentioning selectivity as a distinct element, see e.g. *Wolfgang Heiser v Finanzamt Innsbruck* (C-172/03) [2005] ECR I-1627 at [27]; *Enirisorse SpA v Sotacarbo SpA* (C-237/04) [2006] ECR I-2843 at [39]; *Presidente del Consiglio dei Ministri v Regione Sardegna* (C-169/08) [2009] ECR I-10821 at [52]; *Ministero dell’Economia e delle Finanze and Agenzia delle Entrate v 3M Italia SpA* (3M Italia SpA) (C-417/10) EU:C:2012:184 at [37].

The concept of fiscal state aid, that is aid granted through tax measures or measures concerning other public charges, does not differ from this general description, as it only signals the form in which aid is provided. It has been long-settled case law that

“the concept of aid is wider than that of a subsidy because it embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without therefore being subsidies in the strict meaning of the word, are similar in character and have the same effect”.<sup>37</sup>

Thus, in order to constitute state aid, a tax measure has to fulfil the same four conditions mentioned above.<sup>38</sup>

Although it seems to be a rather straightforward concept, the analytical framework which the EU Commission (Commission) and the EU Courts apply to examine whether a national tax measure constitutes state aid has, in the past decades, been undergoing constant adjustment and is still extremely uncertain<sup>39</sup> which makes fiscal state aid one of the most complex and volatile areas of EU law.

It is common to distinguish between various categories of fiscal state aid based on the act of the public authority that grants the aid. First, aid can be granted through tax legislation. This is the case when the legislature introduces tax base allowances, preferential tax rates, tax credits or other beneficial tax measures which are available for taxpayers that fulfil certain objective and predefined criteria which are imposed as the conditions of the measure. This type of aid is called an aid scheme. Although in this case it is not possible to identify in advance the individual beneficiaries of the aid, this does not mean that the measure cannot favour certain taxpayers. That is the case if, in practice, only a certain group (for example, a certain sector, size of business or undertakings in a certain geographical area of a Member State) can fulfil the conditions of the measure.<sup>40</sup> Secondly, aid can also be granted through the administration of taxes. An example of this could be the non-enforcement of a tax claim which has been duly assessed on the basis of generally applicable laws.<sup>41</sup> In this case it is not the legislature that does not assert a taxing right over certain taxpayers but the tax administration which does not enforce an existing tax debt of a certain taxpayer. This can, for example, take the form of a settlement between the tax authority and the taxpayer. In this regard the Court of Justice of the European Union (CJEU) held that tax settlements (for example, full or partial waiver of the tax claim, deferral of payment)

<sup>37</sup> *De Gezamenlijke Steenkolenmijnen in Limburg v High Authority* (C-30/59) [1961] ECR 1 at [19]; *Banco Exterior de España SA v Ayuntamiento de Valencia* (C-387/92) [1994] ECR I-877 at [13]; *French Republic v Commission of the European Communities* (C-241/94) EU:C:1996:353 at [34]; *Commission v Portugal* (C-404/97) [2000] ECR I-4897 at [44]; *SFEI and Others v Commission* (T-36/92) [1992] ECR II-2479 at [58]; *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke* (C-143/99) [2001] ECR I-8365 at [38]; *Air Liquide Industries Belgium* (Joined Cases C-393/04 and C-41/05) [2006] ECR I-5293 at [29].

<sup>38</sup> Commission notice on the application of the State aid rules to measures relating to direct business taxation (Commission’s 1998 Notice) [1998] OJ C384, paras 8–12.

<sup>39</sup> L. de Broe, “The State Aid Review against Aggressive Tax Planning: ‘Always Look a Gift Horse in the Mouth’” (2015) 6 *EC Tax Review* 290, 290; W. Schön, “Tax Legislation and the Notion of Fiscal Aid — A Review of Five Years of European Jurisprudence” (2015) 14 *Max Planck Institute for Tax Law and Public Finance Working Paper* 4.

<sup>40</sup> *CETM v Commission* (T-55/99) [2000] ECR II-3207 at [40].

<sup>41</sup> Schön, above fn.39, 1.



“constitute State aid for the purposes of Article 107(1) TFEU where, taking account of the significance of the economic advantage thereby granted, the recipient undertaking would manifestly not have obtained comparable facilities from a private creditor in a situation as close as possible to that of the public creditor and seeking to recover sums due to it by a debtor in financial difficulty”.<sup>42</sup>

Another category of aid granted through the administration of taxes is where the tax authority applies the general tax rules in a way which leads to a lower tax assessment for certain taxpayers. Such a derogation from the general rules by the tax authority can result from a (deliberate or accidental) misapplication of the law. Such misapplication can occur *ex post*, that is, after the taxable event took place, or *ex ante* in the form of a prior confirmation given by the tax administration at the request of the taxpayer before certain transactions take place as regards how the tax rules will be applied to those transactions (that is, issuing advance rulings or advance pricing agreements).<sup>43</sup> The Commission’s recent tax ruling investigations which caused unprecedented turbulence in the field of fiscal state aid belong to this category.<sup>44</sup> Furthermore, aid through tax administration can also be granted, as will be explained in more detail below (see section 5(c)(iv)), by the tax authority’s exercise of discretionary powers which are too broad and not sufficiently circumscribed by objectively defined criteria.<sup>45</sup> Aid granted through tax administration normally takes the form of individual aid which benefits one certain undertaking as opposed to an aid scheme which benefits an undetermined number of undertakings which nevertheless form a specific group.

As discussed above, co-operative compliance programmes are generally not introduced through legislation but rather by way of changing the administrative practice *vis-à-vis* taxpayers who are part of the programme. In this sense, they would normally fall in the category of aid through tax administration. Although granted through tax administration, these programmes constitute schemes that benefit not only a single taxpayer but also a certain group of them. The majority of these programmes are open to any taxpayer that is able to meet the conditions for participation and wants to participate in the programme. Sometimes the entrance criteria leave a certain amount of discretion to the tax administrations as regards admittance to the programme.<sup>46</sup>

In order to determine whether particular co-operative compliance programmes benefit the taxpayers entitled to participate in them in a way which contravenes the state aid rules, these programmes have to be tested in light of the four elements of the state aid concept.

<sup>42</sup> *Frucona Košice a.s. v European Commission* (C-73/11 P) EU:C:2013:32 at [72]; *European Commission v Électricité de France (EDF)* (C-124/10 P) EU:C:2012:318 at [79].

<sup>43</sup> C. Quigley, *European State Aid Law and Policy*, 2nd edn (Oxford: Hart Publishing, 2009), 70–71.

<sup>44</sup> See European Commission press release, *State aid: Commission investigates transfer pricing arrangements on corporate taxation of Apple (Ireland) Starbucks (Netherlands) and Fiat Finance and Trade (Luxembourg)* (11 June 2014); European Commission press release, *State aid: Commission investigates transfer pricing arrangements on corporate taxation of Amazon in Luxembourg* (7 October 2014); European Commission press release, *State aid: Commission opens in-depth investigation into the Belgian excess profit ruling system* (3 February 2015) (IP/15/4080); European Commission press release, *Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules* (21 October 2015) (IP/15/5880); European Commission press release, *State aid: Commission concludes Belgian “Excess Profit” tax scheme illegal; around €700 million to be recovered from 35 multinational companies* (11 January 2016) (IP/16/42).

<sup>45</sup> Commission’s 1998 Notice, above fn.38, para.21.

<sup>46</sup> Normally, pilot programmes are exceptions, see also s.5(c)(ii), below.

