EFTA SURVEILLANCE AUTHORITY

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EFTA SURVEILLANCE AUTHORITY DECISION

OF 7 FEBRUARY 1996

TO PROPOSE APPROPRIATE MEASURES TO ICELAND
WITH REGARD TO STATE AID IN THE FORM OF
SECTORALLY DIFFERENTIATED SOCIAL SECURITY TAX
(AID NO. 93-386)

THE EFTA SURVEILLANCE AUTHORITY,

Having regard to the Agreement on the European Economic Area[1], in particular to Protocol 26 and to Articles 61 to 63 of the Agreement,

Having regard to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice[2], in particular to Article 24 and Article 1(1) of Protocol 3 thereof,

WHEREAS:

I. FACTS

1. Introduction

Article 1(1) of Protocol 3 to the Surveillance and Court Agreement provides that "the EFTA Surveillance Authority shall, in cooperation with the EFTA States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the EEA Agreement."

By letters of 12 September 1994 and 16 November 1994 the EFTA Surveillance Authority requested the Icelandic authorities to submit full details on the existing system of social security tax in Iceland ("*tryggingagjald*"), in particular the reduced rate of this tax for certain sectors, as there was reason to believe that this system might constitute State aid in the meaning of Article 61(1) of the EEA Agreement.

[1] Hereinafter referred to as the EEA Agreement.
[2] Hereinafter referred to as the Surveillance and Court Agreement.

The Icelandic authorities responded to this request by letter from the Ministry of Finance dated 28 November 1994. The matter has also been discussed at meetings on several occasions, i.a. at the meetings on the review of existing state aid in Iceland held in Reykjavík on 2 March 1995 and again on 19 June 1995.

In these discussions the Authority has noted that a number of cases dealt with by the EC Court of Justice and the European Commission involve, to various degrees, issues of the kind present in this case.[3]

Following the meeting on 19 June 1995, the President of the EFTA Surveillance Authority has by letter of 14 July 1995 (Doc. no. 95-4252 D) written to the Icelandic authorities, informing of the examination of the case by the Authority's Competition and State Aid Directorate and the Directorate's preliminary view that it would foresee a need for adjusting the system in order to bring it into line with the State aid provisions of the EEA Agreement.

Furthermore, the Authority has on 5 September 1995 received a complaint from an interested party alleging that the differentiated social security tax in Iceland involves State aid incompatible with the EEA Agreement.

2. Relevant provisions of the legislation on the Social Security Tax

The Act no. 113/1990 on the social security tax ('Lög um tryggingagjald'), as subsequently amended by Acts no. 111/1992, 122/1993, 74/1994, 32/1995 and 141/1995, provides that employers, as well as self-employed persons, shall pay a tax to be levied on all kinds of wages, salaries and emoluments for any kind of activity as specified under Article 6 of the Act.

According to Article 1 of the Act, as amended by Act no. 141/1995, the tax is composed of two parts, the general social security fee ("almennt tryggingagjald") and the employment insurance fee ("atvinnutryggingagjald").

Article 2 provides that the employment insurance fee shall be levied at a uniform rate on all economic operators taxable under the law, currently at the rate of 1,5% of taxable wages and salaries. The same Article also provides for annual review of this tax rate, taking account of the financial results of the Unemployment Insurance Fund

[3]See e.g. the following judgements and decisions:
ECJ, 10.12.1969, Joined Cases 6 and 11/69, Commission of the European Communities v French Republic
ECJ, 2.7.1974, Case 173/73, Italian Government v Commission of the European Communities
ECJ, 14.7.1983, Case 203/82, Commission of the European Communities v Italian Republic
ECJ, 17.3.1993, Joined Cases C-72/91 and C-73/91, reference to the Court under Article 177 of the EEC Treaty by the Arbeitsgericht Bremen for a preliminary ruling in the proceedings pending before that court between Sloman Neptun Schiffahrts AG and Seebetriebstrat Bodo Ziesemer der Sloman Neptun Schiffahrts AG, see in particular the opinion in this case of Advocate General Darmon delivered on 17.3.1992
Commission Decision of 25 July 1973, OJ No. L. 254/14
Commission Decision of 15 September 1980, OJ No. L. 264/28
Commission Decision of 2 March 1988, OJ No. L. 143/37
Commission Decision of 1 March 1995, OJ No. L. 265/23.

("Atvinnuleysistryggingasjóður"). However, the rate of this fee can only be amended by an amendment of the legislation.

