



European Foundation

For democracy & freedom

Briefing on State aid

The Withdrawal Agreement's State aid rules mean increasing EU control over UK taxation

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1. Control over State aid is becoming control over domestic taxation

- a. The European Commission has direct executive power to approve (or not) State aid granted by the Member States. This is an intrinsically political process entrusted to the Commission: State aid is an example of the Commission exercising direct executive authority.
- b. State aid was originally aimed at controlling competition between Member States via direct and indirect industrial subsidies, with the Commission acting as referee. This is a **coherent idea in a customs union** since no state can use countervailing tariffs to protect against subsidisation by another.
- c. The Withdrawal Agreement contains very **intrusive provisions on State aid**, however, especially given the lack of incentive for the EU to release the UK from the potentially indefinite backstop (it would need to agree to do this).
- d. The EU sees this as essential to any free trade agreement as part of “level playing field” provisions, and the **UK government appears not to have regarded this as contentious** in the negotiations.
- e. State aid is overseen by the ECJ. The **definition of State aid has been expanded by ECJ judgments** (therefore so too has the ECJ's jurisdiction, and that of the European Commission). In tax policy especially, the Commission has been unable to get agreement on tax harmonisation, but stretched State aid rules now achieve a similar objective.
- f. The **definition of a “selective” advantage in tax through State aid** (vs. a general tax rule outside State aid control) **has been broadened dramatically**. It now includes, for instance, tax breaks to encourage particular behaviour by companies. The prevailing corporation tax rate, for example, is a general measure, and outside State aid control. A corporation tax holiday for a particular company meanwhile would be specific and qualify as State aid. The approach to this vital concept of “selectivity” has been relaxed by the ECJ however, hence the broadening of the measures falling into the definition of State aid.

- g. Indications of this appeared as early as 1998, when the *Aéroports de Paris vs. the Commission* case expanded the concept of State aid to potentially cover infrastructure spending which could be economically exploited. Previously, it was open to Member States to build without Commission approval, provided the *operation* of infrastructure was not subsidised.
- h. The recent World Duty Free case – relating to Spanish tax – decided that the rules could be used to control taxes not only that benefit a particular class of people who fit certain criteria (e.g. energy companies), but a **class that people can select into** (i.e. who simply decide to do certain things, or do them in a certain way), i.e. a feature of virtually all tax measures. In this case, Spanish “companies undertaking overseas acquisitions” were deemed a class that triggered State aid control, as it excluded Spanish companies that had not resolved to make overseas acquisitions. The ECJ decided that the fact a measure was generally available to any company that bought a stake in a foreign company was irrelevant. Selectivity meant whether specific *behaviours* were treated in a similar way.
- i. This allows the control via State aid of **very large areas of UK fiscal policy**: the UK could be, in principle, unable to reduce tax for a particular sector, e.g. finance, to make it more competitive.

2. The role of the backstop

- a. Under the backstop, the UK is committed not just to non-regression, but to **continued harmonisation** with the EU, but **without representation** in its institutions. The backstop also grants the **Commission executive power in Northern Ireland** over State aid approval. The Commission’s power in Northern Ireland opens the possibility of parallel investigations by the UK and the Commission into almost any State aid in the UK. This means that if the supervision powers below fail, the Commission may simply take direct oversight over GB aid on the basis that it may “affect NI/EU trade”.
- b. The backstop also grants the Commission extensive powers **to supervise the UK Competition and Markets Authority (CMA)**, which must submit its decisions in draft to the Commission, which then comments within three months (a period the Commission may extend by seeking additional information, which it often does, taking a year or more).
- c. The Commission also has the power to impose unspecified “interim measures” if the CMA does not conform to the Commission’s preferred approach.

3. The UK appears already a special target – but the alternative is a bilateral agreement with reasonable thresholds

- a. Negotiators from BEIS seem to have assumed in negotiating the State aid provisions in the Withdrawal Agreement that their friendly working relationship with the Commission as a well-respected Member State with a reputation for compliance will be an adequate safeguard against overreach.
- b. However, reports suggest that a majority of the Commission’s State aid enforcement personnel have now been diverted onto UK cases. As supervision intensifies, formal cases

can be brought against the UK during the transition. Under the Withdrawal Agreement, the Commission will retain full jurisdiction over such cases – regardless of how long they take. As the UK loses its vote in the EU institutions, **it is becoming a target for EU officials, over whose actions we will have no control.** The Commission can pursue the UK with no adverse political consequences, despite the fact that the UK has one of the best (if not the best) record of State aid compliance in the EU.

- c. After the Withdrawal Agreement comes into force, the UK will have no serious leverage. There is no reason for the Commission to agree to a trade arrangement beyond the backstop which does not replicate the control the Commission has over State aid in the current Withdrawal Agreement. This control is **far more extensive than commonly appreciated**, and will increasingly allow the Commission straightforward control over UK fiscal policy – especially with respect to fiscal changes that the UK could introduce to improve its competitive position.
- d. Instead of the one-sided prescriptions of the Withdrawal Agreement, State aid controls in a trade agreement should be bilateral. This means each side will have the right to employ remedies against the other, but using a process that is independent, and an intervention threshold that requires evidence of a distortive effect on trade and competition.