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Acts whose titles are printed in light type are those relating to day-to-day management of agricultural matters, and are generally valid for a limited period.

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III

(Other acts)

EUROPEAN ECONOMIC AREA

EFTA SURVEILLANCE AUTHORITY DECISION

No 97/10/COL

of 24 March 2010

**regarding the taxation of captive insurance companies under the Liechtenstein Tax Act
(Liechtenstein)**

THE EFTA SURVEILLANCE AUTHORITY ('THE AUTHORITY');

HAVING REGARD to the Agreement on the European Economic Area ('the EEA Agreement'), in particular to Articles 61 to 63 and Protocol 26,

HAVING REGARD to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice ('the Surveillance and Court Agreement'), in particular to Article 24,

HAVING REGARD to Protocol 3 to the Surveillance and Court Agreement ('Protocol 3'), in particular to Article 1(2) of Part I and Articles 4(4), 6, 7(5) and 14 of Part II,

HAVING REGARD to the Authority's Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement ⁽¹⁾, and in particular the chapter dealing with the application of State aid rules to measures relating to direct business taxation,

HAVING REGARD to the consolidated version of the Authority's Decision No 195/04/COL of 14 July 2004 on the implementing provisions referred to under Article 27 of Part II of Protocol 3 ('the Implementing Provisions Decision') ⁽²⁾, and

HAVING ADOPTED Decision No 620/08/COL to initiate the procedure provided for in Article 1(2) of Protocol 3, and having called on interested parties to submit their comments pursuant to those provisions and having regard to their comments,

Whereas:

I. FACTS

1. PROCEDURE

By letter dated 14 March 2007 (Event No 393563), the Authority sent a request for information to the Liechtenstein authorities, inquiring about various tax derogations for certain forms of company under the Liechtenstein Tax Act. The Liechtenstein authorities replied by letter dated 30 May 2007 (Event No 423398).

There then followed an exchange of correspondence and meetings between representatives of the Authority and of the Liechtenstein authorities, and eventually on 24 September 2008, the Authority adopted Decision No 620/08/COL to initiate a formal investigation procedure. This Decision was published in the *Official Journal of the European Union* and the EEA Supplement to it ⁽³⁾. The Authority called on interested parties to submit their comments and received such comments from 12 interested parties. By letter dated 22 July 2009 (Event No 525074) the Authority forwarded these to the Liechtenstein authorities, who were given the opportunity to respond. This was done by letter dated 2 October 2009 (Event No 532480).

⁽¹⁾ Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement and Article 1 of Protocol 3 to the Surveillance and Court Agreement, adopted and issued by the Authority on 19 January 1994 (OJ L 231, 3.9.1994, p. 1, and EEA Supplement No 32, 3.9.1994, p. 1). The updated version is available at: <http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines>

⁽²⁾ Consolidated version available at: <http://www.eftasurv.int/media/decisions/195-04-COL.pdf>

⁽³⁾ OJ C 75, 31.3.2009, p. 45, and EEA Supplement No 17, 26.3.2009, p. 1.

2. SPECIAL TAX PROVISIONS CONCERNING CAPTIVE INSURANCE COMPANIES

By virtue of an Act dated 18 December 1997 amending the Liechtenstein Tax Act ⁽⁴⁾, the Liechtenstein authorities introduced special tax rules applicable to captive insurance companies: new Articles 82a and 88d(3) were introduced into the Tax Act with effect from 1 January 1998 onwards and still apply today.

2.1. Income and capital tax

Part 4, heading B of the Tax Act — Special company taxes ('Besondere Gesellschaftssteuern') — Articles 82 to 88, contains special tax provisions for certain forms of company such as insurance companies, holding companies, domiciliary companies and investment undertakings. Article 82a of the Tax Act refers to captive insurance companies.

Article 82a paragraph 1 of the Tax Act states as follows: 'insurance companies in accordance with the definition of the Insurance Supervision Law, which exclusively engage in captive insurance ("Eigenversicherung"), pay a capital tax of 1 % on the company's own capital, cf. Article 82a(1) of the Tax Act. For capital exceeding 50 million the tax rate is reduced to ¾ % and for capital in excess of 100 million to ½ %' ⁽⁵⁾.

In other words, instead of paying the normal 0,2 % capital tax, captive insurance companies are only obliged to pay 0,1 %, and this rate is further reduced for amounts exceeding CHF 50 million and CHF 100 million.

Under paragraph 2 of Article 82a of the Tax Act, insurance companies which engage in both captive insurance and ordinary insurance activities for third parties are liable to pay the standard capital and income tax (set out in Articles 73 to 81 of the Tax Act) for that part of their activities which concerns insuring third parties.

As Article 82a of the Tax Act constitutes a *lex specialis* with respect to Article 73 of the same Act, it can be concluded that captive insurance companies do not pay income tax ⁽⁶⁾.

In conclusion, captive insurance companies only pay a reduced capital tax as described in Article 82a(1) of the Tax Act and no income tax.

2.2. 'Couponsteuer' (coupon (withholding) tax)

Under Liechtenstein legislation, a coupon tax is levied on the coupons of securities or documents equal to securities issued by a 'national' at a rate of 4 % on any distribution of dividends or

profit shares. By virtue of Article 88d(3) of the Tax Act, shares or parts of captive insurance companies are exempted from payment of the coupon tax.

2.3. The objective of the aid measure

The Liechtenstein authorities have stated that these provisions were introduced in order to attract companies to Liechtenstein and establish and develop the captive insurance sector as a new field of economic activity.

2.4. Grounds for initiating the procedure

In its decision opening the formal investigation, the Authority raised doubts regarding the compatibility of the tax classification of captive insurance companies with the State aid rules. Contrary to the arguments brought forward by the Liechtenstein authorities, the Authority took the initial view that the provision of insurance is a service which is an economic activity, and that any entity carrying out an economic activity qualifies as undertaking irrespective of its corporate form, subsidiary status or financing. Furthermore, the Authority had doubts as to whether the tax exemption in favour of captive insurance companies could be said to fall within the nature and logic of the tax system as argued by the Liechtenstein authorities.

On this basis, the Authority could not exclude that the tax rules applicable to captive insurance companies (full exemption from payment of income and coupon tax and a partial exemption from payment of capital tax) constitute State aid within the meaning of Article 61(1) of the EEA Agreement. The Authority also had doubts that these measures could be considered compatible with the State aid provisions of the EEA Agreement, in particular Article 61(3)(c).

3. COMMENTS FROM THIRD PARTIES

The following comments were received from third parties during the course of the formal investigation.

3.1. Comments from Company A

Company A commented in two letters dated 22 May and 9 September 2009, received from their legal representatives. Company A RE has operated a captive reinsurance company in Liechtenstein since 1997 through its subsidiary Company A RE Aktiengesellschaft.

It is Company A's view that the Liechtenstein captive insurance company tax measures do not involve State aid. In the alternative Company A argued that should the Authority conclude that aid is present it should be considered to be existing aid, failing which the company contends that it had legitimate expectations that the tax legislation was lawful and no recovery of aid should therefore be ordered.

⁽⁴⁾ By virtue of Act of 18 December 1997 on the amendment of the Liechtenstein Tax Act, Law Gazette 1998 No 36.

⁽⁵⁾ Translation made by the services of the Authority.

⁽⁶⁾ This was confirmed in a letter dated 30.5.2007 from the Liechtenstein authorities.

Company A argued that the tax measures do not involve State aid for the following reasons:

- its captive insurance company is not an undertaking within the meaning of Article 61(1) of the EEA Agreement as it does not operate on an open market ⁽⁷⁾ and because captive reinsurance operations are distinct from other open market operations as risks covered by the captive are either uninsurable or could be insured only with a prohibitive premium,
- the tax treatment of captives in Liechtenstein is a general measure as forming a captive does not require a certain economic strength and applies to all forms of company, citing similarities with decisions of the European Commission concerning an Irish Company Holding Regime ⁽⁸⁾ and a Spanish scheme reducing tax on revenue from certain intangible assets ⁽⁹⁾,
- in the alternative Company A argued that if the measure is selective it is nevertheless justified by the nature and logic of the Liechtenstein tax regime as captive reinsurance companies and open market reinsurance companies are in a different legal and factual position; and a differential (lower) tax treatment is merited if the activities are confined within a group of companies, and
- captive reinsurance companies neither distort competition nor affect trade within the EEA as the captive does not compete for market share and the services it provides are not tradable.

Company A also argued that the Liechtenstein tax measures on captive insurance companies, introduced in 1997, preceded the evolution of any assessment by the Authority or European Commission that such taxation on intra-group activities could involve State aid. In the alternative, it argued that in light of the principles of legitimate expectations and legal certainty, the Authority should not order recovery if it concludes that State aid has been granted.

In its second submission, Company A expanded upon its contention that captive insurance companies are not in a legally and factually comparable position to that of insurance companies providing services to unrelated companies, and that

⁽⁷⁾ In this respect Company A refers to cases 118/85 [1987] ECR 2599, paragraph 7 and C-35/96 [1998] ECR I-3851, paragraph 36 (both *Commission v Italian Republic*); case C-222/04 *Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Firenze SpA* [2006] ECR I-289; and the Authority's Decision No 349/07/COL of 18 July 2007 concerning the Norwegian Road Administration Møre and Romsdal District Office (OJ C 310, 20.12.2007, p. 35, and EEA Supplement No 61, 20.12.2007, p. 35).

⁽⁸⁾ Commission Decision of 22 September 2004, State aid N 354/04, referred to again below.

⁽⁹⁾ Commission Decision of 13 February 2008, State aid N 480/07, referred to again below.

a differential tax treatment is justified, by making reference to the Commission's decision concerning the Dutch *Groepsrentebox* scheme ⁽¹⁰⁾.

3.2. Comments from Company B

Company B is a Liechtenstein based direct writing captive insurance company owned by Company C. Company C makes use not only of its captive, but also purchases both insurance and reinsurance on the international markets. It stressed, however, that it is unable to insure all of its risks either because such insurance cover is not available or because it is not financially efficient.

Company B was founded in Liechtenstein in 2004 as a reaction to adverse insurance market developments after 2001 when commercial insurers and reinsurers began to demand higher retentions, limited their capacities, and sold insurance and reinsurance at higher prices and at more restrictive terms and conditions.

Company C argued in particular that a commercial risk transfer (to a general insurer) always involves the customer retaining a certain portion of the risk. It stated that it is considered uneconomic and inefficient to seek risk transfer up to a certain level of risk retention. The company contended that there is market consensus on levels of risk that companies keep and that below this level 'one cannot speak of a liquid insurance market'.

Company C also considered certain risks to be uninsurable and are therefore forcibly retained by companies, and that in this area captive insurance companies do not substitute commercial insurers.

Company C explained that in its opinion forming captives is merely one way of formalising and organising retained risk within a company, and that it is not an option limited to large corporations, and does not confer an economic advantage in comparison to companies that do not form captives. Although Company C stated that it is not an option limited to large companies, it also accepted, however, that larger companies have a lower cost of risk (due to economies of scale, capital structure and risk diversification) than smaller ones, and are more likely to own captive insurance companies.

Company C emphasised that Company B is only able to operate within its group of companies, and that it does not participate in the commercial direct insurance market.

⁽¹⁰⁾ Commission Decision of 8 July 2009 C 4/07 (ex N 465/06), referred to again below.

Finally, Company C contended that its captive does not compete with other market recipients, and, as Company C is unable to procure the services offered by its captive from other market recipients, there is no effect on cross-border competition.

