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Press and Information

PRESS RELEASE No 99/08

18 December 2008

Judgment of the Court of First Instance in Joined Cases T-211/04 and T-215/04

Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland v Commission

THE COURT OF FIRST INSTANCE ANNULS THE COMMISSION DECISION ACCORDING TO WHICH THE PROPOSED REFORM OF CORPORATE TAX IN GIBRALTAR CONSTITUTES UNLAWFUL STATE AID

The reference framework for assessing the reform's regional selectivity must correspond exclusively to Gibraltar's, and not the United Kingdom's, territorial limits. Furthermore, the Commission did not observe the analytical framework relating to the determination of selectivity

In August 2002 the United Kingdom notified the Commission of the Government of Gibraltar's proposed reform of corporate tax. That reform included in particular the repeal of the former tax system and the imposition of three taxes applicable to all Gibraltar companies, namely a registration fee, a payroll tax and a business property occupation tax ('BPOT'), with a cap on liability to payroll tax and BPOT of 15% of profits.

In 2004, following a formal investigation procedure, the Commission decided[1] that the proposals notified for the reform of the system of corporate taxation in Gibraltar constituted a scheme of State aid that was incompatible with the common market and accordingly could not be implemented.

In its decision, the Commission found that the reform was regionally selective since it provided for a system under which companies in Gibraltar would be taxed, in general, at a lower rate than those in the United Kingdom. It found, furthermore, that three aspects of the reform were materially selective: first, the requirement that a company must make a profit before it becomes liable to payroll tax and BPOT, since that requirement would favour companies which make no profit; second, the cap limiting liability to payroll tax and BPOT to 15% of profits, since that cap would favour companies which, for the tax year in question, have profits that are low in relation to their number of employees and their occupation of business property; and, third, the payroll tax and BPOT, since those two taxes would inherently favour companies which have no real physical presence in Gibraltar.

[1] Commission Decision 2005/261/EC of 30 March 2004 on the aid scheme which the United Kingdom is planning to implement as regards the Government of Gibraltar Corporation Tax Reform (OJ 2005 L 85, p. 1).

The Government of Gibraltar and the United Kingdom brought actions before the Court of First Instance for annulment of the Commission decision.

So far as concerns **regional selectivity**, the Court of First Instance notes first of all in today's judgment that the rules of Community law relating to aid granted by the Member States apply to Gibraltar. It points out that State aid 'favouring certain undertakings or the production of certain goods', that is to say aid which is selective, is prohibited.

Next, the Court examines whether, in accordance with **the three conditions laid down in the judgment on the tax regime in the Azores**[2]**,** it is the territory of the United Kingdom or the territory of Gibraltar that constitutes the appropriate reference framework for assessing whether the tax reform at issue is regionally selective.

As regards the first condition laid down in that judgment (institutional autonomy), the Court finds that the competent Gibraltar authorities which have devised the tax reform have, from a constitutional point of view, a political and administrative status separate from that of the central government of the United Kingdom.

So far as concerns the second condition (procedural autonomy), the Court notes that this condition is met if the tax reform has been devised without the central government of the United Kingdom being able to intervene directly as regards its content. It finds in this regard that the United Kingdom's residual power to legislate for Gibraltar and the various powers granted to the Governor of Gibraltar must be interpreted as means enabling the United Kingdom to assume its responsibilities towards the population of Gibraltar and to perform its obligations under international law, and not as granting an ability to intervene directly as regards the content of a tax measure adopted by the Gibraltar authorities, in particular since those residual powers have never been exercised in matters of taxation.

The third condition (economic and financial autonomy) requires any financial consequences for Gibraltar of introducing the tax reform not to be offset by aid or subsidies from other regions or from the central government of the United Kingdom. The Court finds that none of the financing referred to by the Commission serves to offset any financial consequences that the tax reform would entail for Gibraltar.

Since the three conditions set out in the judgment on the tax regime in the Azores are met, the **Court concludes that the reference framework for assessing whether the tax reform at issue is regionally selective corresponds exclusively to the geographical limits of the territory of Gibraltar** and that, accordingly, no comparison can be made between the tax system applicable to companies established in Gibraltar and that applicable to companies established in the United Kingdom for the purpose of establishing a selective advantage favouring the former.

So far as concerns **material selectivity** of the tax reform at issue, the Court notes that classification by the Commission of a tax measure as selective involves an analysis in three stages.

The Commission must begin by identifying and examining the common or 'normal' regime under the tax system applicable in the geographical area constituting the relevant reference framework. It is in relation to this common or 'normal' tax regime that the Commission is required, secondly, to determine whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure derogates from that common regime and thereby differentiates between economic operators who are in a comparable factual and legal situation.

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[2] Judgment of the Court of Justice of 6 September 2006 in Case C-88/03 *Portugal* v *Commission* (see also Press Release No 66/06).

If the Commission demonstrates the existence of derogations from the common or 'normal' tax regime resulting in a differentiation between undertakings, it is possible, however, for such a differentiation not to be selective, namely if it arises from the nature or general scheme of the system of charges of which it forms part. In that situation, it is for the Member State concerned to show that the differentiations at issue are justified by the nature and general scheme of its tax system. The Commission must determine, in a third stage, whether that is in fact the case.

The Court adds that, if the Commission fails to carry out the first two stages of the above analysis, it cannot embark upon the third and final stage, as otherwise it will go beyond the limits of its review. Such an approach would be liable, first, to enable the Commission to assume the role of the Member State with regard to determination of that State's tax system and of the common or 'normal' regime under it and, second, thus to make it impossible for the Member State to justify the differentiations in question on the basis of the nature and of the general scheme of the tax system notified, since the Commission would not first either have identified the common or 'normal' regime under that system or have established that those differentiations constitute derogations from that regime.

Since the Commission did not begin by identifying the common or 'normal' regime under the notified tax system or challenge the Gibraltar authorities' description of that regime, **it was impossible for it to establish that certain of the elements of the notified tax system constituted derogations, and were therefore prima facie selective, vis-à-vis the common or 'normal' regime. The Court considers likewise that it was impossible for the Commission to assess correctly whether any differentiations between undertakings were capable of being justified by the nature or the general scheme of the notified tax system, since the Commission had neither identified nor examined the common regime first.**

The Court further states that, in not observing the three-stage analysis that is referred to above, **the Commission went beyond the limits of its review, in the light of the extent of the competence of the Gibraltar authorities regarding the determination of its tax system and of the common or 'normal' regime under that system.** In not using as the starting point for its analysis regarding material selectivity the regime which the applicants classified in this instance as the common or 'normal' tax regime and by failing to identify that regime and to examine its validity, the Commission imposed its own logic as to the content and operation of the tax system notified.

For those reasons, the Court holds that the Commission has not established the existence of selective advantages stemming from the three aspects of the tax reform that are at issue and, having regard also to its assessment relating to regional selectivity, annuls the Commission decision in its entirety.

REMINDER: An appeal, limited to points of law only, may be brought before the Court of Justice of the European Communities against a decision of the Court of First Instance, within two months of its notification.

For further information, please contact Christopher Fretwell
Tel: (00352) 4303 3355 Fax: (00352) 4303 2731