


EFTA SURVEILLANCE AUTHORITY

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EFTA SURVEILLANCE AUTHORITY DECISION

of 6 December 2001

to open the formal investigation procedure provided for in Article 1(2) of Protocol 3 to the Surveillance and Court Agreement on the taxation of International Trading Companies in Iceland

(ICELAND)

THE EFTA SURVEILLANCE AUTHORITY,

HAVING REGARD TO the Agreement on the European Economic Area¹, in particular to Articles 61 to 63 and to Protocol 26 thereof,

HAVING REGARD TO the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice², in particular to Article 24 and Article 1 of Protocol 3 thereof,

HAVING REGARD TO the Authority's State Aid Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement, in particular to Chapter 17B thereof³,

WHEREAS:

I. FACTS

1. Procedure

By letter dated 28 July 2000 (Doc. No: 00-4830-D), the EFTA Surveillance Authority informed the Icelandic Government that it had become aware that Iceland had introduced a bill offering favourable tax treatment for International Trading

¹ Hereinafter referred to as the "EEA Agreement".

² Hereinafter referred to as the "Surveillance and Court Agreement".

³ Guidelines on the application and interpretation of Article 61 and 62 of the EEA Agreement and Article 1 of Protocol 3 to the Surveillance and Court Agreement, adopted and issued by the EFTA Surveillance Authority on 19 January 1994, published in OJ 1994 L 231, EEA Supplements 03.09.94 No. 32, last amended on 28 November 2001 (not yet published) hereinafter referred to as the "Authority's State Aid Guidelines".

Companies (ITCs). It also informed the Icelandic Government that, on the basis of the information made available to the Authority, the Competition and State Aid Directorate was of the view that the tax treatment of ITCs may imply State aid in the meaning of Article 61(1) of the EEA Agreement. The Authority requested the Icelandic Government to submit comments and to provide all information necessary to reach a conclusion on the question, whether the Icelandic tax measures for ITCs are compatible with Article 61 of the EEA Agreement.

By letter dated 24 October 2000 (Doc. No: 00-7751-A), the Icelandic Government provided the requested information and submitted its comments. According to the letter, the Icelandic Government was of the view that the ITC legislation did not confer any rights or advantages to a selective group of companies and thus, did not contain aid which would fall within the scope of Article 61 of the EEA Agreement.

By letter dated 24 July 2001 (Doc. No: 01-5609-D), the Authority informed the Icelandic Government that the Competition and State Aid Directorate was of the preliminary view that the tax measures concerning ITCs may imply State aid within the meaning of Article 61(1) of the EEA Agreement. If the Icelandic Government would not be able to remove the doubts the State Aid Directorate had, concerning the compatibility of the tax measure for ITCs, the Directorate would feel obliged to propose that the Authority opens an investigation procedure as provided for in Article 1(2) of Protocol 3 to the Surveillance and Court Agreement. The Icelandic Government was invited to submit comments on the matter within two months of receipt of the letter.

By letter dated 20 September 2001 (Doc. No: 01-7477-A), the Icelandic Government submitted its view on the compatibility of the tax measures concerning ITCs. According to the letter, the Icelandic Government was of the view that the tax regime as regards ITCs did not constitute State aid.

2. Legislation and taxation of ITCs

According to the Act No. 31 of 10 March 1999 on ITCs, ITCs have to be public limited or private limited companies. Commencement of the operation of an ITC requires the issuing of an operating license. The Act limits which activities an ITC can engage in. ITCs can engage in the following activities:

- Trade in its own name with foreign entities outside Iceland, or as an intermediary in such trading, in goods which are not covered by the EEA Agreement and which do not originate in Iceland.
- Act as an intermediary in the trading of services between foreign entities outside Icelandic jurisdiction.
- Operate as a holding company that owns and invests in foreign enterprises, or intangible assets, officially registered outside of Iceland, such as trade marks, patents, design rights and publishing rights.
- Own or control and register aircrafts and vessels other than fishing vessels in Iceland, provided that such aircrafts and vessels are only used for activities in which ITCs are permitted to be engaged.
- Own or control and register aircrafts or vessels other than fishing vessels in Iceland, and lease or sub-lease to foreign entities for transport outside Icelandic jurisdiction.

- It may not trade in its own name neither in goods with parties in Iceland nor with parties outside Iceland, nor may it serve as an intermediary in such trading and, it may not process goods in Iceland partly or fully.