3.3. Comments from Company D

Company D described itself as the leading captive manager in Liechtenstein, providing management services to six of the 12 captive insurance companies currently located in the principality.

In its letter received on 11 May 2009, Company D stated that in its opinion the tax measures to which captive insurance companies are subject do not distort competition as the companies do not have competitors and there is, therefore, no market.

Company D acknowledged that in terms of supply-side substitution, 'many commercial insurers can insure the risks captives insure', but contended that in terms of demand-side substitution, buyers of insurance do not view captives and commercial insurers as alternatives, but as separate products. This is because commercial insurance is considered not to be as effective a risk management tool as using a captive; as the insurable risks are different (the products being complementary rather than interchangeable); and because in some countries commercial insurers and captives face different licence and regulatory requirements (Company D was of the view that it is unreasonable to classify captives as operating in the same market as commercial insurers when they do not have the same opportunity to participate in that market).

Company D also argued that any decision by the Authority ordering recovery of unlawful State aid from captives in Liechtenstein would be contrary to general principles of law, as it would be retrospective and in breach of the legitimate expectation of the companies that they would not be subject to an increased tax burden.

3.4. Comments from Company E

Company E is a captive insurance company located in Liechtenstein. In its letter received by the Authority on 12 May 2009, Company E claimed that the Authority had made incorrect assumptions in its decision to open the formal

procedure. Company E argued that a captive insurance company does not offset risk through the purchase of reinsurance as stated by the European Commission (and referred to by the Authority) in its decision concerning aid for captive insurance companies in Åland (Finland)⁽¹⁾ explaining that a captive carries all of the risks of its parent. Company E also argued that insurance through a captive is not an alternative to obtaining insurance on the 'general market', and indeed that captives are at a disadvantage compared to general insurers as they are unable to pool risks, and should be compared not with general insurers but with the uninsured risks that companies carry.

Company E stated that it does not currently provide insurance to its group that cannot be bought on the international market. Company E stated that establishing a captive involves substantial costs and can only be justified on commercial grounds. One of the reasons, it informed the Authority, that the company was formed in Liechtenstein was that the principality was 'not disadvantageous' in tax terms in comparison to other locations, and a change to the tax regime 'will adversely affect the viability of Liechtenstein as a captive location'.

3.5. Comments from Company F

Company F firstly explained how captive insurance and reinsurance companies, and in particular Company F as part of the [...] Holding, are organised. It stressed the fact that captives constitute a pooling of risks within a company group to allow for efficient risk management and financing. It also considered that the establishment of a captive creates greater transparency of risks within the group.

Company F referred to the lesser requirements of market integration that exist among the EFTA States of the EEA compared to the EU. It referred in particular to Articles 113, 114(2), and 115 TFEU regarding approximation of laws in the area of taxation, which do not have analogous provisions in the EEA Agreement.

Company F argued that the tax measures in favour of captive insurance companies in Liechtenstein do not constitute State aid within the meaning of Article 61(1) of the EEA Agreement. This statement was based on two reasons: captives are not undertakings, and the tax measures do not selectively benefit any undertaking.

⁽¹⁾ Commission Decision of 10 July 2002 on the aid scheme implemented by Finland for Åland Islands captive insurance companies (OJ L 329, 5.12.2002, p. 22).

Referring to a decision of the Authority concerning the Norwegian Road Administration Møre and Romsdal District Office ⁽¹²⁾, Company F argued that captives are not undertakings because they only provide insurance services 'in-house'. Moreover, the activity carried out by captive insurance companies does not have an economic nature as it is exclusively limited to the transfer of internal risks from the activities of the remainder of the [...] Holding Group. Disagreeing with the arguments put forward by the Authority in the opening decision, Company F contended that the reason for establishing a captive was not that it is economically advantageous but because it means that the risks of the group are pooled for more efficient risk management and increased transparency. This specific function cannot be assumed by an 'external' company and in consequence there is no market for this specific type of activities. Company F also contended that there is no open market alternative to the service it provides.

Company F also argued that the reference to the Åland Decision of the European Commission is questionable since the Authority is not bound by the decisions of the Commission, but must assess the measures independently and solely based on the provisions of the EEA Agreement.

Company F also argued that the tax measures are not linked to a given undertaking but to a particular function and are, therefore, not selective. Company F considered that selectivity does not relate to the economic strength of the undertaking and the question of whether it could establish a captive insurance company was wrongly argued both by the Authority and by the Commission in the Åland case. Company F argued that in the latter case the Commission had not fully assessed selectivity as it did not assess whether the measures fell within the nature and logic of the tax system. Referring in this context to the Commission's Decision in the *Irish Holding Company Regime* case ⁽¹³⁾, Company F argued that the Authority should have assessed whether captive insurance companies are factually and legally in a similar situation and come to the conclusion that the specific regulatory provisions applicable to them (in particular Directive 2005/68/EC of the European Parliament and of the Council ⁽¹⁴⁾ which provides a definition of captive insurance companies, as well as the Solvency II Directive) prove that they are not. With reference to the case-law of the EFTA Court, Company F argued that 'any direct or indirect discrimination which is to be considered justified must derive from the inherent logic of the general system and result from objective conditions within that general system'.

As secondary arguments, Company F considered that the tax measure existed prior to the entry into force of the EEA

Agreement in Liechtenstein, and that the company has been subject to the same tax rules since its establishment in 1990. These rules were explicitly applicable to captive insurance companies from January 1998 and have not been substantially modified since. Company F contended that it is only the evolution of EEA rules that has led to the tax measures applicable to captives in Liechtenstein being considered to be State aid. The decision-making practice of the Commission from 1960 to 1990, during which time the Liechtenstein scheme was introduced, did not consider tax measures to constitute State aid.

Finally, referring to previous Commission decisions, some of which had considered similar tax arrangements not to constitute State aid, Company F considered that no recovery should be requested in this case because of legal certainty and the protection of legitimate expectations.

3.6. Comments from Company G

In letters dated 1 December 2008 and 25 May 2009, Company G expressed its surprise at the investigation given that it had trusted the legality of the Liechtenstein tax system for more than 10 years, and that to date there had been no indications that the rules applicable to captive insurance companies could be State aid. In its opinion, an undertaking cannot be expected to verify whether legislation in place for more than 10 years had been notified to the Authority. Moreover, the retroactive payment of taxes, it said, is questionable from a legal perspective and counterproductive from an economic point of view, in particular in the context of the current financial crisis. Company G referred also to the principles of legitimate expectations and legal certainty.

3.7. Comments from Company H

In letters dated 17 October 2008 and 27 May 2009, Company H expressed its concern that the tax legislation in favour of captive insurance companies in Liechtenstein could be considered incompatible State aid. The company stated that it had trusted the legality of the legislation in place for more than 10 years, and it would not be realistic to require it to ensure that it is compliant with the State aid rules of the EEA Agreement. Recovery of taxes would violate the principles of legitimate expectations and legal certainty, and would contravene the principle of equal treatment within the EEA at time in which the European Commission has allowed millions of euro of State aid to alleviate the financial crisis.

⁽¹²⁾ Authority Decision No 349/07/COL of 18 July 2007 concerning the Norwegian Road Administration Møre and Romsdal District Office, for publication reference, see footnote 7.

⁽¹³⁾ Commission Decision of 22 September 2004 in Case N 354/04 (OJ C 131, 28.5.2005, p. 10).

⁽¹⁴⁾ OJ L 323, 9.12.2005, p. 1.

3.8. Comments from Company I

Company I communicated its concern that the taxation of captive insurance companies in Liechtenstein may constitute incompatible State aid, and stressed its trust in the legislation applicable in Liechtenstein for 10 years. This, in its opinion, justified the application of legitimate expectations and legal certainty in the context of recovery.

3.9. Comments from Company J

Company J presented its concerns regarding the possible incompatibility of the Liechtenstein taxation for captive insurance companies with the State aid rules in letters dated 13 November 2008 and 20 April 2009.

Company J argued that special provisions for captive insurance companies in new Solvency II legislation are an indication that captives are not active on the same market, and are not subject to the same regulatory mechanisms, as other insurance companies. Company J also argued that any undertaking can establish a captive insurance company and in consequence the measure is not selective.

The company was of the view that taxing captive insurance companies 'across the board' on their net earnings would lead to unequal treatment of undertakings. Captives, the company argued, are an instrument of self insurance and should only be taxed on their income from insurance branches liable for a legal insurance obligation in the country of the insurer. Otherwise, it was said, undertakings that create a captive will be worse off from a tax point of view than those that do not have a captive insurance company, and choose not to insure risks which do not have to be insured by law. Captives take insurance policies for risks for which there is no market and income from these activities should, therefore, not be taxed.

The company argued that it would contradict the principle of legal certainty to expect an undertaking to question legislation that had applied for more than 10 years. It stated that it had legitimately trusted the legality of the tax measures and contended that should the Authority come to the conclusion that State aid is involved, the measures qualify as existing aid, or (alternatively) recovery would contravene fundamental principles of law.

Finally, Company J referred to the financial crisis and how it has had an impact on the assessment of State aid. In its view, many of the measures adopted by several Member States of the European Union will not have a temporary character but will

become permanent. Against this background, Company J expected that the Authority will not request the amendment of the Liechtenstein tax legislation applicable to captives.

3.10. Comments from Company K

Company K provided comments in December 2008 and April 2009. It expressed its surprise that the tax legislation applicable in Liechtenstein for the last 10 years would entail the grant of incompatible State aid. It argued that any order to repay aid would contravene the principle of legal certainty (pointing out that Liechtenstein law has a limitation period of five years for challenging tax liabilities). Company K explained the history of the foundation of the company, which would be tax exempted in Switzerland and only insures risks within the Company K group. It is not profit making, it insures also risks that are not or not fully covered in the insurance market and its premiums are calculated on the basis of the claims history/experience. Should the Authority conclude that incompatible State aid was granted, the Company K considers that a recovery would violate the principles of legal certainty, homogeneity and legitimate expectations.

4. COMMENTS BY THE LIECHTENSTEIN AUTHORITIES

4.1. Comments on the opening decision

In a letter dated 25 November 2008, the Liechtenstein authorities referred to the evolution of the assessment of State aid in the context of business taxation from the beginning of the 1980s to the issue of a notice on the application of the State aid rules to direct business taxation in 1998, and to the European Commission's decisions in the early 2000s (for example on the Belgian coordination centres ⁽¹⁵⁾).

The Liechtenstein authorities argued that captive insurance companies are not active on an open market as their activities are limited to managing intra-group risks, i.e. the risks of its own corporate group. Any income generated by the captive insurance through transactions within the group is not ordinary income that should be subject to income taxation, as the administration of own assets does not constitute a commercial activity subject to taxation. In their view, an entity that does not exercise its activity on a market in competition with other market players cannot be considered as engaging in economic activity as an undertaking ⁽¹⁶⁾. Even if they were to provide services on the 'free' market, the Liechtenstein system ensures that the regular tax rates apply to these

⁽¹⁵⁾ Commission Decision of 17 February 2003 on the aid scheme for coordination centres established in Belgium (OJ L 282, 30.10.2003, p. 25). Further reference to this decision is made at Section 4 below.

⁽¹⁶⁾ Reference was made to case C-222/04 *Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Firenze SpA* [2006] ECR I-289.

free market activities. In the opinion of the Liechtenstein authorities, it is only to the extent that the companies engage in those 'free' activities that they should qualify as undertakings.

The Liechtenstein authorities argued that captive insurance companies (like reinsurance companies) constitute a separate market from direct insurance due to the risk allocation within a group, the different regulatory framework, and the management function captives undertake within the group to which they belong. Captive insurance companies only insure their own group's risks (where there is no market or where costs are too high) and not the risks of third parties.