## 5. Can co-operative compliance programmes constitute state aid? Analysis in the light of the different elements of state aid

### (a) Advantage

In order to determine whether a measure constitutes state aid within the meaning of Article 107(1) TFEU, it is necessary to establish whether or not the addressees of the measure receive any advantage. An “advantage” under Article 107(1) TFEU is a broad notion covering “any economic benefit which an undertaking could not have obtained under normal market conditions, that is to say in the absence of State intervention”<sup>47</sup> and which improves the taxpayer’s net financial position.<sup>48</sup>

As far as tax measures are concerned, an advantage is present within the meaning of Article 107(1) TFEU, when the measure relieves its recipients of charges that are normally borne from their budgets.<sup>49</sup> It covers not only a reduction in the tax base, a total or partial reduction in the amount of tax but also deferment, cancellation or even special rescheduling of tax debt.<sup>50</sup>

It is doubtful whether co-operative compliance regimes convey any economic benefit to the participating taxpayers in this sense. The aim of these programmes is to improve the working relationship between the tax administration and the taxpayer so that the correct tax liability may be ascertained more efficiently. For this reason, they mainly involve procedural benefits (for example, smoother communication with, and easier access to, the tax administration, faster replies to questions, less burdensome audits, etc.) and, in almost all cases, do not affect the substantive tax liability of participating taxpayers. In this respect, these programmes differ from all the other tax measures that have so far been examined by the Commission or the EU Courts, which concerned substantive tax provisions affecting the tax burden in one way or another (tax allowances, exemptions, accelerated depreciation, reduced tax rates, tax credits). Although some procedural measures have also been subject to state aid review, such measures always had an effect on the amount of tax due.<sup>51</sup>

Although—as the OECD also emphasises<sup>52</sup>—co-operative compliance regimes should not affect the amount of tax payable by a taxpayer, a closer look at co-operative compliance programmes in place in various countries shows that some programmes allow taxpayers to reduce their tax burden under the programme. A reduction of tax burden does not necessarily mean a lower tax rate or a smaller amount of tax due than for other taxpayers. Reduction of the overall tax burden can be achieved by lowering or waiving the penalties on unpaid taxes. Even postponement of taxes due might be considered as a state aid, as it provides a cash flow benefit to the taxpayer concerned. In its decision on the tax amnesty measure notified by Latvia, the Commission recognised a single extension of 60 months of the payment term as well as a waiver

<sup>47</sup> European Commission, Commission Notice on the notion of State aid pursuant to Article 107(1) of the Treaty on the Functioning of the European Union C/2016/2946 [2016] OJ C262, available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C\\_.2016.262.01.0001.01.ENG&toc=OJ:C:2016:262:TOC](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2016.262.01.0001.01.ENG&toc=OJ:C:2016:262:TOC) [Accessed 29 March 2017], para.66.

<sup>48</sup> Quigley, above fn.36, 3.

<sup>49</sup> Commission’s 1998 Notice, above fn.38, para.9.

<sup>50</sup> Commission’s 1998 Notice, above fn.38, para.9.

<sup>51</sup> See e.g. *3M Italia SpA* (C-417/10), above fn.36, EU:C:2012:184.

<sup>52</sup> OECD, above fn.4, 45.

of the late interest and audit penalty as an advantage.<sup>53</sup> As discussed above, settlements of outstanding tax debts can also amount to state aid unless the “private creditor test” cited above is fulfilled.<sup>54</sup>

The Italian co-operative compliance programme is an example of programmes which affect the taxpayers’ overall tax burden. Taxpayers participating in this programme can benefit from a special penalty system. If the taxpayer participating in the programme communicates its tax risks before the submission of the tax return, a concession is provided for up to half of the minimum penalty payable (a 50 per cent haircut on penalties).<sup>55</sup> Such a measure clearly provides a relevant economic advantage for the purposes of Article 107(1) TFEU and as such may constitute state aid provided that it also meets the other conditions of the state aid definition.

Other programmes offer benefits which do not entail a reduction of tax liability for participating taxpayers. One of the key benefits offered by co-operative compliance programmes to participating taxpayers is increased certainty. This can be provided by the tax administration in the form of advance rulings issued prior to the carrying out of a transaction which may have questionable tax consequences. A more informal way of providing such certainty is by issuing non-binding interpretations of the law or other assurances as to the application of the law to a certain set of facts. Under the Irish and Dutch programmes, taxpayers can ask the tax administration for an informal clarification with regard to the application of certain provisions of the tax code. Communicating informal interpretations of the law to the taxpayer is undeniably a less transparent way of granting certainty than is the case with official written rulings and, as such, could make the detection of any potential state aid granted under the guise of such informal interpretations more difficult. As a rule, however, the issuance of these instruments should not in itself create any problems under the state aid rules. This can be inferred from the Commission’s statement in the tax ruling investigations mentioned above according to which such rulings are not problematic if they are only used to provide selective advantages to a specific company or group of companies.<sup>56</sup> Thus, the Commission’s position appears to be that increased certainty does not qualify, in itself, as an advantage under the state aid rules. Increased certainty is inherent in every ruling which clarifies the tax consequences of a contemplated transaction in advance. Therefore, when the Commission says that “rulings as such are not problematic”, it expresses the view that the enhanced certainty inherent in all advance rulings is not a concern under the state aid rules unless such rulings provide for a selective advantage which goes beyond mere certainty. In order for a ruling (or any other less formal instrument of interpretation) to qualify as an advantage for

<sup>53</sup> Commission Decision on the tax amnesty measure notified by Latvia SA 33183 [2013] OJ C1/6. The measure at stake was not found to be selective and, therefore, as a general measure was not recognised as a state aid.

<sup>54</sup> Some countries recommend resolution of pending issues before entering into the co-operative compliance programme, which may involve the settlement of certain tax debts. This is the practice, e.g. in the Netherlands. For more details see: Committee Horizontal Monitoring Tax and Customs Administration, above fn.23.

<sup>55</sup> Tax risk refers to the cases when the taxpayer and the tax administration do not share the same view with regard to the tax consequences of the case, see P. Braccioni, B. Accili, D. Gioia and C. Sacerdote, *Tax Reform Update: International Experience to Mark Italian Way to Cooperative Compliance* (Paul Hastings LLP, Insights, 10 June 2015), available at: <https://www.paulhastings.com/publications-items/details/?id=9183e469-2334-6428-811c-ff00004cbded> [Accessed 29 March 2017].

<sup>56</sup> European Commission press release, *State aid: Commission investigates transfer pricing arrangements on corporate taxation of Amazon in Luxembourg* (7 October 2014), available at: [http://europa.eu/rapid/press-release\\_IP-14-1105\\_en.htm](http://europa.eu/rapid/press-release_IP-14-1105_en.htm) [Accessed 29 March 2017].

state aid purposes it must as a ruling derogate from the generally applicable law. In sum, in order to avoid the suspicion of state aid, instruments providing for advance certainty—whether given in the form of official rulings, informal comfort letters, clearances or verbal assurances—should do no more than interpret the law<sup>57</sup>; in other words, they cannot deviate from the generally applicable law or generally followed administrative practice to the effect of favouring the addressee by lowering its tax burden.<sup>58</sup>

In addition to the issuance of rulings and other informal interpretations of the law, other benefits of a procedural nature are also provided for by co-operative compliance regimes. For instance, in Italy a taxpayer participating in the co-operative compliance programme can benefit not only from certainty through rulings but also from a fast track procedure for the issuance of rulings. In comparison to an ordinary procedure, deadlines for the tax administration are shortened significantly. The tax administration provides feedback about the suitability of the request and enclosed documentation in 15 days instead of a maximum of four months under the normal procedure. Also the period for issuing a ruling is shortened—in some cases by more than half of the standard period.<sup>59</sup> Accessibility and personal contacts within the tax administration are also important factors under the various programmes. In the Austrian pilot programme the tax administration undertakes in its signed declaration of intention that the taxpayer will have a designated special contact person who will be in charge of maintaining contact between the tax administration and the taxpayer. Fast-track procedures together with better accessibility to and responsiveness by the tax administration also contribute to enhancing certainty.

