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EFTA SURVEILLANCE
AUTHORITY

SVTH – Federation of Trade & Services
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Subject: The duty free zone at Keflavik airport (complaint)
- *Preliminary assessment under paragraph 48 (b) of the Authority's Guidelines on Best Practice for the conduct of state aid control procedures*¹

1 General

The EFTA Surveillance Authority (“the Authority”) refers to your complaint dated 14 April 2016, regarding the duty free zone at the Leifur Eiriksson Air Terminal (“LEAT”) in Keflavík, Iceland. In particular, the complaint concerns alleged state aid, within the meaning of Article 61(1) of the EEA Agreement, granted to the duty free stores at Keflavík Airport through a general exemption from custom duties and value added tax (“VAT”), hereafter collectively referred to as import duties. The alleged beneficiaries are Frihöfnin ehf. as well as the other stores operating within the duty free zone.

On 19 April 2016,² the Authority acknowledged receipt of the complaint and subsequently forwarded it to the Icelandic authorities.³ On 9 June 2016,⁴ the Icelandic authorities provided comments on the complaint. By letter dated 25 January 2017,⁵ the Icelandic authorities provided the Authority with additional information.

The Authority has now concluded its preliminary examination of the exemption from import duties. Based on this examination, the Authority considers that the measure does not appear to involve state aid within the meaning of Article 61(1) of the EEA Agreement.

2 The operation of duty free stores in Iceland

When goods are imported into Iceland, customs duties are payable to the Treasury in accordance with the Customs Tariff in Annex I to the Icelandic Custom Act No 88/2005. The Directorate of Customs is responsible for collecting custom duties as well as other import duties, such as VAT, on all goods imported to Iceland. However, there are certain exemptions found in the Customs Act to the main rule concerning the imposition of import

¹ The Authority's Guidelines on Best Practice for the conduct of state aid control procedures, published in the OJ L82, 22.3.12, p.7 and EEA supplement No 17 on the same date. Also available at: <http://www.eftasurv.int/media/state-aid-guidelines/Part-II---Guidelines-on-Best-Practice-for-the-conduct-of-state-aid-control-procedures-DOC.pdf>

² Document No 801119

³ Document No 801878

⁴ Document No 807917

⁵ Document No 837828

duties, such as for travellers coming from abroad, the import of gifts, samples etc. Moreover, the Customs Act provides for the operation of duty free stores in certain airports and seaports in Iceland.

The legal framework for the operation of duty free stores in Iceland can be found in Articles 101 to 104 of the Customs Act. The Directorate of Customs, having received a written application, can grant a licence for the operation of duty free stores in airports and seaports to legal entities subject to compliance with the conditions of Article 91(1), points 1-3 and 6-9 of the Customs Act. Any legal entity can apply for a licence. Although the authorisation for duty free stores to sell goods duty and VAT free is not formulated directly in the provisions of the Customs Act, it can nevertheless be derived from a number of provisions therein.

In accordance with Article 104(1) of the Customs Act, duty free stores are only authorised to sell goods to departing passengers and crew of vessels engaged in international journeys. However, an exemption is made in Article 104(2) where it is stated that without prejudice to the provisions of paragraph 1, the Directorate of Customs can authorise the licensee to sell goods from a duty free store to arriving passengers and crew of vessels engaged in international journeys. Such a store is specially demarcated and only accessible to passengers and crew upon arrival to Iceland. The goods sold in the arrival stores cannot be offered to anyone other than arriving passengers and therefore online ordering services are prohibited.⁶

3 Preliminary assessment

3.1 General

A measure constitutes state aid within the meaning of Article 61(1) of the EEA Agreement if the following conditions are fulfilled: the measure (i) is granted by the State or through state resources; (ii) confers an economic advantage on an undertaking; (iii) is selective; and (iv) is liable to affect trade between Contracting Parties and to distort competition. These conditions are cumulative. Therefore, if one of these conditions is not fulfilled, the measure does not constitute state aid.

