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European Union tax alert
CJEU rules on Spanish state aid cases involving amortization of goodwill

On 21 December 2016, the Court of Justice of the European Union (CJEU) issued its long-awaited decision in the Spanish financial goodwill amortization state aid cases. Significantly, the court set aside the 2014 decisions of the EU General Court (EGC), in which the EGC held that the goodwill amortization regime did not constitute unlawful state aid under EU law and annulled two decisions of the European Commission (dating from 2009 and 2011). The CJEU has referred the cases back to the EGC for a reassessment in light of the CJEU's conclusions.

As a result of the CJEU decision, the two decisions of the European Commission, which considered the financial goodwill amortization regime to be state aid, are reinstated and Spain must recover the aid granted.

Overview of goodwill amortization regime

The rule allowing the tax amortization of financial goodwill for foreign shareholding acquisitions was introduced by Law 24/2001 and has applied since 1 January 2002.

The amortization regime—which provides for a derogation from the general corporate income tax regime—grants a corporate income tax deduction to Spanish tax resident companies that purchase shares of foreign companies. The deduction is not available when the acquired company is a Spanish company.

Under the regime, a Spanish taxable company may deduct from its corporate income tax base the tax amortization of the "financial goodwill" (i.e. the difference between the acquisition cost of the shares of the foreign entity and the value of its net equity that is not attributable to the assets of the foreign entity) resulting from the shares of qualifying nonresident companies. The maximum tax amortization rate is 5% annually. To benefit from this measure, the Spanish company must acquire at least a 5% stake in the company and hold the participation for a continuous period of at least one year.

In 2012, Spain's General Directorate of Taxes issued a binding ruling in which it extended the application of the measure to financial goodwill arising on the indirect acquisition of shares of foreign entities (i.e. the direct acquisition of foreign holding companies that, in turn, owned shares in foreign operating companies).

European Commission decisions

Following an investigation of the financial goodwill tax amortization regime, the European Commission issued a decision on 28 October 2009 concluding that, with respect to the acquisition of shares of foreign entities resident in EU member states, the amortization rule gave Spanish companies a selective advantage over their competitors when acquiring EU companies, in breach of the EU state aid rules and the breach could not be justified (First Decision).

On 12 January 2011**,** the commission concluded that the measure constituted incompatible state aid with respect to the acquisition of non-EU companies (Second Decision) (for prior coverage, see *World Tax Advisor* **article dated 21 January 2011**).

The commission ordered Spain to recover the aid granted, except in cases where there were legitimate expectations of the taxpayers (i.e. acquisitions of EU and non-EU entities carried out before 21 December 2007 and for some non-EU acquisitions made before 21 May 2011 in relation to entities resident in countries where there were specific obstacles to cross-border combinations).

On 15 October 2014, the commission concluded that the extended application of the amortization rule regarding the indirect acquisition of shares of foreign entities constituted new state aid that "unduly enlarged the scope of an aid scheme" and that the new interpretation was incompatible with EU rules; the commission ordered Spain to recover the aid granted (Third Decision).

The Third Decision refers to tax benefits derived from indirect acquisitions made at any time because these acquisitions were not covered by the scope of the measures that applied at the time of the commission's First and Second Decisions and, thus, there cannot be any legitimate expectations of taxpayers.

EGC decisions

Some Spanish taxpayers that benefited from the amortization rule appealed the decisions of the European Commission to the EGC. On 7 November 2014, the EGC annulled the First and Second Decisions on the grounds that the commission failed to establish the "selective nature" of the amortization rule, one of the conditions that must be satisfied to consider a tax measure to constitute state aid.

In its decisions, the EGC stated that, to constitute state aid, it is necessary to specify a particular category of undertakings that benefit from the challenged measure. The court noted that the existence of a derogation from a "reference framework" (Spain's general corporation tax regime, according to the commission) does not on its own, establish that the financial goodwill amortization rule favors certain undertakings over other undertakings (and, therefore, is selective), since the regime is available to any undertaking. The

EGC maintained that the amortization rule is not aimed at any particular category of undertaking and it does not exclude any category of undertaking from taking advantage of the regime. Since the commission did not proved that the tax measure benefited a particular category of undertakings, the EGC held that the commission failed to establish the selective nature of the measure and, therefore, the measure could not be considered state aid.

The commission appealed the EGC rulings regarding the First and Second Decisions to the CJEU, arguing that the EGC erred in law in its interpretation of the selectivity condition.

The Third Decision was not affected by the November 2014 EGC judgments. The appeal of the Third Decision before the EGC is still pending resolution.

Decision of the CJEU

In its decision, the CJEU set aside the EGC's 7 November 2014 decisions and referred the cases back to the EGC.

The CJEU held, in determining whether a measure can be classified as "selective" for purposes of the state aid rules, it is not necessary to identify a specific category of undertakings that benefit exclusively from the measure.

The CJEU held that the appropriate standard for establishing the selectivity of a measure is whether the measure benefits certain undertakings as compared to other undertakings or applies different treatment to undertakings that are in comparable factual and legal situations, unless the different treatment can be justified by the nature of the tax regime. This is the case even if, in principle, the beneficial measure is available to all companies. According to the CJEU, the fact that the European Commission failed to identify a particular category of undertakings that benefitted from the financial goodwill amortization regime was not a valid reason for the EGC to annul the commission's First and Second Decisions.

Consequences of CJEU decision

The following consequences ensue from the decision of the CJEU:

- The CJEU decision supports the approach of the commission regarding the selectivity condition of tax measures. Thus, it would seem that the commission's burden of proof regarding the selectivity of tax measures in other state aid cases is eased.
- The EGC now must determine whether Spain's amortization regime constitutes unlawful state aid because it provides different treatment for companies that are in a comparable situation. However, the future decision of the EGC will not affect the amortization of financial goodwill in cases where the taxpayer had legitimate expectations that the regime would apply (i.e. for acquisitions of foreign entities, both EU and non-EU, made before 21 December 2007 and for some non-EU acquisitions made before 21 May 2011 in relation to entities resident in countries where there are specific obstacles to cross-borders combination of entities).
- The future decision of the EGC also may be appealed to the CJEU, so it is possible that the issue may not be resolved for several years.
- The First and Second Decisions of the European Commission are reinstated and, therefore, Spain is required to recover the aid granted. The commission issued a press release

immediately following the CJEU decision in which it welcomed the ruling, commenting that the decision is significant because it confirms that a measure may be selective if it benefits only companies that carry out certain transactions, even if the measure, in principle, is open to all companies.

- Upon the request of the Spanish tax authorities, affected taxpayers will have to “repay” the aid received (i.e. the unpaid taxes due to the application of the tax amortization regime, plus delayed payment interest).
- It is expected that the commission will require the Spanish tax authorities to resume recovery procedures that were suspended.
- Spain also must carry out the recovery ordered in the Third Decision.

Contacts

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