As concluded above, the increased legal certainty which is inherent in an advance ruling is not in itself a relevant economic advantage. However, if we take into account the cumulative effect of all the measures which enhance certainty under a co-operative compliance programme together with the indirect effect of such measures, the picture changes. One indirect benefit for the taxpayer which flows from the measures mentioned above is better and easier tax risk management and a need for a lower level of reserves for tax risks. Furthermore, increased and advance certainty can also reduce the number of legal disputes between the taxpayer and the tax administration and when such disputes are unavoidable, the participation in co-operative compliance can make their resolution both faster and smoother.

On the whole, all the procedural benefits together with their indirect consequences can considerably decrease the compliance costs for taxpayers participating in co-operative compliance programmes.

Another visible advantage of participation in co-operative compliance programmes for taxpayers is reputational gains. In the Netherlands, many taxpayers publish signed covenants or information about these covenants on their websites to prove to their customers that transparency and corporate social responsibility are core values in the conduct of their business.<sup>60</sup>

<sup>57</sup> Commission's 1998 Notice, above fn.38, para.22; Commission Notice, above fn.47, para.175.

<sup>58</sup> Commission Notice, above fn.47, para.176.

<sup>59</sup> Legislative Decree No. 128 of August 5, 2015, Provisions on Legal Certainty in the Relations Between the Treasury and the Taxpayer, Pursuant to Articles 5, 6 and 8(2) of the Law No.23 of March 11, 2014 art.6(2).

<sup>60</sup> See, e.g. Dutch Tax and Customs Administration and Confed Horizontal Monitoring covenant, signed 20 April 2015, available at: <http://www.confed.eu/en/dutch-tax-and-customs-administration/> [Accessed 29 March 2017].

Having regard to all these benefits, it can be concluded that they improve the financial position of the taxpayer, even though they may not result in an actual reduction of the taxpayer's tax burden. The benefits mitigate the operative expenses incurred by taxpayers in participating in the programmes because they can save on compliance costs and increase their profits due to reputational gains. While it is true that these advantages may be quite difficult to measure, it is hard to negate the fact that they improve the financial position of the participating taxpayers. Given the broad interpretation of the notion of advantage under the state aid rules, it seems that the benefits obtained by a taxpayer within co-operative compliance could be considered to be an advantage in the sense of Article 107(1) TFEU.

*(b) Granted by a Member State or through state resources*

Pursuant to Article 107(1) TFEU state aid rules apply to “any aid granted by a Member State or through State resources”. Although the wording of the provision suggests that aid should be granted either by a Member State or through state resources, the interpretation provided by the CJEU explicitly indicates that these are two separate and cumulative conditions.<sup>61</sup> Therefore, a public support measure has to be granted both “by a Member State” and “through State resources” in order to constitute state aid.

The condition that aid should be “granted by a Member State” requires that the aid is imputable to the state. In the case of co-operative compliance programmes, it is rather obvious that they are provided for by the state irrespective of whether or not the co-operative compliance model is laid down in legislation or merely exists as the practice of the tax administration, that is, a public authority, as long as the latter is sufficiently clear, precise and firm enough to prove the state's commitment.<sup>62</sup> This can hardly be disputed given that most of the programmes involve an instrument confirming the commitment of the tax administration to the co-operative compliance relationship (such as a covenant, declaration of intention, or unilateral statement of the tax administration).

As regards the second condition, aid is perceived to be “granted through State resources” when the benefit granted to the taxpayer is a burden to the public budget.<sup>63</sup> In this respect it is settled case law that

“for the purposes of establishing the existence of State aid, the Commission must establish a sufficiently direct link between, on the one hand, the advantage given to the beneficiary and, on the other, a reduction of the State budget or a sufficiently concrete economic risk of burdens on that budget”.<sup>64</sup>

<sup>61</sup> See, for instance, *France v Commission (Stardust)* (C-482/99) [2002] ECR I-4397 at [24]; *Deutsche Bahn AG v Commission* (T-351/02) [2006] ECR II-1047 at [103].

<sup>62</sup> Quigley, above fn.36, 18–19.

<sup>63</sup> Quigley, above fn.36, 34–35; Commission Notice, above fn.47, para.68.

<sup>64</sup> *Bouygues SA, Bouygues Télécom SA v European Commission and Others, European Commission, French Republic v Bouygues SA and Others* (Joined Cases C-399/10 P and C-401/10 P) EU:C:2013:175 at [109].

Therefore, in terms of the state aid definition, what is an advantage for the undertaking is, on the other side of the coin, a burden for the state. In other words, the granting of an advantage involves a transfer of resources from the state to the beneficiary.<sup>65</sup>

The fact that an economic advantage granted to a certain beneficiary is not sufficient for a measure to constitute state aid without a corresponding burden on the state has also been confirmed by the CJEU's case law.

In *Firma Sloman Neptun Schiffahrts AG v Seebetriebsrat Bodo Ziesemer (Sloman Neptun)*<sup>66</sup> the CJEU examined German legislation which provided that the contracts of employment of crew members of shipping companies were not governed by German law if the crew member had no permanent abode or residence in Germany. As a result, salaries could be agreed on in such contracts which were lower than those agreed on in contracts which were governed by German labour law. According to the Commission, the measure granted an advantage to shipping companies, as they were allowed to pay lower salaries. The Commission also maintained that such advantage was financed from state resources and thus amounted to state aid. The CJEU rejected this argument and emphasised that, even if the German system could contribute to the reduction of state resources incidentally (that is, lower social security contributions paid on lower salaries), it

“does not seek, through its object and general structure, to create an advantage which would constitute an additional burden for the State or the abovementioned bodies, but only to alter in favour of shipping undertakings the framework within which contractual relations are formed between those undertakings and their employees”.<sup>67</sup>

Also in *PreussenElektra AG v Schleswag AG (PreussenElektra)*,<sup>68</sup> the CJEU confirmed that an advantage that does not impose a public financial burden cannot be recognised as state aid. The case concerned German legislation which required private electricity supply undertakings to purchase electricity produced in their area of supply from renewable energy sources at minimum prices higher than the real economic value of that type of electricity and allocated the financial burden arising from that obligation amongst the electricity supply undertakings and upstream private electricity network operators. The obligation to purchase electricity produced from renewable energy sources at minimum prices conferred a certain economic advantage on producers of that type of electricity, as it guaranteed them, with no risk, higher profits than they would have otherwise made. However, as the CJEU pointed out, neither such obligation nor the allocation of its financial burden between various private undertakings involved any transfer of state resources to the beneficiaries of the measure.<sup>69</sup> As a result, the measure did not constitute state aid.

In the case of co-operative compliance programmes, we may not find an obvious correlation between advantage and consumption of state resources. As already mentioned, the co-operative compliance model aims at improving the relationship between the tax administration and the

<sup>65</sup> Commission Notice, above fn.47, para.51.

<sup>66</sup> *Firma Sloman Neptun Schiffahrts AG v Seebetriebsrat Bodo Ziesemer* (Joined Cases C-72/91 and C-73/91) [1993] ECR I-887.

<sup>67</sup> *Sloman Neptun* (Joined Cases C-72/91 and C-73/91), above fn.66, [1993] ECR I-887 at [21].

<sup>68</sup> *PreussenElektra AG v Schleswag AG* (C-379/98) [2001] ECR I-2099.