According to the information submitted, ITCs are taxed differently than other undertakings with limited liability. As the Authority understands, the differences are:

- The corporate income tax at 5 per cent instead of the general tax rate of 30 per cent.
- ITCs are exempted from net wealth tax. Normally Icelandic companies are subject to a net wealth tax of 1,2 per cent.
- ITCs are partially exempted from stamp duty.
- To receive an operating licence, the ITCs are subject to a charge of ISK 100 000. They are also subject to an annual surveillance charge of ISK 100 000 which other undertakings are not subject to.
- Special rules apply to taxation of dividends from an ITC to an Icelandic resident shareholder. The general rule on taxation of dividends in Iceland is that dividends paid from a limited liability company to another company are tax exempted, but dividends paid to individuals are taxed by a final withholding tax of 10 per cent. If the company, which pays dividends, is an ITC, the recipient must pay the income tax in full whether it be an individual or a limited liability company.

3. Comments submitted by the Icelandic Government

The Icelandic Government argues in its letters, dated 24 October 2000 (Doc. No: 00-7751-A) and 20 September 2001 (Doc. No: 01-7477-A), that the mere fact that different tax regimes exist for different forms of undertakings, cannot in itself form a basis for a presumption that such different treatment constitutes aid. It emphasised that the Icelandic tax regime, as regards ITCs, is neither sector-specific nor does it favour certain geographical areas. Furthermore it is argued that the ITC regime permits a wide range of activities and all undertakings within the EEA, operating in these fields, can take advantage of the regime, regardless of the founder's domicile or other such factors. The conditions for the establishment of ITCs are open to all persons and undertakings within the EEA. The regime is thus of a general nature and cannot be characterised as "providing in favour of certain undertakings an exception of the application of the tax system".

The Icelandic Government points out that one of the main differences in fiscal treatment of the ITCs is that the corporate income tax is 5 per cent instead of the general tax rate of 30 per cent. According to the Icelandic Government, this difference should not be looked upon in isolation. The 5 per cent corporate income tax is strictly a deferral of taxation until profits are distributed as dividends, due to the special rules on distributed dividends. Therefore, taking all factors into consideration and keeping in mind the net effects of the tax regime, the Icelandic Government is of the view that ITCs are not recipients of a tax credit and therefore do not enjoy favourable tax treatment.

The Icelandic Government argues that undertakings registered as ITCs would, in absence of the regime, not be established in Iceland and thus not be liable to pay taxes in Iceland. Consequently, there is no effect of net tax loss.

The Icelandic Government is also of the opinion that the criteria of the *de minimis* principle, as laid down in Chapter 12 of the Authority's State Aid Guidelines, are met in this case. Hence, should the Authority reach a finding that State aid is involved, such aid would be below the *de minimis* ceiling and should be considered not to have an appreciable effect on trade and competition within the EEA.

II. APPRECIATION

To be considered as State aid under Article 61(1) of the EEA Agreement, a measure must fulfil the four following criteria.

Firstly, the measure must confer the beneficiaries an advantage that reduces the costs they normally bear in course of the business. According to Chapter 17B.3.(2) of the Authority's State Aid Guidelines the advantage may be provided through a reduction in the firm's tax burden in various ways including *inter alia* "a total or partial reduction in the amount of tax (such as exemption or a tax credit)".

The main advantage for ITCs is the lower corporate tax of 5 per cent instead of 30 per cent. As pointed out by the Icelandic Government, this is a deferral of taxation until profits are distributed as dividends, due to the special rules on distributed dividends. Nevertheless, this could imply a tax credit for the ITCs. Taking all the elements of the tax regime into account the taxation of ITCs, in the view of the Authority, implies a favourable tax treatment for ITCs.

Secondly, the advantage must be granted by the State or through State resources. The grant of a tax reduction involves a loss of tax revenue which, according to Chapter 17B.3.(3) of the Authority's State Aid Guidelines, is equivalent to consumption of State resources in form of fiscal expenditure.

Thirdly, the measure must be specific or selective in that it favours "certain undertakings or the production of certain goods". According to Chapter 17B.3.2(4) of the Authority's State Aid Guidelines on direct business taxation: "*Some tax benefits are on occasion restricted to certain types of undertakings, to some of their functioning (intra-group services, intermediation coordination) or to production of certain goods. In so far as they favour certain undertakings or the production of certain goods, they may constitute State aid as referred to in Article 61(1)*". The favourable tax treatment applies only to undertakings, which fulfil the condition in the Act on ITCs. It is therefore, in the Authority's view, selective because it favours only undertakings engaged in limited activities provided for in the Act.

The Authority finds it hard to see that the favourable tax treatment of ITCs falls within the logic of the tax system. In the Authority's view, the Icelandic Government has not provided any justification for this derogation from the general tax system on the basis of the nature or general scheme of the system⁴.