As far as selectivity is concerned, with reference to the Åland captive insurance system and the Irish Company Holding Regime, the Liechtenstein authorities submitted that the tax regime applicable to captive insurance companies is not materially selective. This is because the conditions for these companies are horizontal in nature and could be achieved by any undertaking, i.e. no specific economic strength is required from undertakings to set up a captive insurance company and it, therefore, applies to all sorts of companies. On that basis any legal person, irrespective of the sector of activity or size of operations, could qualify for the tax reduction through ownership of a captive insurance company.

In line with the *Gil Insurance* ⁽¹⁷⁾ case-law, the Liechtenstein authorities argued in the alternative that the measures are justified by the nature and general scheme of the tax system, arguing that: 'What matters is whether the apparent exception is actually in line with the internal logic of the measure. [...] A tax measure is specific only if it unreasonably discriminates between situations being legally and factually comparable in the light of objectives set by the tax system.' Under Liechtenstein law, captive insurances may be defined as a limited-purpose insurance entity established with the specific objective of financing risks emanating from their corporate group: 'Hence, it is an in-house self-insurance vehicle. The captive insurance is made out of the own means of its corporate groups. Hence, the captive insurance follows the principle that the coverage of liabilities out of own means should be treated differently for tax purposes.'

Furthermore, the Liechtenstein authorities highlighted the different treatment of captive insurance companies in comparison with conventional insurance companies by reference to Community/EEA law examples under the reinsurance directive and the Solvency II directive. These, it is said, take note of the specific nature of captive insurance and reinsurance undertakings. They argued that it is acknowledged

that as those undertakings cover only risks associated with the industrial or commercial group to which they belong, account is taken of their specific (and different) position.

Finally (in the alternative), the Liechtenstein authorities considered that the 1997 Tax Act constitutes existing aid because at the time it was put into effect it did not constitute an aid, but subsequently became aid due to the evolution of EEA law. If the Authority characterises the measures as new aid, they argued that there are sufficient grounds for not recovering the aid. This is for two reasons. The first is legitimate expectations based on a reliance on the approach taken by the Commission in its decisions relating to the tax incentives for intra-group financial treasury centres in France and the tax incentives for international financial activities in the Netherlands. The second is legal certainty, since at the time Liechtenstein joined the EEA in 1995, the Commission's State aid practice (which is part of the *acquis communautaire*) did not consider taxation of intra-group activities to be a matter subject to the State aid rules.

4.2. Comments on third party submissions

The Liechtenstein authorities stressed that nearly all captive insurance companies operating in Liechtenstein submitted comments during the formal investigation, reflecting the importance of the issue. They emphasised that the decision to open a formal investigation came as a surprise to the companies since Liechtenstein's tax regime had been adopted more than 10 years ago. Agreeing with the comments submitted by third parties, the Liechtenstein authorities argued that:

4.2.1. Captives do not qualify as undertakings

The Liechtenstein authorities considered that the comments submitted by Company B provided a good overview of captive insurance operations. They agree, in particular, that there is no 'liquid insurance market' for all of the activities of captives. In this context the Liechtenstein authorities referred to an International Association of Insurance Supervisors (IAIS) Captive Issues Paper stating that:

'Certain types of risk such as sensitive product liability risks, environmental impairment, pharmaceutical liability and selected professional indemnity, regardless of the claims history, are frequently either extremely difficult or even impossible to place in traditional markets. Alternatively they demand either high premiums or unacceptable terms and conditions even though the insured may have an acceptable claims history.'

⁽¹⁷⁾ Case C-308/01 *Gil Insurance and Others v Commissioners of Customs & Excise* [2004] ECR I-4777.

The Liechtenstein authorities reiterated that all captives established in Liechtenstein are confined to managing intra-group risks only. Further, the risks insured by captives are often not transferable to other commercial insurers. Captives are therefore in a position to cover risks for which the traditional insurance market does not offer economically viable solutions. In addition, captives differ considerably from direct insurance companies as the latter insure many sorts of risks and therefore hold a risk pool to balance claims. A captive on the other hand only insures its own companies' risks and is not able to balance those risks. The Liechtenstein authorities argue, therefore, that the captive insurance market is distinct from conventional insurance market operations and that captive insurances do not compete with insurance companies. Reference was also made to Court of Justice case-law concluding that an entity which does not exercise its activity on a market 'in competition with other market players' cannot be considered as operating an economic activity as an undertaking, and to the Authority's decision in the Norwegian Road Administration case which — it is argued — shows that entities engaged only in in-house activities are not undertakings as they do not engage in economic activities.

4.2.2. *The tax treatment of captives constitutes a general measure*

4.2.2.1. Material selectivity

The Liechtenstein authorities argued that the tax treatment of captives is not materially selective as it is an option available to all and does not require a certain economic strength. The tax measures are not limited to certain sectors, certain types of companies, or certain parts of the Liechtenstein territory — there are also no restrictions regarding turnover, size, the number of employees or a necessity to be part of a multinational group. They argue, therefore, that their tax provisions for captive insurance companies are not materially selective.

The Liechtenstein authorities referred to the European Commission's Decisions regarding the Åland Islands captive insurance tax system, the Irish Company Holding Regime, the Spanish reduced tax from intangible assets, and the Dutch reduced tax on revenue from intra-group loans (*Groepsrentebox*)⁽¹⁸⁾, in order to support the claim that the taxation of captive insurance companies in Liechtenstein is not materially selective. The Dutch decision was quoted as follows:

⁽¹⁸⁾ See footnotes 5 to 8 above.

'With respect to debt financing activities, related companies are not in a comparable legal and factual situation as unrelated companies. The reason is that related companies are not engaged in a merely commercial transaction, unlike unrelated companies, when they try to obtain loan or equity financing within the group. The parent and the subsidiary share the same interest, which is not the case of a commercial transaction with a third party provider of finance, where each party tries to maximise its profits at the expense of the other.'

4.2.2.2. Justification by the nature and general scheme of the system

Even if the Authority were to consider the measures at stake to be materially selective, the Liechtenstein authorities argue that they are, in any event, justified by the nature and general scheme of the Liechtenstein tax scheme. In doing so, they agree with the views expressed by third parties on this point.

The Liechtenstein authorities supported arguments relating to the definition and treatment of captive insurance companies under the EU Reinsurance and Solvency II Directives, claiming that captive insurance should be distinguished from classical insurance business. The Liechtenstein authorities agreed that different treatment of the captives is justified given the limited area of operation of captives and their specific intra-group nature.

4.2.3. *No distortion of competition and no effect on trade between Contracting Parties*

The Liechtenstein authorities concurred with Company A RE that the services provided by captives are not tradable since there is no 'free market solution' available for some risks. Consequently, the measures in question neither distort competition nor affect trade between the Contracting Parties to the EEA Agreement.

4.2.4. *If aid is present it is existing aid*

The Liechtenstein authorities argued that the measures in question should be regarded as existing aid within the meaning of Article 1(1) of Part I and Article 1(b)(v) of Part II of Protocol 3 if they are to be characterised as State aid at all. In doing so, they again shared the opinion of third parties on that point.

They argued that captives have been taxed at a reduced capital tax of 0,1 % since 1989 before any specific legislation was enacted for captive insurance companies. Further, the Liechtenstein authorities supported arguments that the tax measures became aid as a result of the evolution of the EEA Agreement. Agreeing with Company F, the Liechtenstein authorities considered that the evolution which took place at the end of the 1990s occurred after the specific measures relating to captive insurance companies were introduced by the Act of 18 December 1997.

4.2.5. *Recovery of aid would be incompatible with the general principles of Community law*

Agreeing with Company A and Company F's statements, the Liechtenstein authorities submitted that the captives could not have anticipated that the measures, when adopted in 1997, could be State aid given the similarities between their position and cases on intra-group activities. All interested parties claim that there were no indications at the time that any of the Authority's preliminary findings were likely, or foreseeable.

In line with the statements of all interested parties, the Liechtenstein authorities also expressed their opinion that recovery would be in contravention of the principle of legal certainty. The fundamental requirement of legal certainty is to ensure that the application of European Union/EEA law is certain and foreseeable. It is also argued that this necessity must be enforced all the more strictly where there are financial consequences. It is submitted that when Liechtenstein joined the EEA Agreement in 1995 the *acquis communautaire* (including the Commission's State aid decision practice) did not designate the taxation of intra-group activities as State aid, and that there were no developments between 1995 and 1997 (when the measures were adopted) to suggest that this position would change.

II. ASSESSMENT

1. THE PRESENCE OF STATE AID

Article 61(1) of the EEA Agreement reads as follows:

'Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Contracting Parties, be incompatible with the functioning of this Agreement.'

1.1. **Presence of State resources**

The aid measures must be granted by the State or through State resources.

While the capital tax rate in Liechtenstein is currently set at 0,2 %, captive insurance companies are subject to a reduced rate of 0,1 % (and 0,075 % for capital exceeding CHF 50 million and 0,05 % for capital in excess of CHF 100 million). Captive insurance companies are also fully exempted from payment of income tax and the coupon tax.

The granting of a full or partial tax exemption involves a loss of tax revenues for the State which is equivalent to consumption of State resources in the form of fiscal (tax) expenditure ⁽¹⁹⁾. The Liechtenstein authorities forego revenue corresponding to the non-payment of income tax, the payment of a reduced capital tax rate as well as the non-payment of coupon taxes.

For these reasons, the Authority considers that the special tax rules applicable to captive insurance companies are granted through State resources.

1.2. **Favouring certain undertakings or the production of certain goods**

1.2.1. *Undertaking*

State aid can only be granted to undertakings that are engaged in economic activity.

According to the European Court of Justice, the notion of an undertaking within the meaning of Article 87 EC (now Article 107 of the Treaty on the Functioning of the European Union), which corresponds to Article 61(1) of the EEA Agreement, encompasses 'every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed' ⁽²⁰⁾. The Court has further 'consistently held that any activity consisting in offering goods or services on a given market is an economic activity' ⁽²¹⁾.

Providing insurance is a service, which in principle is an economic activity ⁽²²⁾. Captive insurance companies offer insurance services for a premium on a given market. The fact that their clients are restricted only to undertakings of the same group to which they belong does not affect this conclusion. The undertakings of the group to which the captive belongs have chosen to purchase insurance from another company within its group which provides such services instead of purchasing from a third party insurance company. As referred to below, the Authority is of the view, therefore, that the services provided by captive insurers are an alternative to purchasing insurance from a third party. The fact that captive insurance companies supply demand for insurance from certain undertakings is

⁽¹⁹⁾ See point 3(3) of the Authority's State Aid Guidelines to Business Taxation.

⁽²⁰⁾ Case C-41/90 *Höfner and Elser v Macrotron GmbH* [1991] ECR I-1979, paragraph 21.

⁽²¹⁾ Joined Cases C-180/98 to C-184/98 *Pavlov* [2000] ECR I-6451, paragraph 75.

⁽²²⁾ NACE code is a pan-European classification system which groups organisations according to their business activities. K65 — Insurance, reinsurance and pension funding, except compulsory social security.

sufficient to conclude that they offer their services on the market. By establishing a captive, the insurance of these risks is 'captive' to one company of the group, which means that none of the other insurance companies active in the market will be able to compete for the insurance of the risks of the group. The insurance of these risks would normally be undertaken by choosing another commercial provider but here the service is provided by the captive insurance company formed by the group instead.