<sup>69</sup> *PreussenElektra* (C-379/98), above fn.68, [2001] ECR I-2099 at [59]–[60].

taxpayer to the benefit of both parties. Thus, in principle, such programmes should result in a win-win situation, which is also advantageous for the tax administration without a loss of revenue for it. Nevertheless, as we have seen above, there are co-operative compliance programmes which allow a reduction of the tax burden for the taxpayer—for example, the Italian regime which offers concessions on penalties—where there is, undoubtedly, a financial burden on the state due to the lost tax revenue resulting from the non-collection of the taxes or penalties due. In this case the link between advantage granted to the taxpayer and the loss of the state’s revenue is evident. The other programmes, that is, the Dutch, Irish and Austrian, are aimed only at the improvement of co-operation between the tax administration and the taxpayer without forgoing budget revenues. Compared to the traditional model of administering and enforcing taxes, this type of comparative compliance programme does not apparently entail an additional burden for the state. On the contrary, such programmes enable the tax administration to make savings in resources by reducing the scope of audits, minimising the number of litigated cases and focusing its limited resources on high risk cases.

Hence, applying the CJEU’s interpretation of the term “financed through State resources” to co-operative compliance programmes, it can be maintained that, in most cases, they do not involve a consumption of state resources and, consequently, they lack a direct link between the advantage granted to the beneficiary and the consumption of state resources. Co-operative compliance programmes can be perceived as altering the legal framework within which taxes are administered, in favour of taxpayers eligible to enter the programme but without, however, transferring state resources to those taxpayers. As long as co-operative compliance regimes do no more than this, they cannot qualify as state aid.

In contrast, in the case of co-operative compliance programmes which involve a mitigation of the tax burden (taxes and/or penalties due) there is a direct link between the advantage granted to the participating taxpayers and the ensuing reduction of state resources. Therefore, such programmes should constitute state aid provided that the other conditions of the state aid definition, in particular, that of selectivity are also fulfilled.

In this respect, it also has to be emphasised that any reduction of the tax burden is a loss of tax revenue for the state and as such may qualify as state aid. That is the case even if the overall budget revenues increase because of the improved compliance of taxpayers or the reduced administrative costs accruing to the tax administration. Even if the co-operative compliance programme can lead to an overall increase of tax revenues due to improved efficiency, it may still involve state aid when it leads—on an individual basis—to forgone tax revenues.<sup>70</sup>

<sup>70</sup> See, e.g. Commission Decision 2003/515/EC of 17 February 2003 on the State aid implemented by the Netherlands for the international financing activities [2003] OJ L180/52, 18 July 2003; Commission Decision 2005/77/EC of 30 March 2004 on the aid scheme implemented by the United Kingdom in favour of Gibraltar Qualifying Companies [2005] OJ L29/24, 2 February 2005, paras 58–59; Commission Decision 2003/755/EC of 17 February 2003 on the aid scheme implemented by Belgium for coordination centres established in Belgium [2003] OJ L282/25, 30 October 2003, paras 96–98. The Court seems to be of the same opinion, see *Kingdom of Belgium v Commission of the European Communities and Forum 187 ASBL v Commission of the European Communities* (Joined Cases C-182/03 and C-217/03) [2006] ECR I-5479 at [128]–[129].

*(c) Selectivity**(i) Derogation from a reference system*

Pursuant to Article 107(1) TFEU, it is necessary that an advantage which is granted from state resources favours “certain undertakings or the production of certain goods”. In other words, the measure has to fulfil the condition of selectivity.

As the CJEU has established in its case law

“in order to classify a domestic tax measure as ‘selective’, it is necessary to begin by identifying and examining the common or ‘normal’ regime applicable in the Member State concerned. It is in relation to this common or ‘normal’ tax regime that it is necessary, secondly, to assess and determine whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure derogates from that common regime inasmuch as it differentiates between economic operators who, in light of the objective assigned to the tax system of the Member State concerned, are in a comparable factual and legal situation.”<sup>71</sup>

Even where a tax measure derogates from the general rules to the effect of treating comparable situations differently, such differentiation may be in line with the logic or general scheme of the tax system. Thus, the selectivity test consists, in fact, of three elements: a derogation test; a comparison test; and an examination of whether any justification by the nature and general scheme of the tax system exists.

The derogation test aims to identify whether or not a measure constitutes a derogation from the standard application of the tax system<sup>72</sup> or, as it was laid down in the Commission’s 1998 Notice, “provides in favour of certain undertakings in the Member State an exception to the application of the tax system”.<sup>73</sup> In order to ascertain whether this condition is met, “the common system applicable should thus first be determined”.<sup>74</sup> Secondly, it has to be verified whether the measure at stake constitutes a derogation from that reference framework.<sup>75</sup> In the case of co-operative compliance programmes the reference framework is constituted by the general rules of tax procedure. Compared to the general rules of tax procedure, co-operative compliance programmes represent exceptions reserved for those taxpayers who are entitled to participate in them. Each of the programmes analysed entails a kind of special tax procedure for these taxpayers which usually offers improved and advance certainty and decreased compliance costs (although usually it is subject to meeting certain conditions, for example, implementing an appropriate tax control framework, which involves some costs for the taxpayer too). Additionally, other exceptions to the regular tax procedure and administration may be provided, for instance, in the Italian

<sup>71</sup> *Ministero dell’Economia e delle Finanze v Paint Graphos Sarl and others (Paint Graphos)* (Joined Cases C-78/08 to C-80/08) [2011] ECR I-7611 at [49]; *Portugal v Commission* (C-88/03) [2006] ECR I-7115 at [56]; *P Oy v Veronsaajien Oikeudenvaltayksikko (P Oy)* (C-6/12) EU:C:2013:525; [2014] 1 CMLR 15 at [19]; *Banco Santander SA v Commission* (T-399/11) EU:T:2014:938 at [37].

<sup>72</sup> C. Micheau, “Tax Selectivity in European Law of State Aid: Legal Assessment and Alternative Approaches” (2015) 3 *European Law Review* 330.

<sup>73</sup> Commission’s 1998 Notice, above fn.38, para.16.

<sup>74</sup> Commission’s 1998 Notice, above fn.38, para.16.

<sup>75</sup> Micheau, above fn.72, 330.



programme a concessionary penalty regime and a fast track ruling procedure, in the Irish programme easier and more direct communication with the tax administration, and in the Dutch programme fewer tax audits.

(ii) Are the participants of co-operative compliance programmes in a similar situation to other taxpayers?

The fact that they represent an exception to the reference framework for eligible taxpayers does not automatically qualify co-operative compliance programmes as selective under the state aid rules. It has to be verified whether the derogation leads to a different treatment of comparable undertakings in the light of the objective of the reference system of which the measure forms part.

In order to determine whether this condition is fulfilled by co-operative compliance regimes, it has to be seen whether taxpayers who are eligible to participate in these regimes are comparable to others who are excluded from them. Most of the programmes examined allow only large business taxpayers to enter into a co-operative compliance relationship with the tax administration. For instance in Ireland only corporate groups with a turnover greater than €162 million or total tax payments greater than €16 million are eligible to participate in the co-operative compliance programme.<sup>76</sup> In Italy, eligible taxpayers are defined as those with an annual turnover higher than €10 billion or an annual turnover higher than €1 billion provided that the latter adhered to the pilot project on co-operative compliance launched by the Italian revenue agency in 2013. In addition, taxpayers that realise investments in excess of €30 million as a result of a spontaneously initiated ruling procedure<sup>77</sup> are also eligible to access the programme. The access of those taxpayers was allowed within the package of measures aimed at attracting new foreign investments<sup>78</sup> after the law on the Italian co-operative compliance programme was passed by the Parliament.<sup>79</sup> As a result the Italian programme is open to two different groups of taxpayers; the first is defined on the basis of the volume of their annual turnover and the second is based on the size of the realised investment.