As for the general social security fee, Article 2 provides that this shall be levied in two rates, a general rate of 5,35% and a special rate of 2,05%. Combined, i.e. adding the general social security part and the employment insurance part, the social security tax is therefore levied at a general rate of 6,85% and a special rate of 3,55%. References to tax rates shall hereinafter be understood to mean these two combined tax rates last referred to.

The higher (general) tax rate is applied to all economic sectors subject to the tax except the following:

1. Fisheries, fish processing and manufacturing under groups 1, 2 and 3 in the Classification of Industrial Activity issued by the Statistical Bureau of Iceland.
2. Agriculture.
3. Computer software industry, film industry, hotel accommodation, restaurants and car hire.

The sectors enumerated above are eligible for the lower (special) tax rate. The legislation in other words provides for sectoral reduction or differentiation in the tax rate, in favour of the above sectors.

According to Article 3 of the Act no. 113/1990, the proceeds from the employment insurance part of the tax are allocated to the Unemployment Insurance Fund, whereas revenues from the general social security fee are appropriated to the Occupational Safety and Health Administration (0,08% of the taxbase) and the State Social Security Institute, to finance social security pensions and accident insurance under social security schemes.

3. Submission by the Icelandic authorities

The Icelandic authorities have clarified the background to the Act no. 113/1990 by explaining that the social security tax, which was first applied to wages and salaries from the beginning of 1991, replaced the payroll tax and several small levies. The payroll tax was 3,5% of wages and salaries, but did not apply to agriculture, fisheries and manufacturing. On the other hand these branches were subject to the other wage and insurance levies, thus paying in effect 2,5% in wage-related levies, as compared to 6% for sectors also liable to the payroll tax. The differentiation in tax rates under the social security tax have thus been carried over from the previous legislation on the payroll tax.

The Icelandic authorities indicate that when determining the different tax rates, account was taken of the fact that the proportion of wages and salaries to turnover differs from one activity to another, and that the proportion is generally higher in branches which are eligible

for the lower rate. According to the Icelandic authorities it could thus be argued that the differences between the actual tax burden of activity under the two tax rates is not as large as the tax rates themselves would indicate.

It is also claimed by the Icelandic authorities that the largest portion of the tax revenue collected under the lower levy is paid by branches which do not come under Article 61 of the EEA Agreement. In this context the Icelandic authorities refer to agriculture and fisheries.

Furthermore, the Icelandic authorities have submitted that although the different tax rates are not tied to particular regions of the country or particular projects, the fact that agriculture and fisheries come under the lower levy would appear to indicate that regional considerations were taken into account when the two tax rates were determined.

Apart from the above consideration the Icelandic authorities have not explicitly expressed what are the objectives of the sectoral differentiation of the tax rate.

II. APPRECIATION

Article 61(1) of the EEA Agreement provides that "Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States 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 Contracting Parties, be incompatible with the functioning of this Agreement".

The measure under consideration, which is the reduced (special) tax rate in favour of certain economic sectors, is a part of the central authorities' tax legislation, the tax being intended to finance publicly administered insurance schemes, and therefore evidently channelled "through State resources" in the meaning of Article 61(1) of the EEA Agreement.

The measure favours i.a. sectors (e.g. manufacturing industries and service sectors susceptible to external competition) which are covered by the EEA Agreement and are engaged in the production of goods and provision of services, which are extensively traded within the territory covered by the EEA Agreement. The measure is therefore deemed to be liable to affect trade between Contracting Parties.

As the wording of Article 61(1) suggests, distortion of competition may occur when a measure favours certain enterprises or the production of certain goods. The main criterion for distinguishing state aid from a general economic measure is in other words whether or not the measure is selective in nature. The selectivity criterion is normally considered to be fulfilled i.a. when a measure favours a certain industry or industries, as opposed to other industries or economic sectors, which do not benefit from the measure.

A measure, as the one under consideration, which favours certain sectors by derogating from a general tax system, has to be regarded as constituting state aid, unless, in exceptional circumstances, the measure might be justified by the nature and general scheme of the system. In the case at issue, the Icelandic authorities have not provided evidence of any such exceptional circumstances.