A captive insurance company is established as a separate legal entity in Liechtenstein and set up like any other company. The services it provides are paid for, risk is transferred to it on an arm's length basis, it keeps separate accounts and is liable to tax under national law. Captive insurance companies are indeed subject to taxation in Liechtenstein in the first place as they are undertakings that are engaged in economic activity within the jurisdiction. Forming a separate company is a deliberate choice on the part of companies which decide to form captives, and it is common practice to locate the captive in a low tax jurisdiction in order to benefit from lower rates of taxation. If a new, separate company was not created, and the risks were self-insured within the existing company structure, generally speaking, the cost benefit from deciding not to pay commercial insurers would merely be reflected in lower costs — and therefore higher profits, paid at the normal rate within the company's home tax jurisdiction. Creating a company and locating it offshore means that the insurance services can be provided outside the company's home tax jurisdiction(s), enabling the group to benefit (among other ways ⁽²³⁾) from lower taxation on the profits made from the decision to self-insure ⁽²⁴⁾.

During the formal investigation some of the parties involved argued that captives are not undertakings, firstly, because they only provide insurance services 'in-house', and, secondly, because the services provided are not offered by the open market mainly as they concern common high frequency risks commonly retained by companies, or complex, high value risks that cannot be insured on the market or can only be insured at prohibitive cost.

⁽²³⁾ For example, forming a separate company in this way can also mean that the company holds capital reserves (required for regulatory reasons) which are tax deductible.

⁽²⁴⁾ See the reasoning in the Commission Decision of 10 July 2002 on the aid scheme implemented by Finland for Åland Islands captive insurance companies, cited above, paragraph 51.

'In-house' provisions

As stated above, specific references were made during the investigation to the Authority's decision concerning the Norwegian Road Administration Møre and Romsdal District Office. The Norwegian Road Administration was reorganised in 1995 and split into district offices, each with a production department responsible for construction and maintenance of roads, tunnels and bridges, and an administrative department in charge of ordering works and administering public tenders. The production departments carried out tasks falling within the responsibilities of the Road Administration according to applicable quality standards and framework conditions, but was not engaged in any work falling outside the responsibilities of the Road Administration, for example on the open market. Since the Production Department of the Møre and Romsdal District Office carried out its activities confined to the State 'in-house', the Authority concluded that those activities did not compete on a market with other market players. Accordingly, the Department was not considered to be an undertaking, and its funding, therefore, was not State aid.

Interested parties have argued that the same reasoning should apply to captive insurance companies. The Authority does not concur with such a position. Consistent with case-law ⁽²⁵⁾, the principles referred to in the Norwegian Road Administration decision are applicable in the case of public authorities exercising their right to undertake public services themselves without offering a contract to tender on the open market. As referred to by the Court of Justice in the *Stadt Halle* judgment ⁽²⁶⁾: 'A public authority which is a contracting authority has the possibility of performing the tasks conferred on it in the public interest by using its own administrative, technical and other resources, without being obliged to call on outside entities not forming part of its own departments.' Referring to the difference between such a scenario and one involving a private undertaking, the Court went on to say that 'it must be observed ... that the relationship between a public authority which is a contracting authority and its own departments is governed by considerations and requirements proper to the pursuit of objectives in the public interest. Any private capital investment in an undertaking, on the other hand, follows considerations proper to private interests and pursues objectives of a different kind.'

⁽²⁵⁾ See case C-107/98 *Teckal SRL and Comune di Viano, Azienda Gas-Acqua Consorziale (AGAC) di Reggio Emilia*, judgment of 18 November 1999.

⁽²⁶⁾ Case C-26/03 *Stadt Halle and RPL Recyclingpark Lochau GmbH v Arbeitsgemeinschaft Thermische Restabfall- und Energieverwertungsanlage TREA Leuna* [2005] ECR I-1, paragraph 48.

The Authority, in line with such reasoning, considers the legal and factual position of captive insurance companies to be very different from that of public authorities providing services in the public need. Captive insurance companies provide commercial services to private undertakings and are not in a comparable position — and any assistance provided to them by the State through tax exemptions must be considered within that context.

Captives providing services that are not available from commercial insurance providers

The European Commission recently completed a sectoral investigation into the European insurance industry. In its interim report ⁽²⁷⁾, the Commission explained that insurance undertakings can be classified in various ways, for example ⁽²⁸⁾:

- according to whether they are proprietary insurance companies or mutual insurers,
- according to the line(s) of insurance they write,
- according to whether they are direct (primary) insurers or reinsurers,
- according to whether they are independent of any particular buyer of insurance or closely affiliated to a particular buyer or group of buyers (as in the case of captive insurers or reinsurers).

Competition in the insurance market is impacted upon by the availability of alternatives to taking out traditional insurance products ⁽²⁹⁾. The Authority is of the view that there are three main alternatives: self-insurance, captive insurance and alternative risk transfer products ⁽³⁰⁾. In each case, the primary reason for using a substitute for insurance is the potential for reducing costs. A captive insurance company enables investment income on the premiums to be retained within the group and potentially allows for more flexibility in the pattern of premiums. Although these are not necessarily perfect substitutes for insurance, they pose a degree of competitive restraint on the insurance market. Captive insurance companies are, therefore, considered to be an alternative to the third party insurance available on the market. According to the Commission's Report, 'large commercial clients (and they are increasingly large, since many are themselves the product of M&A activity) may now use their size to justify buying less insurance rather than more. They retain more

exposures, take bigger deductibles, and increasingly use captives and other corporate vehicles in preference to full commercial insurance.'

The Commission's report states that the main objectives in establishing a captive are:

- to obtain the full benefit of the parent company/group's risk control techniques by paying premiums based on its own experience,
- to avoid the direct insurers' overheads and administrative costs,
- to retain as much of the premiums, and the investment income on them, as possible within the group,
- to obtain tax advantages and the lower cost of (less rigorous) regulation in an offshore base,
- to obtain a lower overall risk premium level by purchasing reinsurance 'wholesale' and at lower cost than that required by the conventional or direct insurer.

The Authority disagrees with the contentions of certain third parties that the services provided by captives are not alternatives to commercial insurance. As stated above, the Authority considers that captive insurance is a service substitutable for commercial insurance ⁽³¹⁾. Although it may be the case that certain risks cannot be insured on the market (or, more likely, cannot be insured at what the potential purchaser considers to be a reasonable price), the Authority does not accept that captive insurance companies exclusively provide insurance services that are not available from commercial insurers. The Authority, furthermore, does not accept that what may be prohibitive pricing by commercial insurers means that captive insurance companies are not engaged in economic activities in competition with those insurers. Undertakings belonging to a group have the choice to insure their (obligatory and voluntary) risks with a commercial insurer or create a captive insurance company. If they choose the latter option, they are foreclosing the insurance market as far as their risks are concerned. Competition with other insurance providers therefore exists at the point of formation of the captive, and at each point in which the client of the captive decides to what extent it wishes to retain risk within the captive or purchase insurance (or reinsurance) on the open market.

⁽²⁷⁾ Business insurance sector inquiry — Inquiry into the European business insurance sector pursuant to Article 17 of Regulation (EC) No 1/2003 — Interim report January 2007. Available under: http://ec.europa.eu/competition/sectors/financial_services/inquiries/interim_report_24012007.pdf

⁽²⁸⁾ See Chapter 5 Insurance markets: basic structure, Commission's Report, p. 32.

⁽²⁹⁾ See Chapter 4.2.1 Substitutes for insurance of the FSA report.

⁽³⁰⁾ See, for example, a report prepared for the United Kingdom Financial Services Authority by CRA International in December 2007. Available at: http://www.fsa.gov.uk/pubs/other/cra_report_cicd.pdf

⁽³¹⁾ See the FSA report, p. 51.

The Authority also notes that captive insurance companies are at present subject to tax in Liechtenstein, like other undertakings, albeit with exemptions and at different rates.

The Authority has concluded, therefore, that the activities carried out by captive insurance companies in providing insurance (or reinsurance) services to their associated companies constitute an economic activity. On that basis the companies are undertakings within the meaning of Article 61(1) of the EEA Agreement.

1.2.2. Advantage

The measure confers upon captive insurance companies falling under Article 82a of the Tax Act an advantage by relieving them of charges (non-payment of income tax and only a reduced payment of a capital tax) that would normally be borne from their budgets.

The payment of taxes is an operating cost incurred in the normal course of an undertaking's economic activity, which is normally borne by the undertaking itself. In general, qualification for a lower rate of taxation than would normally be due or an exemption from paying taxes confers an advantage on the eligible companies. These companies are granted an advantage because their operating costs are reduced in comparison with others that are in a similar factual and legal position.

One of the third parties argued that captives provide insurance cover for risks for which there is no market and income from these activities should therefore not be taxed. Again, the Authority does not accept this argument. It is a deliberate choice of the group of undertakings to insure its risks in the form of a separate company set up on an arm's length basis that is paid for the service provided. The tax rules do not relate to the risks insured but to the income generated irrespective of its source. The undertaking receives an advantage on lower or zero taxation of the income and capital which it derives from this source of economic activity.

By exempting shares or parts of captive insurance companies from payment of the coupon tax, the Liechtenstein legislation also makes it more attractive to invest in captive insurance companies than in other undertakings. Investors in captive insurance companies are, therefore, granted an advantage⁽³²⁾. The exemption also grants an advantage to the captive insurance companies as it makes capital more easily accessible to them⁽³³⁾.

⁽³²⁾ In the case of investors which are private persons, the grant of a tax exemption does not constitute State aid within the meaning of Article 61(1) of the EEA Agreement.

⁽³³⁾ Commission Decision of 21 January 1998 on tax concessions under paragraph 52(8) of the German Income Tax Act (OJ L 212, 30.7.1998, p. 50). Case C-156/98 *Germany v Commission* ECR [2000] I-6857, paragraph 26.

1.2.3. Selectivity

For a measure to be aid it must be selective in that it favours 'certain undertakings or the production of certain goods'.

1.2.3.1. Assessment of material selectivity

According to Article 73 of the Tax Act, legal persons operating commercial businesses in Liechtenstein (including foreign companies operating a branch in Liechtenstein) pay income and capital tax. The annual net income of companies in Liechtenstein is subject to business income tax ('*Ertragssteuer*')⁽³⁴⁾ at a rate between 7,5 % and 15 %⁽³⁵⁾. At the end of the company's financial year (generally on 31 December) companies located in Liechtenstein also pay a capital tax ('*Kapitalsteuer*') on the paid-up capital stock, joint stock, share capital, or initial capital as well as the reserves of the company constituting company equity at a rate of 0,2 %⁽³⁶⁾. Further, a coupon tax is levied on the coupons of securities or documents equal to securities issued by a 'national' at a rate of 4 % on any distribution of dividends or profit shares.

By virtue of Article 82a of the Liechtenstein Tax Act, however, captive insurance companies ('*Eigenversicherung*') pay a reduced capital tax of 0,1 % instead of the generally applicable 0,2 % capital tax rate. This rate is further reduced for amounts exceeding CHF 50 million and CHF 100 million. As confirmed by the Liechtenstein authorities, on the basis of the same provision, captive insurance companies do not pay income tax. On the basis of Article 88d(3) of the Tax Act, captive insurance companies are also exempted from payment of the coupon tax.

By not being subject to any income or coupon tax and only a reduced rate of capital tax, captive insurance companies receive a selective advantage in comparison to other undertakings which are subject to ordinary taxation on revenues from their business activities. According to the Liechtenstein legislation, in particular Article 82a paragraph 1 of the Tax Act, these tax reductions are only applicable to insurance companies which exclusively engage in captive insurance ('*Eigenversicherung*'). Other insurance companies as well as any other type of undertaking active in other sectors of the economy are subject to normal tax rules.