3.2 Selectivity – favouring certain undertakings or the production of certain goods

The selectivity criterion allows to distinguish between aid measures and general measures of tax or economic policy.⁷ Advantages resulting from a general measure applicable without distinction to all economic operators do not constitute state aid within the meaning of Article 61(1) of the EEA Agreement.⁸

Moreover, the concept of state aid does not encompass tax measures that differentiate between undertakings and are *prima facie* selective, where that differentiation arises from the nature and general scheme of the system of which they form part. Therefore, a measure that creates an exemption to the application of a general national tax system can be justified if the EEA state concerned can demonstrate that it follows directly from the basic or guiding principles of the tax system.

⁶ See Article 8 of Icelandic Act No 54/2016 on amendments to several provisions concerning taxes and fees. Available online at: <http://www.althingi.is/altext/stjt/2016.054.html>.

⁷ Judgment in *Air Liquide Industries and others*, C-393/04 and C-41/05, EU:C:2006:403, paragraph 32. See also the Authority's Guidelines "Application of State aid rules to measures relating to direct business taxation". The Guidelines are available at: <http://www.eftasurv.int/?l=1&showLinkID=15141&l=1>.

⁸ Joined Cases E-17/10 and E-6/11 *Liechtenstein v ESA* [2012] EFTA Ct. Rep. 114, paragraph 53 and the case law cited.

Prima facie selectivity

A measure is *prima facie* selective if it constitutes an exemption from its system of reference, *i.e.* the system applicable to other undertakings in the same legal or factual situation.⁹ Therefore, the first step in the selectivity analysis requires the identification of the system of reference.

The reference system is composed of a consistent set of rules that generally apply – on the basis of objective criteria – to all undertakings falling within its scope as defined by its objective. Typically, those rules define not only the scope of the system, but also the conditions under which the system applies, the rights and obligations of undertakings subject to it and the technicalities of the functioning of the system.¹⁰

The contested exemption for the operation of duty free stores derives from Articles 101 to 104 of the Customs Act. The exemption allows for the sale of goods without imposing either custom duties or VAT. Both custom duties and VAT are imposed by the Directorate of Customs when goods are imported and thus the Authority considers that the exemption must be viewed as one single measure. The Authority therefore considers that the correct system of reference is the Icelandic customs system (system of import duties).

As previously noted, the main rule of the Icelandic Customs Act is that import duties are imposed on all goods imported into the Icelandic customs territory. Thus, custom duties and VAT are levied on all goods which are sold within Iceland. Allowing for the sale of duty free goods in certain stores within airports and seaports is an exception from the main rule.

However, the fact that a tax measure constitutes an exemption from the reference system is not sufficient to consider the measure selective, when such a measure is potentially accessible to all undertakings. Similarly, even if benefitting from a tax measure requires the fulfilment of certain conditions, this is not sufficient to make the tax measure selective *a priori*. In order for a tax measure to constitute aid, it is necessary to identify a particular category of undertakings which can be differentiated from other undertakings based on their specific characteristics. In the case at hand, only those stores which have been granted an operating licence by the Directorate of Customs to sell goods within certain seaports and airports are allowed to sell goods duty free in Iceland. All other retail stores within Iceland have to pay import duties on the goods they sell to their customers. Thus, the measure appears to be *prima facie* selective for the operators of duty free stores.

Justification by the nature and logic of the Icelandic system of import duties

A derogation from a reference system can be justified by the logic and general nature of the reference system. This justification, based on the nature and logic of the system, reflects the consistency of a specific measure with the internal logic of the system in general. In that context, it should be noted that it is the basic and guiding principles of the reference system which are relevant, not those of the particular measure in question.¹¹ The basis for a possible

⁹ Judgment in *Adria-Wien Pipeline*, C-143/99, EU:C:2001:598, paragraph 41.

¹⁰ See the Authority's Guidelines on the notion of State aid as referred to in Article 61(1) of the EEA Agreement, paragraph 133. Available at: <http://www.eftasurv.int/media/esa-docs/physical/EFTA-Surveillance-Auhtority-Guidelines-on-the-notion-of-State-aid.pdf>.