<sup>76</sup> OECD, *Forum on Tax Administration: Compliance Management of Large Business Task Group, Guidance note. Experiences and Practices of Eight OECD Countries* (July 2009), available at: <https://www.oecd.org/tax/administration/43241144.pdf> [Accessed 29 March 2017].

<sup>77</sup> The taxpayers that are eligible are those who request a tax ruling available for companies that intend to invest in Italy. The new system is aimed at providing them with certainty about the income tax and indirect tax consequences arising from their investment plan. The investor, either resident or non-resident, must file a business plan, detailing the amount of the investment, the industry, the timing and implementation phases and the expected number of new hires. The ruling may include, among other aspects, the likelihood of application of abuse of law or other anti-avoidance measures, tax profiles of reorganisations and whether certain asset purchases will amount to a going concern. The procedure applies to investments of not less than €30 million. Tax authorities should provide the investor with a written answer in 120 days, binding as long as the facts and circumstances set out in the application do not change. The procedure was implemented by Legislative Decree No. 147 of September 14, 2015 art.2 and the implementation rules were set out in a decree by the Ministry of Economics and Finance.

<sup>78</sup> See also: Paul Hastings LLP, *Italian tax reform: facilitating inbound foreign investments* (15 May 2015, Lexology), available at: <http://www.lexology.com/library/detail.aspx?g=3ee180bd-9b4e-4e2d-9e2f-4af5c8d992d8> [Accessed 29 March 2017].

<sup>79</sup> Atto del Governo: 163, Schema di decreto legislativo recante disposizioni sulla certezza del diritto nei rapporti tra fisco e contribuente, available at: <http://www.camera.it/leg17/682?atto=163&tipoatto=Atto&leg=17&tab=1> [Accessed 29 March 2017].

Unlike the other programmes, the Dutch programme is not confined exclusively to large taxpayers. It was designed first only for very large taxpayers but in the course of time it was extended to small and medium-sized taxpayers.<sup>80</sup> However, the programmes for large, medium and small taxpayers differ. Only the large taxpayers conclude “covenants” with the tax administration directly. Small and medium-sized taxpayers rely on tax intermediaries. This differentiation in the programme design between large taxpayers, on the one hand, and small and medium-sized taxpayers, on the other, may lead to selectivity in itself.

In contrast to the regular programmes, pilot programmes are often limited to a smaller number of taxpayers. Often the tax administration itself will approach certain large taxpayers that it considers to be low risk and invite them to enter the pilot.<sup>81</sup> This is due to the fact that it is through a pilot that the tax administration aims to test the design of a programme and so it is advisable to include just a few participants which the tax administration deems to be reliable and suitable as test cases.<sup>82</sup> Even in these cases, however, the tax administration usually selects taxpayers that fulfil some objective and predefined criteria, for example, size, the level of tax compliance, etc. Thus, the discretion of the tax administration is not unlimited in this respect. The Austrian pilot programme can serve as an example. In this programme 17 companies took part.<sup>83</sup> According to the information that is available, selection was made by the tax administration from taxpayers that met certain predefined criteria. In particular, eligible taxpayers were those that were obliged to undergo audits of large-scale undertakings and audits of the annual financial statements (or voluntarily participate in these audits), had no financial criminal charges and had in place, or intended to set up, a tax control framework. In fact, these requirements limited the scope of the taxpayers that could be selected to those that had minimum turnover of €9.68 million.<sup>84</sup>

As is apparent, when analysing the selectivity of co-operative compliance programmes, the question that needs to be answered is whether large business taxpayers who are the beneficiaries of these programmes are in a comparable situation to small and medium-sized business taxpayers. It is common ground in state aid law that different treatment based on the size of undertakings leads to selectivity for the purposes of Article 107(1) TFEU.<sup>85</sup>

However, general conclusions about the comparability of large undertakings and small and medium-sized enterprises cannot be drawn, as comparability has to be examined in the light of the objective of the system of which the measure is part. As the authors have already established,

<sup>80</sup> van der Hel - van Dijk and Poolen, above fn.11.

<sup>81</sup> Usually countries do not publish many materials on their pilot programmes and the information whether a pilot programme was initiated per invitation can be obtained only by interviewing civil servants, tax intermediaries or the taxpayers directly. On the other hand, it can also happen that the tax administration will announce a public call for participation in a pilot rather than send invitations. The participants of the US CAP programme were initially recruited per invitation only but as the programme developed the IRS moved to an open call. See: Osofsky, above fn.7, 316.

<sup>82</sup> M. Verbič, M. Čok and D. Šinkovec, “Some evidence for implementing an enhanced relationship in Slovenia” (2014) 38 *Financial theory and practice* 61.

<sup>83</sup> Bundesministerium für Finanzen, *Horizontal monitoring: Evaluationsbericht*, above fn.28.

<sup>84</sup> W. Koller, H. Schuh and H. Woischitzschlagger (eds), “Handbuch zur Praxis der steuerlichen Betriebsprüfung” in *Betriebsprüfung* (LexisNexis, 2013), 8.

<sup>85</sup> C. Micheau, *State Aid, Subsidy and Tax Incentives under EU and WTO Law*, 1st edn (Kluwer Law International, 2014), 222. See also: *Diputación Foral de Álava and Gobierno Vasco v Commission* (T-227/01 to T-229/01 and T-265/01, T-266/01 and T-270/01) [2009] ECR II-3029; Commission Decision 2002/937/EC of 10 July 2002 on the aid scheme implemented by Finland for Åland Islands captive insurance companies [2002] OJ L329/22, 5 December 2002, paras 22–29.

the reference system is the general rule of tax procedure. The objective of such a system is the enforcement of tax liabilities and duties connected to taxation. According to the OECD, large business taxpayers participating in co-operative compliance programmes are not in a situation which is comparable to small and medium-sized business taxpayers. The lack of comparability between these two groups of taxpayers results from “the complexity and scale of the affairs of a large multinational enterprise”.<sup>86</sup> If the argument is that the complexity of the structure and business transactions of large taxpayers makes it more difficult to correctly calculate their tax obligations, it is easier to accept the relevance of size. A further argument would be, besides the high complexity and the cross-border character of the transactions of large business taxpayers, the higher probability that these taxpayers enter into aggressive tax schemes.<sup>87</sup> It should be pointed out in this regard that co-operative compliance appeared on the agenda of the OECD in the context of a discussion about aggressive tax planning and its impact on tax administration which sought to answer the question: what kind of measures should be undertaken to better collect the taxes due.<sup>88</sup> Usually large business taxpayers have more capacity to engage in sophisticated tax planning and to pay for expert advice on the latter. In addition, the scale of their operations allows them to exploit differences and mismatches between various tax systems which constitutes a key element of aggressive tax planning. That is not the case with small and medium-sized enterprises the business of which is often confined to one domestic market. From this perspective, large business taxpayers and small and medium-sized taxpayers are not in a comparable situation. Another fact which points in this direction is that large business taxpayers in general attract a high level of attention from the tax administration, simply because they pay the largest proportion of corporate income tax. Thus, it can be maintained that there is a generic degree of “discrimination” inherent in many tax systems and co-operative compliance programmes, as they sit within that overall context, merely reflect such discrimination.<sup>89</sup>

The question still remains, however, as to how to define large taxpayers. Where is the boundary between large taxpayers and other taxpayers? The examples of co-operative compliance programmes described above demonstrate that different countries have established different thresholds but that most of these countries refer to the amount of turnover or tax liability of the taxpayer, that is, they apply an essentially quantitative criterion.