The Authority is also of the view that the tax measures contain a further element of selectivity as they also provide for greater tax reductions for captive insurance companies which have capital exceeding CHF 50 million or CHF 100 million.

⁽³⁴⁾ See Article 77 of the Tax Act.

⁽³⁵⁾ The income tax rate depends on the ratio of net income to taxable capital. The tax rate may be increased by 1 percentage point to, at most, 5 percentage points, the maximum income tax being therefore 20 %.

⁽³⁶⁾ See Article 76 of the Tax Act.

Reference has been made in the context of the assessment of selectivity to the decision of the European Commission regarding taxation of captive insurance companies in Åland ⁽³⁷⁾. In this decision, the Commission considered that captive insurance companies which benefited from lower taxation than would normally apply to companies had received a selective advantage because this favoured only captive insurance companies as the prime beneficiaries of the tax relief. The Authority concurs with this view and is of the opinion that this in itself is sufficient to make the measures selective ⁽³⁸⁾. By reference to the European Court of Justice's conclusions in the *GIL Insurance* case ⁽³⁹⁾, 'Article 87(1) EC requires it to be determined whether, under a particular statutory scheme, a State measure is such as to favour "certain undertakings or the production of certain goods" in comparison with others which, in the light of the objective pursued by the system in question, are in a comparable legal and factual situation'. The Authority concludes that the undertakings in the same legal and factual position in this case are those who pay the (full) income, capital and coupon taxes in Liechtenstein — and in comparison to those, captive insurance companies in Liechtenstein receive a selective advantage. Unlike many recent complex fiscal aid cases, the objectives of the measure in question were straightforward. The standard rate taxes generate revenue for the State, while the reduction and exemption applicable to captive insurance companies were (by the Liechtenstein authorities' own admission) designed to attract a mobile (and tax sensitive) service sector to the Principality. In turn, captive insurance companies are created and normally located apart from the rest of their group (at least in part), in order to benefit from lower taxation on profits generated by a formalised form of self-insurance.

The Authority is of the view that there is no reason to conclude, therefore, that captive insurance companies are in a different legal and factual situation to the other undertakings subject to Liechtenstein taxation.

⁽³⁷⁾ Commission Decision of 10 July 2002 on the aid scheme implemented by Finland for Åland Islands captive insurance companies, cited above.

⁽³⁸⁾ The Commission also concluded that the measure debarred insurance companies which normally insure non-affiliated companies (or any other undertakings) from operating on the same market and on the same conditions as captive insurance companies. Again, the Authority concurs with this view.

⁽³⁹⁾ Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, paragraph 68. See also Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, paragraph 41, Case C-409/00 *Spain v Commission* [2003] ECR I-1487, paragraph 47.

1.2.3.2. Assessment of selectivity in previous State aid decisions regarding tax measures

Certain third parties asserted during the formal investigation that the exemptions from tax in Liechtenstein are not selective as any economic undertaking is free to form a captive. The Authority does not concur that this is a valid legal consideration, and disagrees with the factual basis for the argument in any event. The Authority is of the view that there are two conditions that must be fulfilled to be able to form a captive insurance company. The first is that only companies that are able to absorb the fixed costs inherent in forming a captive insurance company can benefit. The second, more important, condition follows from the fact that forming a captive insurance company is essentially a formalised way of self insuring. The Authority is of the view that only undertakings that have significant resources (mainly large companies) can cover the risks of self-insuring ⁽⁴⁰⁾ and that principles of insurance mean that a certain size and diversity of operation is required in order to manage risk without use of third party cover. This need for size and diversity is, in the Authority's opinion, self evident, given that the smallest of companies can, depending on their activity, incur high liabilities (for example through the deterioration of fixed assets caused by accidents or fire, or through injury caused by negligently supplied products or services), which they would not be able to pay. The Commission also considered (in the Åland decision) that the conditions under which the measure applied (the ability to form a captive) implicitly required a certain economic strength, and therefore could apply only to sufficiently large companies ⁽⁴¹⁾.

The Authority is of the view, therefore, that the measure is available and applicable only to undertakings that have sufficient resources to form a captive insurance company, and notes that a restriction of this nature led the Court of First Instance to conclude that tax exemptions in the *Territorio Histórico de Álava* case ⁽⁴²⁾ were selective.

⁽⁴⁰⁾ Reference is made to the FSA report which stated that: 'Evidence from interviews with clients made clear that the use of captives and alternative risk transfer products was limited to large corporate customers. Self-insurance was also more common among large corporate customers although around 33 % of firms in the GBP 20 million to GBP 100 million range use self-insurance to cover some risks', and 'Competitive discipline on intermediation from alternatives to insurance such as self-insurance, captive insurance companies and alternative risk transfer products is limited to large companies.' The Authority also considers it significant that the Commission's Report on the business insurance market found that there were only approximately 5 200 captive insurance companies in existence worldwide in 2005. This figure, compared to the number of companies worldwide, is obviously very low and supports the Authority's conclusion that the establishment of a captive insurance company is not an option for most undertakings.

⁽⁴¹⁾ See paragraph 52 of the Åland decision. The Commission estimated that the formation of a captive company implied that the group with which insurance contracts would be concluded would be large enough to generate a turnover that would allow it to cover the fixed costs and obtain a profit.

⁽⁴²⁾ Joined cases T-92/00 and T-103/00, *Territorio Histórico de Álava and others v Commission (Ramondín)* [2002] ECR II-1385, paragraph 39.

Reference was also made during the investigation to the European Commission's Decision on the Irish Company Holding Regime. In that case the Commission found that an exemption from tax on capital gains made on the disposal of shares by investors who had held at least 5 % of the investee company's ordinary share capital for an uninterrupted period of not less than 12 months was not materially selective. The Commission concluded that a 5 % holding requirement did not favour any undertaking in a comparable legal and factual situation in light of the objective pursued by the measure, given that this was available to undertakings no matter what their size or legal structure⁽⁴³⁾. The tax measure under assessment in this decision, on the other hand, applies only to a particular form of undertaking engaged in a particular form of economic activity (captive insurance companies), and in any event these are companies that can be formed only by those with sufficient resources to form such a company and to self-insure against corporate risk.

A Spanish reduced tax on intangible assets was also cited during the investigation. In this case, the Commission considered that privileged treatment of income from intangible assets derogated from the ordinary corporate taxation rules. However, it concluded that the measure was not selective as it was open to any undertaking subject to corporate taxation in Spain that develops intangible assets, and any corporate tax payer (no matter what its size, legal structure or sector) in which it operates can be the beneficiary. The Spanish authorities had provided the Commission with statistics showing that intangible assets (and the R&D activities which had preceded them) were held widely throughout all sectors of the economy, including the service sector. The Commission considered that the measure does not strengthen the position of any particular class of undertakings in relation to others competing in intra-Community trade⁽⁴⁴⁾ and applies without distinction to all economically active persons⁽⁴⁵⁾. Again, the Authority does not consider that this decision is relevant to the taxation of captive insurance companies in Liechtenstein.

Finally, reference has been made to the Commission Decision on the *Groepsrentebox* scheme, a Dutch measure aimed at reducing the difference in fiscal treatment between two instruments of intra-group financing, debt and equity. Under the measure, the positive balance between received and paid interests on intra-group financing transactions is taxed in an 'interest group box' at the rate of 5 %, instead of the 25,5 % standard corporate tax rate. The Commission considered that the advantage given to a company providing a loan to a related

company cannot be considered as discriminatory, since a loan to a related company cannot be compared to a loan to an unrelated company. The Commission was of the view that the requirement of exercising control of another company is a horizontal criterion applying to all companies regardless of their size, sector or of any other distinction — a different rate of taxation for debt financing between related companies, therefore, reflects objective differences and does not affect tax neutrality.

While the Authority accepts that there are certain similarities between the above cases and the tax measures under investigation, in particular in relation to the inter-group nature of the Irish and Dutch cases, the Authority does not accept that the reasoning of the Commission applies in this case. An essential part of the Commission's reasoning in each of these cases was that the action which leads to the beneficial tax treatment is open to any undertaking, and in this context the Authority considers it significant that minimum financial transaction amounts (for setting up a company in the Netherlands, and the minimum value of the relevant holding in Ireland) were abolished. For the reasons set out above, the Authority is of the view that creating a captive insurance company is not something that is open to any undertaking (and concludes that a tax exemption specific to one form of company is different to the circumstances of this case in any event).

1.2.4. Logic of the tax system

A specific or selective tax measure can nevertheless be justified by the logic of the tax system⁽⁴⁶⁾. Measures intended partially or wholly to exempt firms in a particular sector from the charges arising from the normal application of the general system can constitute State aid if there is no justification for the exemption on the basis of the nature and logic of the general tax system⁽⁴⁷⁾. It is possible, therefore, for the specific tax rules applicable to captive insurance companies to not be selective if justified by the nature and general scheme of the Liechtenstein tax system. The Authority must assess whether the

⁽⁴³⁾ A proposed minimum value for such a holding of EUR 50 million was omitted from the measures following discussions with the Commission.

⁽⁴⁴⁾ Case C-53/00 *Ferring v ACOSS* [2001] ECR I-9067, paragraph 21.

⁽⁴⁵⁾ Case C-156/98 *Germany v Commission* [2000] ECR I-6857, paragraph 22, in which the ECJ recognised that the tax concession can constitute a general measure if it applies without distinction to all economically active persons. See also C-75/97 *Belgium v Commission* [1999] ECR I-3671, paragraph 28.

⁽⁴⁶⁾ Case E-6/98 *Norway v EFTA Surveillance Authority* [1999] EFTA Court Report, p. 76, paragraph 38; Joined Cases E-5/04, E-6/04 and E-7/04 *Fesil and Finnjord, PIL and others and Norway v EFTA Surveillance Authority* [2005] EFTA Court Report, p. 117, paragraphs 84-85; Joined cases T-127/99, T-129/99 and T-148/99 *Territorio Histórico de Alava and others v Commission* [2002] ECR II-1275, paragraph 163, Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, paragraph 42; Case T-308/00 *Salzgitter v Commission* [2004] ECR II-1933 paragraph 42, Case C-172/03 *Wolfgang Heiser* [2005] ECR I-1627, paragraph 43.

⁽⁴⁷⁾ Case E-6/98 *Norway v EFTA Surveillance Authority*, cited above, paragraph 38; Joined Cases E-5/04, E-6/04 and E-7/04 *Fesil and Finnjord, PIL and others and Norway v EFTA Surveillance Authority*, cited above, paragraphs 76-89; Case 173/73 *Italy v Commission* [1974] ECR 709, paragraph 16.

different treatment of undertakings as regards advantages or burdens introduced by the tax measure in question arise from the nature or general system of the overall scheme which applies. Where such a differentiation is based on objectives other than those pursued by the overall scheme, the measure in question would in principle be considered selective.

According to established case-law, it is for the EFTA State that has introduced different treatment between undertakings to prove that it is justified by the nature and general scheme of the system in question⁽⁴⁸⁾. The Authority must thereafter consider whether the special tax rules applicable to captive insurance companies meet the objectives inherent in the tax system itself, or whether it pursues other objectives.

The Liechtenstein authorities have stated that this tax concession was introduced in order to establish and develop the captive insurance sector as a new field of economic activity in Liechtenstein. In the view of the Authority, this is clearly an economic and political purpose not inherent to a revenue tax which, therefore, does not fall within the logic of a tax system⁽⁴⁹⁾.