As mentioned above the Icelandic authorities have contended that the different tax rates may to a certain extent be justified by differences from one sector to another in the ratio of wages and salaries to turnover. Although the Icelandic authorities have not provided statistical evidence of this, it is undoubtedly correct that the ratio of wages and salaries to turnover differs from one sector to another and that this leads to different tax burdens, when measured in relation to turnover. However, this argument raises the following questions. Firstly, the statistical evidence available to the Authority does not give conclusive support for the claim that wage ratios are, as a rule, higher in sectors eligible for the lower tax rate. When comparing wage ratios between sectors the result is also dependent on at what level of aggregation sectors are defined. Secondly, it is questionable whether turnover is an appropriate denominator in this sort of comparison. It can be argued that value-added would be a more relevant denominator. This view is supported by the fact that value-added tax is generally acknowledged to be a more neutral tax system than turnover taxes. It is finally noted that the European Commission and the EC Court of Justice have, in cases of a similar nature, concluded that differentiated social security contributions involve State aid, without apparently seeing reason to consider differences in the ratio of wages and salaries to turnover. The above argument of the Icelandic authorities therefore does not support the conclusion that the sectoral differentiation in the social security tax in Iceland does not involve systematic favouring of the sectors eligible for the lower tax rate.

Consequently, it is concluded that the preferential tax rate (special rate) applied to certain economic sectors covered by the EEA Agreement, constitutes State aid in the meaning of Article 61(1) of the EEA Agreement.

As mentioned above the Icelandic authorities have not expressly stated what is the objective of maintaining the special (lower) tax rate in favour of certain economic sectors. From the available evidence it would appear that the primary objective and at any rate the main economic effect of the system is to relieve enterprises in certain economic sectors of part of the tax burden, which they otherwise would have to carry, and thus to enhance their competitive position.

It shall be noted that the aid is granted automatically to all enterprises eligible for the special tax rate and without any requirements or conditions which would provide a compensatory justification for the aid, i.e. ensuring that the aid facilitates the development of certain economic activities, in the meaning of Article 61(3)(c) of the EEA Agreement.

It shall furthermore be noted that the aid is unlimited in time.

Aid of the above character, which simply has the effect of reducing labour costs without meeting specific objectives, is to be regarded as operating aid. The EFTA Surveillance Authority has on several occasions, in particular in its Procedural and Substantive Rules in the Field of State Aid[4] (State Aid Guidelines), declared its reservations in principle as to the compatibility of operating aid with the functioning of the EEA Agreement. In this respect the Authority has taken the view that it can, as a rule, only authorize operating aid in specific circumstances and subject to certain conditions when it concerns aid qualifying for the exemption in Article 61(3)(a) of the EEA Agreement to promote the economic development of certain geographical areas. This policy corresponds to a well established policy by the EU Commission, which has been upheld in several judgements by the EC Court of Justice.

As has been stated above the aid measure under consideration is not expressly an instrument of regional policy. Furthermore, even if that were the case, the information provided by Iceland for determining eligibility for regional aid under Article 61(3) of the EEA Agreement does not provide evidence that any region in Iceland would qualify for such aid under Article 61(3)(a). As to the possibility of applying the provisions of Chapter 28.2.3.2 of the State Aid Guidelines on regional transport aid under Article 61(3)(c) of the EEA Agreement, it is noted that nothing indicates that these provisions would be relevant in the present case.

For the above reasons it is concluded that the aid measure under consideration is incompatible with the functioning of the EEA Agreement.

HAS ADOPTED THIS DECISION:

1. The EFTA Surveillance Authority proposes to Iceland, on the basis of Article 1(1) of Protocol 3 to the Surveillance and Court Agreement, the following appropriate measures with regard to the State aid involved in the system of sectorally differentiated rates of social security tax:

(i) The Icelandic Government shall take the necessary steps to effect adjustment of the relevant provisions of the legislation on the social security tax ("Lög nr. 113/1990, um tryggingagjald, með síðari breytingum") in such a manner as to remove, in so far as sectors covered by the relevant provisions of the EEA Agreement are concerned, the present sectoral differentiation in the rates of the social security tax.

(ii) The legislative amendments referred to in point 1(i) above shall enter into force not later than 1 January 1997.

[4]Procedural and Substantive Rules in the Field of State Aid. Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement and Article 1 of Protocol 3 to the Surveillance and Court Agreement. Initially adopted on 19 January 1994 and published in OJ No. L 231, 3.9.94.

(iii) The Icelandic authorities shall inform the EFTA Surveillance Authority in due time and in any case not later than 1 October 1996 of the measures to be taken.

(iv) The Icelandic Government shall signify its agreement to the above proposal or otherwise submit its observations by 20 March 1996.

Done at Brussels, 7 February 1996

For the EFTA Surveillance Authority

Knut Almestad
President

Björn Friðfinnsson
College Member