Taking into account the difficulties of drawing a justified distinction between large taxpayers and other taxpayers on the basis of a non-arbitrary definition of “large”, a qualitative criterion, or criteria, may be more appropriate for differentiating between various taxpayers. Such criteria could be based on the scale and complexity of the taxpayer’s operations. In addition, other factors,

<sup>86</sup> OECD, above fn.4, 47.

<sup>87</sup> Aggressive tax planning and tax avoidance is often associated with multinational enterprises under the BEPS project, see: OECD/G20 Base Erosion and Profit Shifting Project, *Explanatory Statement—2015 Final Reports* (OECD, 2015), available at: <http://www.oecd.org/ctp/beps-explanatory-statement-2015.pdf> [Accessed 29 March 2017].

<sup>88</sup> OECD, above fn.1, 5.

<sup>89</sup> It is to be noted, however, that the current tax agenda puts more emphasis on small and medium-sized enterprises. Tax administrations around the world implement new strategies aimed at facilitation of their tax compliance. For more details see, e.g. OECD, *Tax Compliance by Design: Achieving Improved SME Tax Compliance by Adopting a System Perspective* (OECD Publishing, 2014). The fact that the introduction of special treatment is proposed for small and medium-sized enterprises in the administration of taxes indicates that small and medium-sized enterprises, on the one hand, and large enterprises, on the other, may not, indeed, be in a comparable situation and therefore, the fact that co-operative compliance programmes are restricted to large enterprises does not constitute discrimination either.

for example, the taxpayer's tax compliance record or whether or not the taxpayer has a tax control framework in place, could be taken into account. Different treatment based on these criteria can be explained in the light of the objective of the reference system, that is, the enforcement of tax liabilities and duties connected to taxation. In that light, for example, non-compliant taxpayers are not in a comparable situation to compliant ones. Most of the co-operative compliance programmes also take into account qualitative factors of this kind alongside the amount of turnover or tax liability of the taxpayer. In Italy taxpayers applying for participation in the programme have to have a good track record of timely and proper traditional tax compliance. This tax compliance should be evidenced by good governance and efficient internal control systems which will determine a clear attribution of duties and tasks to internal functions. In the Austrian pilot taxpayers are assessed based on their previous tax compliance. Additionally, all programmes rely on the requirement of a tax control framework that the taxpayer is obliged to establish in order to enter the programme. A tax control framework is the evidence of transparency offered by the taxpayer. All in all, programmes which (also) apply criteria relating to a good track record of past tax compliance are less controversial. This implies that typical tax risk management tools,<sup>90</sup> which are merely based on the classification of taxpayers according to their past tax compliance record, are less susceptible to being found selective than co-operative compliance programmes.

It has to be noted that the way in which the Italian programme defines "eligible taxpayers" provides more reason for the programme to be qualified as selective than the other programmes examined in this article. As the authors have already mentioned, the Italian programme allows access to co-operative compliance for two different categories of taxpayers: large taxpayers defined on the basis of their turnover; and those who make an investment of a certain value in Italy. This introduces a certain inconsistency into the definition of eligible taxpayers, as there is no single criterion used to distinguish eligible from non-eligible taxpayers. Therefore, it cannot be maintained that all those who are eligible to participate in the programme are in an objectively comparable situation and, at the same time, different from those who are excluded from participation. In addition, the criterion of making investment in Italy of a certain value is not in any way related to the objective of the tax procedure, that is, enforcement of tax obligations and collection of taxes. In this sense this criterion is less justifiable than the size of the taxpayer, which—as described above—can, at least indirectly, be linked to tax enforcement and collection. Moreover, the fact that this category of eligible taxpayers was added subsequent to the adoption of the co-operative compliance programme by a legislative package the purpose of which was to incentivise foreign direct investment in Italy makes this feature of the programme even more controversial. Measures aimed at attracting or promoting investment by offering favourable tax treatment to a specific group of undertakings have a history under the state aid rules and have

<sup>90</sup> The OECD recommended the implementation of Compliance Risk Management as a wider strategy that supports the tax administration in the allocation of available resources in a targeted and effective manner. It defines the Compliance Risk Management as "a systematic process in which a tax administration makes deliberate choices on which treatment instruments could be used to effectively stimulate compliance and prevent non-compliance, based on the knowledge of all taxpayers (behaviour) and related to the available capacity" (R.N.J. Kamerling, *The International Guide to Tax Auditing* (IBFD, 1999), 136). For further details see: OECD, above fn.4, 41.

consistently been found to be selective and thus, state aid.<sup>91</sup> The fact that there is a value threshold for the investment is sufficient for finding that the taxpayers who make such investment form a specific group. The offering of participation in co-operative compliance in return for making investments gives the impression that such programmes offer special favourable treatment as a reward for the investment, which impression should be avoided.

(iii) Justification for the potential selectivity of co-operative compliance programmes

Even if a co-operative compliance programme were to qualify as selective pursuant to the previous analysis, it does not mean that it will automatically be considered state aid. A prima facie selective tax measure may be justified by the nature or general scheme of the tax system.<sup>92</sup> Differentiating measures “whose economic rationale makes them necessary to the functioning and effectiveness of the tax system” do not constitute state aid.<sup>93</sup> However, a distinction has to be made between external objectives, which are assigned to a particular tax system and objectives which are inherent to the tax system.<sup>94</sup> Only the latter objectives can serve as justification for the selectivity of a measure. As stated by Advocate General Geelhoed in *Portuguese Republic v Commission of the European Communities*

“... the essence of the justification is that the exceptions to the application of the tax system should derive directly from the basic or guiding principles of the tax systems in the Member State concerned. In this respect, a distinction has been drawn between the external objectives of a tax scheme — for example, social or regional objectives — which fall outside the scope of the justification, and the objectives inherent in the tax system itself — for example efficiency in the collection and progressive taxation.”<sup>95</sup>

With regard to co-operative compliance programmes this means that even if large enterprises are comparable to other taxpayers and therefore that their more favourable treatment makes co-operative compliance programmes prima facie selective, such treatment may be justifiable. These programmes aim to improve the effectiveness and efficiency of tax administration and to ensure better tax compliance and advance certainty. These goals are in line with increasing the

<sup>91</sup> Commission Decision 2003/755/EC of 17 February 2003 on the aid scheme implemented by Belgium for coordination centres established in Belgium [2003] OJ L282/25; Commission Decision 2003/515/EC of 17 February 2003 on the State aid implemented by the Netherlands for international financing activities [2003] OJ L180/52, 18 July 2003; Commission Decision 2003/27/EC of 11 July 2001 on the State aid scheme implemented by Spain for firms in Vizcaya in the form of a tax credit amounting to 45% of investments [2003] OJ L17/1; Commission Decision 2005/77/EC of 30 March 2004 on the aid scheme implemented by the United Kingdom in favour of Gibraltar Qualifying Companies [2005] OJ L29/24. See also: A. Biondi, P. Eeckhout and J. Flynn, *The law of state aid in the European Union*, 1st edn (Oxford: OUP, 2004), 60–61.

<sup>92</sup> *Italian Republic v Commission of the European Communities* (C-173/73) [1974] ECR 709 at [15]; *Kingdom of Belgium v Commission* (C-75/97) [1999] ECR I-3671 at [33]–[34]; *Kingdom of the Netherlands v Commission* (C-159/01) [2004] ECR I-4461 at [42]; *Portuguese Republic v Commission of the European Communities (Portuguese Republic)* (C-88/03) [2006] ECR I-7115 at [81]; *Unicredito Italiano SpA v Agenzia delle Entrate, Ufficio Genova 1 (Unicredito Italiano)* (C-148/04) [2005] ECR I-11137 at [51]; *British Aggregates Association v Commission* (C-487/06 P) [2008] ECR I-10515 at [76]; *Italian Republic v Commission* (T-211/05) [2009] ECR I-2777 at [125].