The Liechtenstein authorities have further argued, in line with certain third parties, that differential treatment of captives in comparison to other insurance companies is recognised by EEA law through secondary legislation concerning insurance companies, in particular, the Reinsurance Directive 2005/68/EC and the new Solvency II Directive 2009/138/EC of the European Parliament and of the Council⁽⁵⁰⁾. It is said that the EU Reinsurance Directive and the Solvency II Directive distinguish captive insurance companies from traditional or commercial insurance businesses, and contend that this is consistent with the differential tax treatment under Liechtenstein law.

The Authority acknowledges that there may be valid reasons to differentiate between captive and other insurance companies in so far as internal market regulatory requirements ensuring retention, for example, of a certain level of capital, are concerned. However, it fails to see how such requirements could justify a difference in taxation of the capital gains and income generated by the economic activity of providing an insurance service. In the Authority's view, these considerations,

no matter how valid they are, do not relate to the logic of the income and capital tax system and cannot therefore be considered as a justification for the total or partial exemption from taxation applicable only to captive insurance companies. The logic of income and capital tax systems is to gain revenue from capital and income generated by an economic activity. Whether this activity is subject to more or less strict regulatory requirements is irrelevant in this context.

For these reasons, the Authority considers that the tax exemptions applicable to captive insurance companies in Liechtenstein are not justified by the nature and general scheme of the Liechtenstein tax system.

1.3. Distortion of competition and effect on trade between Contracting Parties

In order to fall under Article 61(1) of the EEA Agreement, the measure must distort or threaten to distort competition and affect trade between the Contracting Parties.

For a measure to distort competition it is sufficient that the recipient of the aid competes with other undertakings on markets open to competition, and that the measure concerned affects intra-Community trade by financially strengthening the position of an undertaking compared with other undertakings competing in intra-Community trade⁽⁵¹⁾. As stated above, the Authority considers that captive insurance companies carry out an economic activity consisting in offering insurance services as an alternative to commercial insurance. The insurance market is open to competition and therefore any advantage offered to captive insurance companies has a distortive effect. It constitutes an incentive for certain groups of undertakings to establish their own insurance companies to insure risks which had otherwise been insured in the open market.

Since the insurance services which the eligible companies carry out are activities which are the subject of trade between the Contracting Parties, intra-EEA trade is equally deemed to be affected⁽⁵²⁾. In addition, trade is deemed to be affected as the measure could also benefit the groups to which the captive insurers belong, and which may be active in markets open to cross-border competition.

⁽⁴⁸⁾ Case E-6/98 *Norway v EFTA Surveillance Authority*, mentioned above, paragraph 67, Case C-159/01 *Netherlands v Commission*, ECR [2004] I-4461, paragraph 43.

⁽⁴⁹⁾ See for a similar argumentation, Commission Decision of 17 February 2003 on the State aid implemented by the Netherlands for international financing activities, paragraph (95).

⁽⁵⁰⁾ OJ L 335, 17.12.2009, p. 1.

⁽⁵¹⁾ Case T-214/95 *Het Vlaamse Gewest v Commission* [1998] ECR II-717, Case 730/79 *Philip Morris v Commission* [1980] ECR 2671, paragraph 11.

⁽⁵²⁾ Commission Decision of 10 July 2002 on the aid scheme implemented by Finland for Åland Islands captive insurance companies, cited above.

1.4. Conclusion

The Authority concludes that the special tax rules applicable to captive insurance companies in Liechtenstein constitute State aid within the meaning of Article 61(1) of the EEA Agreement.

2. PROCEDURAL REQUIREMENTS

Pursuant to Article 1(3) of Part I of Protocol 3, 'the EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. [...]. The State concerned shall not put its proposed measures into effect until the procedure has resulted in a final decision'.

The special rules regarding the capital, income and coupon taxes applicable to captive insurance undertakings were introduced into the Tax Act in December 1997, i.e. after the entry into force of the EEA Agreement. The Liechtenstein authorities did not notify this amendment of the Tax Act to the Authority.

The Liechtenstein authorities and certain third parties have argued that the Liechtenstein tax regime in favour of captive insurance companies constitutes existing aid. They claim that the tax measures only became aid as a result of the evolution of EEA law since at the time they entered into force, 1 January 1998⁽⁵³⁾, there were no rules or precedents indicating any relationship between the grant of State aid and the tax measures⁽⁵⁴⁾. Article 1(b)(v) of Part II of Protocol 3 to the Surveillance and Court Agreement states that aid is deemed to be an existing aid if it can be established that at the time it was put into effect it did not constitute an aid, but subsequently became aid due to the evolution of the EEA; and if the measure has not been subsequently amended by the EFTA State.

The Authority is of the view, however, that the European Court of Justice had made it clear as far back as the 1970s that tax exemptions of the nature of those under assessment could be State aid. The Court held in 1974⁽⁵⁵⁾ that any measures intended to exempt firms in a particular sector from the charges arising from the normal application of a tax system (without there being any justification for this exemption on the basis of the nature or general scheme of this system) constituted State aid. In 1987⁽⁵⁶⁾ the Court explicitly stated

that a loss of tax revenue was equivalent to consumption of State resources in the form of fiscal expenditure.

This approach is also reflected in decisions of the Authority prior to the implementation of the Liechtenstein Tax Act, where it concluded that exemptions from the tax payable by undertakings was (incompatible) State aid in Finland in 1994⁽⁵⁷⁾ and in Norway in 1995⁽⁵⁸⁾ and 1997⁽⁵⁹⁾. Furthermore, on 1 December 1997, following a wide-ranging discussion on the need for coordinated action at Community level to tackle harmful tax competition, the European Council of Ministers adopted a series of conclusions and agreed a resolution on a code of conduct for business taxation⁽⁶⁰⁾. As part of the agreement reached, the Commission undertook to contribute to the objective of tackling harmful tax competition by implementing a notice⁽⁶¹⁾ on the application of the State aid rules to measures relating to direct business taxation, and committed itself 'to the strict application of the aid rules concerned'. When published in December 1998, the notice stated that 'According to well-established practice and case-law⁽⁶²⁾, a tax measure whose main effect is to promote one or more sectors of activity constitutes aid.'⁽⁶³⁾ The Commission, therefore, committed itself to the stricter application of rules which already existed⁽⁶⁴⁾.

The Authority does not accept that the arguments put forward by the Liechtenstein authorities and third parties show that the criteria for establishing selectivity applied by the Commission (or the Authority) in its assessment of tax issues has changed since the adoption of the tax measures under investigation. The Commission's notice on business taxation, and the Authority's corresponding guidelines, are based on the long-established case-law of the Court of Justice and of the Court of First Instance, and confirm that Articles 107 and 108 TFEU and Article 61(1) EEA (respectively) apply to tax measures. Further, in line with case-law, even if it could be established that there had been such a change of practice, the argument that the tax measures are existing aid still could not be accepted, for it fails to show that any change in the criteria for ascertaining selectivity applied by either the Commission or the Authority is attributable to the 'evolution of the European Economic Area' within the meaning of Article 1(b)(v) of Part II of Protocol 3⁽⁶⁵⁾.

⁽⁵⁷⁾ Where tax reliefs on industrial production were abolished following a decision of the Authority dated 1 December 1994, No 213/94/COL.

⁽⁵⁸⁾ Authority Decision No 106/95/COL concerning a tax exemption from a basic tax for glass packaging dated 31 October 1995.

⁽⁵⁹⁾ Authority Decision No 145/97/COL of 14 May 1997 concerning appropriate measures regarding regionally differentiated social security taxation.

⁽⁶⁰⁾ OJ C 2, 6.1.1998, p. 1.

⁽⁶¹⁾ The Commission issued its notice in November 1998 (OJ C 384, 10.12.1998). A similar notice was incorporated into the Authority's State Aid Guidelines as Chapter 17B in June 1999.

⁽⁶²⁾ See among others Case C-387/92 *Banco Exterior de España SA v Ayuntamiento de Valencia*, ECR [1994] I-877.

⁽⁶³⁾ Paragraph 18 of the notice.

⁽⁶⁴⁾ See Section J of the Code of Conduct.

⁽⁶⁵⁾ Joined Cases T- T-346/99, T-347/99 and T-348/99, *Territorio Histórico de Álava and others v Commission*, ECR [2002] paragraph 84.

⁽⁵³⁾ Having been enacted on 18 December 1997.

⁽⁵⁴⁾ The Liechtenstein authorities and some third parties argued that the Commission had in fact declared that comparable measures relating to intra-group taxation (see below) were not State aid.

⁽⁵⁵⁾ Case 173/73 *Italy v Commission* [1974] ECR 709.

⁽⁵⁶⁾ Case 248/84 *Germany v Commission* [1987] ECR 4013.

The Authority does not accept, therefore, that the measures can be defined as existing aid implemented prior to an evolution of the EEA Agreement. The measure is therefore new aid which was not notified to the Authority. The Liechtenstein authorities did not, therefore, comply with their obligations under Article 1(3) of Part I of Protocol 3.

3. COMPATIBILITY OF THE AID

Support measures designated as State aid under Article 61(1) of the EEA Agreement are generally incompatible with the functioning of the EEA Agreement, unless one of the exemptions in Article 61(2) or (3) of the EEA Agreement applies.

The derogation of Article 61(2) is not applicable to the aid in question, which is not designed to achieve any of the aims listed in this provision. Nor do Article 61(3)(a) or Article 61(3)(b) of the EEA Agreement apply.

The aid in question is not linked to any investment in production capital. It merely reduces the costs which companies would normally have to bear in the course of pursuing their day-to-day business activities, and is consequently to be classified as operating aid. Operating aid is normally not considered suitable to facilitate the development of certain economic activities or of certain regions as provided for in Article 61(3)(c) of the EEA Agreement. Operating aid is only allowed under special circumstances (for example for certain types of environmental or regional aid), when the Authority's Guidelines provide for such an exemption. None of these Guidelines apply to the aid in question.

The Authority therefore concludes that the special tax rules applicable to captive insurance companies are not compatible with the EEA Agreement.

4. LEGITIMATE EXPECTATIONS AND LEGAL CERTAINTY

The fundamental legal principles of legitimate expectations and legal certainty can be invoked by beneficiaries of aid to challenge an order for recovery of unlawfully granted State aid. The principles only apply, however, in exceptional circumstances and an undertaking cannot normally entertain legitimate expectations that aid is lawful unless it has been granted in accordance with the procedure for notifying the aid to the Authority (or the European Commission as the case may be⁽⁶⁶⁾). This is a principle recently reaffirmed by the Court of Justice as follows: 'In a situation such as that in the main proceedings, the existence of an exceptional circumstance also cannot be upheld in the light of the principle of legal certainty, since the Court has already held, essentially, that, so long as the

Commission has not taken a decision approving aid, ... the recipient cannot be certain as to the lawfulness of the aid, with the result that neither the principle of the protection of legitimate expectations nor that of legal certainty can be relied upon.'⁽⁶⁷⁾

In principle, the case-law of the Court of Justice has stated that a legitimate expectation that aid is lawful cannot be invoked unless that aid has been granted in compliance with the procedure laid down in Article 1(3) in Part I of Protocol 3⁽⁶⁸⁾, remarking that a diligent business man should normally be able to determine whether that procedure has been followed⁽⁶⁹⁾.