¹¹ Judgments in *Paint Graphos and others*, C-78/08 to C-80/08, EU:C:2011:550, paragraph 69; and *RENV British Aggregates Association v Commission*, T-210/02, EU:T:2014:65, paragraph 107.

justification could, for instance,¹² be the need to fight fraud or tax evasion, or the need to take into account specific accounting requirements or administrative manageability.¹³

It is the EEA State which introduces a differentiation between undertakings that needs to be able to show that this differentiation is actually justified by the nature and general scheme of the system in question.¹⁴

According to the Icelandic authorities, the exemption for duty free stores reduces the transportation of goods in passenger flights to Iceland and contributes to the reduction of customs evasion. When the exemption was originally put in place in the 1970's, a considerable amount of smuggled goods was being sold within the country and that was considered to have harmful effects on inland wholesale and retail business. The alternative to allowing for the operation of duty free stores would, according to the Icelandic authorities, have been to increase customs surveillance considerably, which would have resulted in delays in passenger arrival and a high surveillance cost.¹⁵

Since the exemption was first introduced, conditions of travel to and from Iceland have improved and the number of travellers passing through LEAT and other entry points in Iceland has increased significantly, further increasing the risk of smuggling and customs evasion. According to the Icelandic authorities, the existence of the exemption for duty free stores still contributes considerably to the goal of preventing smuggling and reducing customs evasion. The Icelandic authorities have also highlighted that the surveillance and customs clearance of travellers luggage and goods is a highly time consuming process. Therefore, the exemption alleviates considerable burdens that would otherwise be borne by the customs authorities, as well as affecting passengers and crew members.

As stated before, it is for the EEA State which introduces a differentiation between undertakings to show that this differentiation is justified by the nature and general scheme of the relevant reference system. The Authority considers that the Icelandic authorities have demonstrated that the exemption in the Icelandic customs system for the operation of duty free stores is justified by the nature and general scheme of the system in question on the basis of the need to prevent smuggling and import duty evasion, as well as to ensure administrative manageability.¹⁶

In light of the above considerations, the Authority concludes that the exemption in the Customs Act concerning the operation of duty free stores is not selective within the meaning of Article 61(1) of the EEA Agreement, since it is justified by the nature and logic of the Icelandic system of import duties.

¹² See the Authority's Guidelines on the notion of State aid as referred to in Article 61(1) of the EEA Agreement, paragraph 139. Available at: <http://www.eftasurv.int/media/esa-docs/physical/EFTA-Surveillance-Auhtority-Guidelines-on-the-notion-of-State-aid.pdf>.

¹³ See Authority Decision No 155/16/COL on alleged state aid arising from the Norwegian import duty exemption for low-value goods imported by final consumers, OJ C 434, 24.11.2016, p.5 and EEA Supplement No 66, 24.11.2016, p.39, paragraph 98.

¹⁴ Joined Cases E-17/10 and E-6/11 *Liechtenstein v ESA* [2012] EFTA Ct. Rep. 114, paragraph 75.

¹⁵ Document No 837828

¹⁶ See Authority Decision No 155/16/COL on alleged state aid arising from the Norwegian import duty exemption for low-value goods imported by final consumers, OJ C 434, 24.11.2016, p. 5 and EEA Supplement No 66, 24.11.2016, p. 39, paragraph 98.

4 Conclusion

With reference to paragraph 48(b) of the Authority's Guidelines on Best Practice for the conduct of state control procedures and based on the information available, it is the Authority's preliminary view that the exemption in the Icelandic Customs law concerning the operation of duty free stores does not entail state aid within the meaning of Article 61(1) of the EEA Agreement.

If you have any additional information you would like to submit that might change this preliminary view, please do so **by 27 April 2017**. Otherwise the case will be closed without further notice.

Yours faithfully,



Gjermund Mathisen

Director

Competition and State aid