<sup>93</sup> Commission’s 1998 Notice, above fn.38, para.23.

<sup>94</sup> Commission’s 1998 Notice, above fn.38, para.26.

<sup>95</sup> *Portuguese Republic* (C-88/03), above fn.92, [2006] ECR I-7115, Opinion of Advocate General Geelhoed, 20 October 2005 at [76].

efficiency of tax collection which, as Advocate General Geelhoed's opinion above shows, is recognised as an objective inherent in the tax system. On the basis of this, co-operative compliance programmes are capable of being justified by the nature and general scheme of the tax system.

In its recent case law the CJEU has, however, clarified that even if a measure can be justified by the nature or general scheme of the tax system, it also has to comply with the principle of proportionality. As stated in *Paint Graphos*

“it is necessary to ensure compliance with the requirement that a benefit must be consistent not only with the inherent characteristics of the tax system in question but also as regards the manner in which that system is implemented”.<sup>96</sup>

Thus, the measure has to be suitable and should not go beyond what is necessary to achieve legitimate objectives.<sup>97</sup> In this context, the question whether co-operative compliance programmes are appropriate measures to achieve their stated goals has to be considered. Here again, the most doubtful issue is whether or not the quantitative criterion that most co-operative compliance regimes apply to determine the eligibility of taxpayers is suitable and necessary to achieve the purpose of improving the effectiveness and efficiency of tax collection. Even if it were to be accepted that only large business taxpayers should be covered by co-operative compliance programmes due to the features that differentiate them from other taxpayers (more complex transactions, higher probability of engaging in aggressive tax planning, the large amount of tax that they pay), how best to define large business taxpayers and thus circumscribe the personal scope of co-operative compliance programmes is open to dispute. If this definition is arbitrary, the co-operative compliance programme is at risk of being considered disproportional.

#### (iv) Selectivity due to the discretion of the tax administration

Another factor that has to be taken into consideration when assessing the selectivity of co-operative compliance models under the state aid rules is the question how and in which form the eligibility criteria for participating in such programmes are to be defined and communicated to the taxpayers. As discussed above, most of the programmes are introduced not through legislation but through administrative practice. In this respect, the question can be raised as to whether or not the discretion which is exercised by the tax administration in taking such a decision can lead to selectivity. The question is legitimate in the light of the established case law of the Court according to which a measure under which a public authority

“enjoys a degree of latitude which enables it to adjust its financial assistance having regard to a number of considerations such as, in particular, the choice of beneficiaries, the amount of financial assistance and the conditions under which it is provided”<sup>98</sup>

is liable to favour certain undertakings at the cost of others and as such constitutes state aid. When the tax administration defines the criteria the fulfilment of which is necessary for taxpayers to join a co-operative compliance programme, it makes a choice of the beneficiaries and determines the conditions under which the assistance in the form of a favourable framework of

<sup>96</sup> *Paint Graphos* (Joined Cases C-78/08 to C-80/08), above fn.71, [2011] ECR I-7611 at [73].

<sup>97</sup> Mischeau, above fn.85, 251.

<sup>98</sup> *French Republic v Commission of the European Communities* (C-241/94), above fn.37, EU:C:1996:353 at [23]–[24].

tax procedure and administration is provided. However, it is to be noted that the Court refined the case law concerning administrative discretion in the recent *P Oy* case<sup>99</sup> where it held that an authorisation system under which the tax administration can decide on the grant of certain benefits is not, in principle, selective (that is, its justification is not precluded) when under such a system the tax administration exercises a degree of latitude which is limited by objective criteria which are not unrelated to the tax system.<sup>100</sup> This statement does not require that the objective criteria which circumscribe the discretion of the tax administration must be laid down in legislation. Thus, it can be inferred that the tax administration can formulate such criteria itself and as long as it applies them in a consistent way thereby creating a generally followed practice (and the criteria are not unrelated to the tax system), the degree of discretion involved in such exercise will not result in selectivity. This was precisely the case in *P Oy* where the tax administration issued administrative guidelines on the conditions under which loss carry forward in the case of change of ownership in a company could be authorised. The only reason why the Court found this system selective was that the administrative guidelines contained criteria which were unrelated to the tax system (for example, maintaining employment). It can be inferred from this case that selectivity is entailed in an arbitrary and ad hoc exercise of discretion by the tax administration which enables the tax administration to favour certain taxpayers while not granting the same favourable treatment to others in an objectively similar situation. Hence, general administrative guidelines which are consistently followed by the tax administration and which lead to the formulation of a predictable practice cannot be challenged under the state aid rules.

With regard to co-operative compliance programmes this means that the conditions of such programmes should be sufficiently clear and objectively defined in advance if not in legislation then in a general administrative instrument. Laying down the framework of the programme, the conditions for participation, the content of the programme and the rights and obligations of the parties in a generally applicable administrative instrument, for example, in a ministerial decree or in guidelines of the ministry or the tax administration, is important in order to avoid the situation where the tax administration would be considered to have too much discretion, not limited by objective criteria, in deciding who can join the programme, what benefits the participants receive and which obligations they are subject to. As the case law discussed above suggests, such overly broad discretion for a public authority can create state aid in itself. Even if the general conditions of joining the programme are laid down in a publicly available administrative instrument while the selection of the actual participants is made by the tax administration on a hand-picked basis and, as a result, not all those who meet the general conditions are permitted to enter the programme, such a system would lead to selectivity. However, if such a selection method is part of a pilot programme, the temporary and experimental nature of the pilot programme may justify it.<sup>101</sup>

<sup>99</sup> *P Oy* (C-6/12), above fn.71, EU:C:2013:525; [2014] 1 CMLR 15.

<sup>100</sup> *P Oy* (C-6/12), above fn.71, EU:C:2013:525; [2014] 1 CMLR 15 at [26]. See also: M. Lang, P. Pistone, J. Schuch, C. Staringer and A. Storck (eds), *ECJ—Recent Developments in Direct Taxation 2014*, 1st edn (Linde Verlag Wien, 2015), 107; M. Lang, “Tax Rulings and State Aid” [2015] BTR 394.

<sup>101</sup> As is often expressed in the literature describing pilot programmes, their purpose is to test the concept and try to find the best tailored design. For example, K. Bronżewska and V. Tamburro explained with respect to the Italian pilot: “The limited Pilot will give the parties the possibility to try out a certain solution and to find the right approach that suits the Italian culture and tax system.” See more in K. Bronżewska and V. Tamburro, “Cooperative Compliance in

In addition, the transparency of the conditions of the programme must be ensured by making them available and accessible to the public. A lack of transparency as regards the conditions upon which co-operative compliance programmes can be joined could create a suspicion that the programmes involve secretive deals offered only to privileged taxpayers.

#### (v) Misuse of co-operative compliance programmes

Another case in which co-operative compliance could lead to selective advantages being granted to the participating taxpayers would be if, under the veil of the programme, the tax administration were to apply the law to the participating taxpayers in a favourable way, that is, the administration derogates from the general tax rules, which leads, as a result, to the reduction of the tax burden of these taxpayers and a loss of tax revenue for the state. As mentioned above regarding rulings, such a derogatory application of the law constitutes an advantage under the state aid rules which involves a transfer of state resources to the beneficiary and which would also qualify as a selective measure, as it would hardly be possible to maintain that such a measure is suitable and necessary that is, proportional, to the aim of facilitating tax enforcement vis-à-vis large business taxpayers and thus justified.