Notwithstanding this the Court has also accepted that in exceptional circumstances a recipient of aid which is granted unlawfully because it was not notified may rely on legitimate expectations that the aid was lawful in order to oppose its repayment⁽⁷⁰⁾. The Court of Justice has held that an entity may rely on the principle of the protection of legitimate expectations where a Community authority has caused it to entertain expectations which are justified⁽⁷¹⁾. This means in this context that a State or beneficiary must have relied on the previous actions of the Authority in, for example, approving the same or a similar aid measure. The Authority has taken no such action, and indeed (as referred to above⁽⁷²⁾) the decisions of the Authority in disallowing fiscal aid measures in Finland and Norway shortly before the implementation of the Liechtenstein Tax Act should have made it clear that tax measures favouring certain companies or groups of companies should be notified to the Authority⁽⁷³⁾.

⁽⁶⁷⁾ Case C1-09 *Centre d'Exportation du Livre Français (CELF), Ministre de la Culture et de la Communication v Société Internationale de Diffusion et d'Édition*, judgment of 11.3.2010 (not yet published). See also Case C-91/01 *Italy v Commission* [2004] ECR I-4355, paragraphs 66 and 67.

⁽⁶⁸⁾ Case C-5/89 *Commission v Germany* [1990] ECR I-3437, paragraph 14 and *Regione Autonoma della Sardegna v Commission* [2005] ECR II-2123, paragraph 64.

⁽⁶⁹⁾ Case C-5/89 *Commission v Germany* [1990] ECR I-3437, paragraph 14, Case C-169/95 *Spain v Commission* [1997] ECR I-135, paragraph 51.

⁽⁷⁰⁾ Joined Cases C-183/02 P and C-187/02 P *Demesa and Territorio Histórico de Álava v Commission* [2004] ECR I-10609, paragraph 51.

⁽⁷¹⁾ Case T-290/97, *Mehibas Dordstelaan v Commission* [2000] ECR II-15 and cases C-182/03 and C-217/03, *Belgium and Forum 187 ASBL v Commission* [2006] ECR I-05479, paragraph 147.

⁽⁷²⁾ See footnotes 54 and 55 referring to Authority decisions on tax reliefs on industrial production, a tax exemption from a basic tax for glass packaging and regarding regionally differentiated social security taxation.

⁽⁷³⁾ According to the report to the Liechtenstein Parliament regarding the EEA Agreement (*Bericht und Antrag der Regierung an den Landtag des Fürstentums Liechtenstein betreffend das Abkommen über den Europäischen Wirtschaftsraum vom 2. Mai 1992*) the Liechtenstein authorities acknowledge that in principle tax reductions constitute State aid within the meaning of Article 61(1) of the EEA Agreement and that a notification of tax measures in Liechtenstein may be necessary under certain circumstances (p. 134). See also explanations in the report to the Liechtenstein Parliament regarding the participation in the European Economic Area (*Bericht und Antrag der Regierung an den Landtag des Fürstentums Liechtenstein betreffend die Teilnahme am Europäischen Wirtschaftsraum (EWR) 2. Teil, Nr. 1995/1*), p. 168.

⁽⁶⁶⁾ Case C-5/89, *Commission v Germany* [1990] ECR I-3437, paragraph 14; Case C-169/95, *Commission v Spain* [1997] ECR I-135, paragraph 51; Case C-24/95, *Land Rheinland-Pfalz v Alcan Deutschland GmbH* [1997] ECR I-1591, paragraph 25.

The tax measures were introduced by the Liechtenstein authorities at a time of considerable developments in the enforcement of the rules relating to State aid in the form of fiscal exemptions. Discussions on corporate tax competition in Europe had been ongoing for some time when, in 1996, a group was formed in order to draw up a code of conduct between European Member States aimed at eradicating harmful tax practices. As referred to above, the Code of Conduct was eventually adopted at the end of 1997⁽⁷⁴⁾ (before the special tax measures were introduced), followed by the Commission's notice, and the Authority's Guidelines, on the application of the State aid rules to measures relating to direct business taxation, which contain specific references to the taxation of intra-group activities. These developments again suggest that the special tax rules on captive insurance companies should have been notified to the Authority.

Reference has, however, been made by the Liechtenstein authorities and certain third parties to the conclusions of the Commission in cases relating to coordination centres in Belgium. In two decisions adopted in 1984⁽⁷⁵⁾ and 1987, the Commission had considered that a tax scheme in favour of coordination centres providing intra-group services for multinational companies did not constitute State aid; and in an answer to a parliamentary question published in 1991 the Commission mentioned that it had not lodged any objections to the scheme in question. As referred to above, however, following the adoption of the Code of Conduct on business taxation (on 1 December 1997) the Commission began to reassess such cases⁽⁷⁶⁾. On 17 July 2000, the Commission informed Belgium that the scheme was likely to involve aid, on 11 July 2001 it proposed appropriate measures to remove the effect of the scheme, and on 27 February 2002 it opened a formal investigation, concluding on 17 February 2003 that the coordination centre tax scheme involved aid incompatible with the common market⁽⁷⁷⁾.

The Authority accepts that there may have been some degree of confusion regarding taxation specifically of intra-group activities following the Commission's decisions on the Belgian coor-

dination centres, and as a result of a number of other similar schemes operating in EU Member States. The Authority also accepts that there are certain similarities between the case of the coordination centres and that of the taxation of captive insurance companies. Captive insurance companies in Liechtenstein may, therefore, have been entitled to expect that taxation of the intra-group service they provide (insurance) could be taxed differently without this involving State aid.

Further, the Authority is of the view that in the wider EEA context, it is possible that beneficiaries in the EFTA States could have relied on the actions of the European Commission or on the case-law of the Court of Justice. The Authority is also conscious of the approach taken by the European Commission in the early 2000s on the issue of legitimate expectations when disallowing similar tax measures⁽⁷⁸⁾. In view of the Commission's practice, therefore, and in order to ensure a uniform approach to this issue across the EEA, the Authority concludes that beneficiaries may have had legitimate expectations that the tax measures did not constitute State aid when they were introduced.

Any such expectations could not, however, have continued indefinitely given the developments in the State aid assessment of tax measures during this period. The Commission opened the formal investigation procedure into tax exemptions in favour of captive insurance companies in Åland, Finland, on 11 July 2001⁽⁷⁹⁾, communicating its doubts that the measures could be compatible with the State aid rules. This investigation resulted from the notification of the measure by the Finnish authorities on 15 July 1998 — seven months after the implementation of the Liechtenstein measures. The Finnish authorities put the introduction of the tax measures on hold pending the Commission's decision. A decision specifically concluding that tax exemptions to captive insurance companies were incompatible State aid followed on 10 July 2002. Given that the Liechtenstein tax measures are substantively the same as those proposed for captive insurance companies based in

⁽⁷⁴⁾ The code, adopted on 1 December 1997, was described as a 'landmark accord' on preventing unfair tax competition. EU Member States agreed to freeze corporate tax rules at the beginning of 1998 and to consult with the Commission before implementing new corporate tax legislation.

⁽⁷⁵⁾ Although the 1984 decision by Member States case by case, thus ensuring that the rules and objectives of the Treaty are applied consistently and equally to all' (OJ C 2, 6.1.1998).

⁽⁷⁶⁾ The Code of Conduct states (at Section J) that 'the Commission intends to examine or re-examine existing tax arrangements and proposed new legislation by Member States case by case, thus ensuring that the rules and objectives of the Treaty are applied consistently and equally to all' (OJ C 2, 6.1.1998).

⁽⁷⁷⁾ OJ L 282, 30.10.2003, p. 25. On the same day, the Commission reached the same conclusion regarding the Dutch International Financing Activities regime (C(2003) 568 on State aid implemented by the Netherlands for international finance activities (OJ L 180, 18.7.2003, p. 52)).

⁽⁷⁸⁾ See not only the Belgian coordination centres decision (OJ L 282, 30.10.2003, p. 25), but also other cases involving preferential tax treatment that were deemed to be similar, including Commission decisions C(2002) 3740 on coordination centres implemented by Luxembourg (OJ L 170, 9.7.2003, p. 20) and C(2003) 568 on State aid implemented by the Netherlands for international finance activities (OJ L 180, 18.7.2003, p. 52).

⁽⁷⁹⁾ OJ C 309, 6.11.2001, p. 4.

the Åland Islands, Finland, the Authority considers that all beneficiaries⁽⁸⁰⁾ should have been aware by the date of publication of the decision to open a formal investigation into the similar tax measures in Åland on 6 November 2001 at the latest, that the measures were likely to involve incompatible State aid. The clear doubts expressed by the Commission as to the compatibility of specific tax exemptions in favour of captive insurance companies negated any legitimate expectations captive insurance companies benefiting from the Liechtenstein tax exemptions may have entertained.

The Authority concludes, therefore, that beneficiaries may have held legitimate expectations that the tax exemptions applicable to captive insurance companies in Liechtenstein did not constitute State aid from their introduction on 1 January 1998 until the date of publication in the Official Journal of the Commission Decision opening the formal investigation into the Åland captive insurance scheme on 6 November 2001, but not thereafter.

Finally, the Authority does not accept that any arguments relating to legal certainty can be valid in this case given the jurisprudence of the court and the wide ranging applicability of Article 61 (of the EEA Agreement) and Article 107 (TFEU). A conclusion that the tax measures under investigation could involve State aid was clearly foreseeable at all times.

5. CONCLUSION

The Authority considers that the special tax rules applicable to captive insurance companies under Articles 82a and 88d(3) of the Liechtenstein Tax Act implemented on 18 December 1998 constitute aid within the meaning of Article 61(1) of the EEA Agreement. For the abovementioned reasons, these measures cannot be considered compatible with the State aid rules of the EEA Agreement.

The Authority also considers that the contested aid measures have been implemented in breach of Article 1(3) of Part I of Protocol 3 and therefore constitute unlawful aid.

In accordance with Article 14 of Protocol 3, where negative decisions are taken in cases of unlawful aid, the Authority shall decide that the EFTA State concerned shall take all necessary measures to recover the aid from the beneficiaries. The Authority shall not require recovery if it would be contrary to a general principle of EEA law. Given the uncertainty regarding the State aid assessment of intra-group tax measures, the Authority accepts that undertakings could have entertained certain expectations that the tax measures in Liechtenstein may not entail aid. These expectations could no longer be maintained after the Commission opened the formal investigation procedure regarding the tax measures in favour of

captive insurance companies in Åland. For this reason, the Authority only requires recovery from the date of publication of the Commission's decision in the Official Journal on 6 November 2001.

The amount of aid to be recovered should be calculated by assessing the income, capital and coupon tax liabilities of captive insurance companies had specific rules not applied to them, less the amounts of capital tax already paid by the beneficiaries,

ADOPTS THIS DECISION:

Article 1

The aid measures which the Liechtenstein authorities have implemented in favour of captive insurance companies under Articles 82a and 88d(3) of the Tax Act implemented on 18 December 1998 constitute unlawful State aid within the meaning of Article 61(1) of the EEA Agreement which is not compatible with the functioning of the EEA Agreement.

Article 2

1. Liechtenstein shall repeal the measures referred to in Article 1 such that they do not apply from the fiscal year 2010 (inclusive) onwards.

2. The Liechtenstein authorities shall inform the Authority of the legislative steps which will be taken to abolish the measure by 30 June 2010.

Article 3

1. The Liechtenstein authorities shall take all necessary measures to recover from the beneficiaries the aid referred to in Article 1 and unlawfully made available to them, from 6 November 2001 to 31 December 2009.

2. The amount of aid to be recovered should be calculated by assessing the income, capital and coupon tax liabilities of captive insurance companies had specific rules not applied to them, less the amounts of capital tax already paid by the beneficiaries.

