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Judgment of the Court of Justice in Case C-88/03

*Portuguese Republic v. Commission of the European Communities*

**THE COURT DISMISSES THE ACTION BROUGHT BY PORTUGAL AGAINST THE COMMISSION DECISION ON THE TAX SCHEME IN THE AZORES**

*The Court rules on the criteria establishing the political and fiscal independence of a regional body in relation to the central State in State aid cases*

In 1999, the legislative body of the Azores Region adopted detailed rules for the adaptation of the national tax system to regional particularities, in accordance with powers which were devolved to it in that matter. Those rules include a reduction of the rate of income and corporation tax which applies automatically to all economic operators. That reduction is designed specifically to enable undertakings established in the Azores Region to overcome structural handicaps which result from their location in an isolated region on the periphery of the Community.

That tax scheme was notified late to the Commission and entered into force without authorisation. Following examination of the measures concerned the Commission concluded that they constituted operating aid which could be authorised only if, in accordance with the Guidelines on national regional aid, they were justified by their contribution to regional development and were proportional to the additional costs they were intended to offset. Those measures cannot, therefore, be applied to undertakings carrying out financial activities or activities of the 'inter-group services' type (activities the economic basis of which is to provide services to undertakings belonging to the same group) as such activities do not contribute sufficiently to regional development<sup>1</sup>. In its decision, the Commission ordered Portugal to take the measures necessary to recover the aid granted from those undertakings.

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<sup>1</sup> Commission Decision of 11 December 2002 on the part of the scheme adapting the national tax system to the specific characteristics of the Autonomous Region of the Azores which concerns reductions in the rates of income and corporation tax (OJ 2003 L 150, p. 52).

Portugal has challenged that decision before the Court of Justice of the European Communities, particularly as regards the classification of the measures concerned as State aid.

The Court observes, first of all, that the EC Treaty prohibits selective measures of State aid, that is, measures favouring certain undertakings or the production of certain goods. However, such measures do not constitute State aid incompatible with the common market if they are justified by the nature or general structure of the tax system.

The Court goes on to state that the measures adopted by regional bodies in the Member States are covered by the Community provisions on State aid in the same way as measures adopted by the central State.

The Court observes that, in order to determine the selectivity of a measure adopted by an infra-State body which establishes a lower tax rate in part of the territory of a Member State, there must be an examination of whether that measure was adopted by that body in the exercise of powers sufficiently autonomous vis-à-vis the central power. There must also be an examination of whether that measure actually applies to all the undertakings established in, or all production of goods on, the territory coming within the competence of that body.

The reference framework for determining whether a tax measure is selective may therefore be limited to the geographical area concerned, where the regional or local authority occupies a fundamental role in the definition of the political and economic environment in which undertakings present on the territory under its competence operate.

In that context, **the exercise of sufficiently autonomous powers requires that the decision must have been taken by a regional or local authority which has, from a constitutional point of view, a political and administrative status separate from that of the central government.** Next, **it must have been adopted without the central government being able to directly intervene as regards its content.** Finally, **the financial consequences of a reduction of the national tax rate for undertakings in the region must not be offset by aid or subsidies from other regions or central government.** The regional or local authority must assume the political and financial consequences of such a measure.

The two aspects of the fiscal policy of the regional government of the Azores, that is to say, the decision to reduce the regional tax burden by exercising its power to reduce tax rates on revenue and the fulfilment of its task of correcting inequalities deriving from insularity, are inextricably linked and dependent, from the financial point of view, on budgetary transfers managed by central government.

In those circumstances, the Court finds that those measures must be assessed in relation to the totality of Portuguese territory, in the context of which they appear to be selective, and not general, measures.

Finally, the Court examines whether that scheme may be justified by the nature and overall structure of the Portuguese tax system, a matter which it is for the Member State concerned to demonstrate. The Court finds that the Portuguese Government has not proved that the adoption of the measures at issue was necessary for the functioning and effectiveness of the general tax system.

Consequently, the Court dismisses the action brought by Portugal.

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*Languages available: EN, ES, FR, DE, PT*

*The full text of the judgment may be found on the Court's internet site*  
<http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=EN&Submit=rechercher&numaff=C-88/03>

*It can usually be consulted after midday (CET) on the day judgment is delivered.*

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