In such a case, however, state aid would be granted in the form of individual administrative measures adopted in the framework of co-operative compliance but this would not be due to the fact of having a co-operative compliance programme in place.<sup>102</sup> The verification of aid being granted in such a way could be very difficult, as the tax administration will not necessarily give a formal confirmation of the derogatory application of the law in the form of a ruling, since informal assurances and deals with participating taxpayers would have the same effect. A trust-based relationship between the tax administration and the taxpayer can be rather easily misused or abused by obtaining such “sweetheart deals”. Ideally, this problem could be addressed by implementing high standards of internal governance within the tax administration. The aim which needs always to be at the forefront when administering co-operative compliance programmes is—as the OECD explained—to ensure that the tax administration

“continues to deal with taxpayers in a way that ensures an equality of outcomes, even if the way in which those outcomes are achieved varies in response to the regulatory attitude of the taxpayer”.<sup>103</sup>

Italy — Does it Stand a Chance?” (2013) 53(12) Eur. Taxn. 595. Similarly E.M. Schrittwieser and H. Woischitzschlägerm about the Austrian pilot: “Das Projekt Horizontal Monitoring wird bis Ende Juni 2016 dauern und bei positiver Evaluierung als eine neue Aufsichtsmaßnahme der Finanzverwaltung auf partnerschaftlicher Basis umgesetzt werden. Sollte sich in der praktischen Arbeit herausstellen, dass auch (verfahrensrechtliche) Gesetzesänderungen erforderlich sind, wird auch dies als Ergebnis des Projekts aufgezeigt werden.” See more in: Schrittwieser and Woischitzschlägerm, above fn.27; Bundesministerium für Finanzen, *Horizontal monitoring: Evaluationsbericht*, above fn.28.

<sup>102</sup> Similarly Lang regarding the case when advance rulings are used for the purpose of granting aid by derogating from the generally applicable law. See Lang, above fn.100, 395.

<sup>103</sup> OECD, above fn.4, 65.



*(d) Effect on intra-Union trade and distortion of competition*

The assessment of “effect on intra-Union trade” and “distortion of competition” does not involve an in-depth examination. Most of the time it is taken for granted that these conditions are met as soon as a measure is found to be selective. The CJEU held that

“it is necessary, not to establish that the aid has a real effect on trade between Member States and that competition is actually being distorted, but only to examine whether that aid is liable to affect such trade and distort competition”.<sup>104</sup>

There is an effect on intra-Union trade “when State financial aid strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade”.<sup>105</sup> Given the wide scope of potential reasons for distortion of competition, it is assumed that whenever a state grants a financial advantage to an undertaking where there is, or could be, competition, then competition is distorted.<sup>106</sup>

In the case of co-operative compliance programmes, beneficiaries are business taxpayers, mostly multinationals, operating in several countries and competing with other market participants. If benefits granted under co-operative compliance programmes meet the other conditions of state aid, they would surely be found to affect intra-Union trade and distort competition in the internal market.

## 6. Conclusions

Co-operative compliance programmes are aimed at improving the effectiveness and efficiency of tax administration and tax compliance. In comparison to other initiatives aimed at increasing tax certainty and transparency, they have a lot to offer not only to tax administrations but also to taxpayers. As such, they could have an important part to play in delivering better tax compliance outcomes while avoiding the disputes that many fear will arise in the aftermath of the BEPS project. However, in order to make use of the full potential of co-operative compliance, tax administrations which consider introducing it must be aware of the limits imposed by the national or EU legal framework upon the design of co-operative compliance regimes.

Due to the fact that co-operative compliance programmes are accessible only to a certain group of taxpayers, mainly large corporations, and that they offer to the latter a more favourable treatment than regular tax procedures, such programmes are inherently suspicious under the EU state aid rules. Given the EU Commission’s use of the state aid rules for the purpose of challenging the allegedly favourable tax treatment that some multinationals obtained in the form of advance rulings from certain EU Member States, it is not at all unlikely that co-operative compliance programmes may also soon come under scrutiny in light of the state aid rules. In addition, the

<sup>104</sup> *Air Liquide Industries Belgium* (Joined Cases C-393/04 and C-41/05), above fn.37, [2006] ECR I-5293 at [34]–[36]; *Italy v Commission* (C-372/97) [2004] ECR I-3679 at [44]; *Italy v Commission* (C-66/02) [2005] ECR I-10901 at [111]; *Unicredito Italiano* (C-148/04), above fn.92, [2005] ECR I-11137 at [54].

<sup>105</sup> *Philip Morris Holland BV v Commission* (C-730/79) [1980] ECR 2671 at [11]; *Regione Friuli Venezia Giulia v Commission of the European Communities* (T-288/97) EU:T:2001:115 at [41].

<sup>106</sup> Commission of the European Communities, *Report on the implementation of the Commission notice on the application of the state aid rules to measures relating to direct business taxation*, 9 February 2004, C(2004) 434, at para.22.

nature of co-operative compliance in which the tax administration and the taxpayer co-operate in a trust-based relationship which involves an ongoing discussion about the taxpayer's tax positions can, in principle, make co-operative compliance a breeding ground for special "sweetheart" deals for large corporations participating in co-operative compliance programmes.

Even if co-operative compliance programmes involve an advantage within the meaning of the state aid concept, that is, the overall reduction of the compliance costs of participating taxpayers, as long as such advantage does not amount to a consumption of state resources, the programme cannot qualify as state aid. Most programmes do not transfer any state resources to participants, as they are limited to procedural benefits. On the other hand, if participation in the programme resulted in the reduction of the tax burden of these taxpayers and a loss of tax revenue for the state, the tax administration's practice under the co-operative compliance programme would constitute state aid.

With regard to the criterion of selectivity, a co-operative compliance model can be regarded as a derogation from the general rules of tax procedure. It aims to offer improved and advance certainty and decreased compliance costs; overall a smoother procedure for administering taxes. Moreover, it is designed only for a selected group of the largest business taxpayers. As a general rule, a co-operative compliance programme will not be found to be selective state aid if the different treatment it entails is in accordance with the objective of the tax procedural system (that is, effective administration and enforcement of tax rules) and is applied equally to all taxpayers that are in a legally and factually comparable situation. Although there are grounds to argue that large business taxpayers are not in a comparable situation with medium or small-sized business taxpayers—as they enter into more complex transactions, are more prone to engage in sophisticated tax planning and pay a much larger proportion of corporate income tax revenue than the latter—this in itself may not suffice to save co-operative compliance programmes from being considered as selectively favouring those large taxpayers eligible to participate in them. It also has to be ensured that such programmes define eligible taxpayers in a non-arbitrary manner. The authors believe that programmes based on pure quantitative criteria (for example, volume of turnover), which designate large business taxpayers as eligible taxpayers without any further requirement, may not withstand the test of selectivity. Qualitative criteria, for example a good track record of past tax compliance, having an internal control framework in place, complexity of structure and transactions carried out, are sounder even when applied in combination with quantitative factors.

In summary, if co-operative compliance programmes are limited to procedural benefits not involving any transfer of state resources to the participants and if they define the scope of eligible taxpayers in a non-arbitrary way, which is explicable in the light of the objective of the tax procedural system, the risk that such programmes could be challenged under the state aid rules is rather low. If these guidelines are observed, tax administrations in the EU should not be wary of introducing a form of co-operative compliance model as another tool in the continuing efforts to achieve better tax compliance and greater tax transparency. <sup>13</sup>

<sup>13</sup> Compliance; Co-operation; EU law; State aid; Tax administration