⁴ See in this context: Case 173/73 *Italy v. Commission* [1974] ECR 709.

Fourthly, the measure must affect competition and trade between the Contracting Parties. ITCs can trade in goods, which are not covered by the EEA Agreement, and which do not originate in Iceland. But the trading activity as such may be considered as a service falling inside the scope of the EEA Agreement. In this context, it may also be referred to the fact that ITCs can act as intermediaries in the trading of services between foreign entities outside Icelandic jurisdiction. ITCs can also own or control and register aircrafts provided that these are being used for activities in which ITCs are permitted to be engaged. Furthermore, ITCs can own or control and register aircrafts and lease or sub-lease such aircrafts to foreign entities for transport outside Iceland. These are services which are covered by the EEA Agreement.

Moreover, ITCs can own or control and register vessels provided that these are being used for activities in which ITCs are permitted to engage, and ITCs can own or control and register vessels and lease or sub-lease such vessels to foreign entities for transport outside Iceland. Such services are covered by the EEA Agreement.

According to Chapter 17B.3.(2) of the Authority's State Aid Guidelines, “[u]nder settled case-law, for the purposes of this provision, the criterion of trade being affected is met if the recipient firm carries on an economic activity involving trade between Contracting Parties”. It follows from the description above that the main activities ITCs can be involved in are international trade activities. Consequently, the measure affects competition and trade between the Contracting Parties.

The Icelandic Government has argued that as of today only ten ITCs have been granted operating licences, and some of these are inactive. According to the Icelandic Government, the aid is at present not capable of affecting trade between member states, due to its minuscule extent and therefore the criteria of the *de minimis* principle, as laid down in Chapter 12 of the Authority's State Aid Guidelines, are met in this case. There appears to be no guarantee in the tax legislation on ITCs that if the threshold in the *de minimis* rule is exceeded further aid may not be granted.

Based on the foregoing considerations the taxation of ITCs appears to constitute operating aid in the meaning of Article 61(1) of the EEA Agreement. It is therefore necessary to determine if such an aid is compatible with the functioning of the EEA Agreement under the exceptions laid down in Article 61(2) and (3).

It appears that the exceptions under Article 61(2) cannot be applied in this case, since they cover different cases.

Under Article 61(3)(a) an aid may be considered compatible with the EEA Agreement when it is designed to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment. Since the measure in question is not limited to such areas this provision seems not to apply. Also the exception laid down in Article 61(3)(b) seems not to be applicable. Lastly, as regards exemption laid down in Article 61(3)(c), it also seems that the aid cannot be considered to facilitate the development of certain economic activities or of certain economic areas. Consequently the aid seems not to qualify for any of the exemptions provided for in Article 61 (3) of the EEA Agreement.

In light of the foregoing considerations, the Authority is of the view that the tax measure concerning ITCs may imply State aid within the meaning of Article 61(1) of the EEA Agreement. Consequently, and in accordance with point 5.2 of Chapter 5 of the Authority's State Aid Guidelines, the Authority is obliged to open the procedure provided for in Article 1(2) of Protocol 3 of the Surveillance and Court Agreement. The decision is without prejudice to the final decision of the Authority.

Finally, the Authority draws the attention of the Icelandic Government to Chapter 6 of the State Aid Guidelines ("Specificities regarding aid unlawful on procedural grounds"). The tax regime was introduced after the entry into force of the EEA Agreement and could therefore be qualified as new aid. In this respect, no notification was received. According to point 6.2.3(1), in negative decisions on cases of unlawful aid, the Authority orders, as a rule, the EFTA State concerned to reclaim aid from the recipient.

HAS ADOPTED THIS DECISION:

1. The Authority has decided to open the formal investigation procedure provided for in Article 1(2) of Protocol 3 to the Surveillance and Court Agreement.
2. The Icelandic Government is invited, pursuant to point 5.3.1. (1) of Chapter 5 of the Authority's State Aid Guidelines, to submit its comments on the opening of the formal investigation procedure within six weeks from notification of this decision.
3. The Icelandic Government shall be informed by means of a letter containing a copy of the decision.
4. The EC Commission shall be informed, in accordance with Protocol 27(d) of the EEA Agreement, by a copy of this decision.
5. Other EFTA States, EC Member States, and interested parties shall be informed by the publishing of the attached notice in the EEA Section of the Official Journal of the European Communities and the EEA Supplement thereto, inviting them to submit comments within one month from the date of the publication.
6. This decision is authentic in the English language.

Done at Brussels, 6 December 2001

For the EFTA Surveillance Authority

Knut Almestad
President

Hannes Hafstein
College Member