3. The sums to be recovered shall bear interest from the date on which the tax reductions were applied to the given undertaking until their actual recovery.

4. The interest shall be calculated on a compound basis in accordance with Article 9 in the EFTA Surveillance Authority Decision No 195/04/COL, as amended by Authority's Decision No 789/08/COL of 17 December 2008, on the implementing provisions referred to under Article 27 of Part II of Protocol 3.

⁽⁸⁰⁾ And indeed the Liechtenstein authorities.

Article 4

Recovery of the aid referred to in Article 1 shall be effected without delay, and in any event by 30 September 2010, and in accordance with the procedures of national law, provided that they allow the immediate and effective execution of the decision.

Article 5

This Decision is addressed to the Principality of Liechtenstein.

Article 6

Only the English language version of this decision is authentic.

Done at Brussels, 24 March 2010.

For the EFTA Surveillance Authority

Per SANDERUD
President

Kurt JÄGER
College Member

EFTA SURVEILLANCE AUTHORITY DECISION

No 416/10/COL

of 3 November 2010

**on the taxation of investment undertakings under the Liechtenstein Tax Act
(Liechtenstein)**

THE EFTA SURVEILLANCE AUTHORITY (‘THE AUTHORITY’),

HAVING REGARD to the Agreement on the European Economic Area (‘the EEA Agreement’), in particular to Articles 61 to 63 and Protocol 26,

HAVING REGARD to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (‘the Surveillance and Court Agreement’), in particular to Article 24,

HAVING REGARD to Protocol 3 to the Surveillance and Court Agreement (‘Protocol 3’), in particular to Article 1(2) of Part I and Articles 4(4), 6, 7(5) and 14 of Part II,

HAVING REGARD to the consolidated version of the Authority’s Decision No 195/04/COL of 14 July 2004 on the implementing provisions referred to under Article 27 of Part II of Protocol 3 (‘the Implementing Provisions Decision’) ⁽¹⁾,

HAVING called on interested parties to submit their comments pursuant to those provisions and having regard to their comments,

Whereas:

I. FACTS**1. PROCEDURE**

By letter dated 14 March 2007, the Authority sent a request for information to the Liechtenstein authorities, inquiring about various tax derogations for certain types of company apparently available under the Liechtenstein Tax Act. After various exchanges of correspondence, by letter dated 18 March 2009 the Authority informed the Liechtenstein authorities that it had decided to initiate the procedure laid down in Article 1(2) of Part I of Protocol 3 in respect of the taxation of investment undertakings. The Authority’s Decision No 149/09/COL to initiate the formal investigation procedure was published in the *Official Journal of the European Union* and the EEA Supplement to it, calling upon interested parties to submit comments ⁽²⁾. The Authority received comments from interested parties. By letter dated 26 January 2010 the Authority

forwarded these to the Liechtenstein authorities, which were given the opportunity to respond. This was done by letter dated 17 March 2010.

2. DESCRIPTION OF THE MEASURE INVESTIGATED**2.1. Title**

The investigation concerned the treatment of investment undertakings under the Liechtenstein Tax Act (*Gesetz über die Landes- und Gemeindesteuern*) ⁽³⁾, (‘the Tax Act’) between 1996 and 2006.

2.2. Definition of investment undertakings

The 1996 Liechtenstein Act on Investment Undertakings (*Gesetz über Investmentunternehmen*) (the ‘Investment Undertakings Act’) defined investment undertakings as:

‘assets raised from the public following public advertising for the purpose of a collective capital investment which are invested and managed for the collective account of the individual investors usually according to the principle of risk-spreading’ ⁽⁴⁾.

Under Liechtenstein law, an investment undertaking could choose the form of a collective trust, called an investment fund (*Anlagefonds*) ⁽⁵⁾, or opt for the legal form of an investment company (*Anlagegesellschaft*) ⁽⁶⁾. In the case of an investment fund, the management of the fund is carried out by a separate entity (referred to as the ‘fund direction’) ⁽⁷⁾. In the case of an investment company, the management is undertaken by the investment company itself. Unlike an investment fund, therefore, the investment company constitutes one single entity. In both cases, the entities carrying out management functions undertake economic activities by providing services for a fee.

Regardless of the organisational form, the assets managed on behalf of investors must be differentiated from the own assets of the management company. In return for management services, a management company is paid a management fee, which becomes part of its own assets. In addition, performance or other fees may be levied ⁽⁸⁾ which would also form part of a management company’s own assets.

⁽¹⁾ Available at: <http://www.eftasurv.int/media/decisions/195-04-COL.pdf>

⁽²⁾ OJ C 236, 1.10.2009 and EEA Supplement No 51, 1.10.2009.

⁽³⁾ *Liechtensteinisches Landesgesetzblatt* 1961, Nr. 7, with subsequent amendments.

⁽⁴⁾ Section 2(1) of the 1996 Investment Undertakings Act.

⁽⁵⁾ See Section 3(2) of the 1996 Investment Undertakings Act.

⁽⁶⁾ See Section 3(3) of the 1996 Investment Undertakings Act.

⁽⁷⁾ See Section 39(2) of the 1996 Investment Undertakings Act.

⁽⁸⁾ The Liechtenstein authorities have stated that it is impossible to list these fees exhaustively as a fund direction (or the management side of the investment company) is free to levy fees at its own discretion.

3. TAX PROVISIONS APPLICABLE TO INVESTMENT UNDERTAKINGS IN LIECHTENSTEIN

3.1. Liechtenstein corporate taxation

3.1.1. Income and capital tax

Sections 73 to 81 in Part 4, heading A, 'Company Taxes' (*Die Gesellschaftssteuern*) of the Tax Act provide for two forms of corporate taxation ⁽⁹⁾:

- A business income tax (*Ertragssteuer*), which according to Section 77 of the Tax Act is assessed on revenues less eligible expenditure (including write-offs). The income tax rate depends on the ratio of net income to taxable capital and ranges between 7,5 % and 15 % ⁽¹⁰⁾. This rate may be increased by between 1 and 5 percentage points depending on the ratio between dividends and taxable capital. The maximum income tax is therefore 20 %.
- A capital tax (*Kapitalsteuer*), which according to Section 76 of the Tax Act is levied against paid-up capital stock, joint stock, share capital, and initial capital as well as the reserves of a company constituting company equity. Taxes are assessed at the end of the company's financial year (generally on 31 December). The rate is 2 ‰ (0,2 %).

According to Section 73 of the Tax Act, legal persons operating commercial businesses in Liechtenstein pay both income and capital tax. The same applies to foreign companies operating a branch in Liechtenstein.

3.1.2. Coupon tax

Part 5 of the Tax Act provides for a coupon tax. According to Section 88(a)(1) of the Tax Act, Liechtenstein levies a tax on the coupons of securities (or documents equal to securities) issued by 'a national'. This notion includes any person who has a place of residence, domicile or statutory seat in Liechtenstein. It also covers undertakings that are registered on the public register of Liechtenstein. The coupon tax applies to companies the capital of which is divided into shares, for example, companies limited by shares and companies with limited liability ⁽¹¹⁾. It is levied at the rate of 4 % on any distribution of dividends or profit shares (including distributions in the form of shares).

⁽⁹⁾ Private persons are subject to income tax (*Erwerbssteuer*) and property tax (*Vermögenssteuer*), which are not relevant for this investigation.

⁽¹⁰⁾ The net profit is set in relation to the taxable capital. The tax rate is then set at half the percentage which the net profit constitutes of the taxable capital. However, there is a minimum level of 7,5 % and a maximum ceiling of 15 %, see Section 79(2) of the Tax Act.

⁽¹¹⁾ Section 88(d) of the Tax Act.

3.2. The taxation of investment undertakings between 1996 and 2006

3.2.1. The taxation of the assets managed on behalf of investors

From 1996, with the introduction of Section 84(5) of the Tax Act, the assets managed by investment undertakings were taxed in the same way as domiciliary companies (*Sitzgesellschaften*) ⁽¹²⁾. As domiciliary companies did not pay income tax, the assets managed by investment undertakings were also not subject to income tax. According to Section 84(1) of the Tax Act, only a reduced capital tax of 1 ‰ (instead of 2 ‰) was applied ⁽¹³⁾. This rate was further reduced to 0,4 ‰ for the capital of investment undertakings exceeding CHF 2 million in accordance with Section 85(2) of the Tax Act ⁽¹⁴⁾. The coupon tax on the distribution of profits generated from the fund capital was also abolished in 1996 ⁽¹⁵⁾.

3.2.2. The taxation of the own assets of the management company

3.2.2.1. The taxation of the management side of investment funds

Like any other company operating in Liechtenstein, the fund direction of an investment fund (the management side of the fund) was fully liable to pay income, capital as well as coupon tax on its own income and capital. The fund direction had also been fully taxed prior to 1996 in accordance with Section 84(2) of the Tax Act 1961.

3.2.2.2. The taxation of the management side of investment companies

In the case of investment companies, however, no distinction was made for tax purposes between the management company's own assets and the managed assets. The investment companies' own assets were therefore also subject to the rules applying to domiciliary companies, in accordance with Section 84(2) of the Tax Act. This meant that no income tax was levied on the management activities or on the managed assets; capital tax was payable at 1 ‰ instead of 2 ‰ (and reduced further for

⁽¹²⁾ Domiciliary companies are legal entities registered in the public register which only have their seat or an office in Liechtenstein, but do not exercise any commercial or business activity in Liechtenstein.

⁽¹³⁾ The tax derogation in favour of domiciliary companies pre-dates the entry of Liechtenstein to the EEA Agreement and is therefore not part of this Decision, which deals only with tax derogations introduced after 1.5.1995, the date of Liechtenstein's entry to the EEA.

⁽¹⁴⁾ Cf. Section 85(2) of the Tax Act in the form of the 1996 amendment, LGBL 1996 Nr. 88.

⁽¹⁵⁾ Sections 88(f), 88(g), 88(h)(3), 88(i)(2) of the 1961 Tax Act, which dealt with the coupon taxation of investment funds were repealed. See Government Bill No 69/1995, p. 10, in which it was stated that the repeal of the coupon tax on 'their' distributions was a precondition for the foundation of investment undertakings. Regarding the entry into force, see *Gesetz vom 3.5.1996 über die Abänderung des Steuergesetzes*, LGBL Nr. 88 of 10.7.1996.

any capital exceeding CHF 2 million in accordance with Section 85(2) of the Tax Act); and no coupon tax was levied. The tax situation from 1996 to 2006 for investment funds and investment companies can be illustrated as follows:

Investment Fund (Anlagefond)	
Fund direction (own assets)	Fund capital, i.e. managed assets
Income tax	No income tax
Full capital tax	Reduced capital tax
Coupon tax	No coupon tax

Investment Company (Anlagegesellschaft)	
Own assets of the management company	Fund capital, i.e. managed assets
No income tax	No income tax
Reduced capital tax	Reduced capital tax
No coupon tax	No coupon tax

3.3. The situation from 2006 until today

Legislation introduced in 2005 required investment companies to record and hold their own assets and managed assets separately. The Tax Act was also revised and a new Section 73(f) was inserted, which required both the fund direction of an investment fund and investment companies to pay income, capital, and coupon taxes in relation to their own assets⁽¹⁶⁾.

The tax situation for investment funds and investment companies from 2006 onwards can be illustrated as follows:

Investment Fund (Anlagefond)	
Fund direction (own assets)	Fund capital, i.e. managed assets
Income tax	No taxation
Capital tax	
Coupon tax	

Investment Company (Anlagegesellschaft)	
Own assets of the management company	Fund capital, i.e. managed assets
Income tax	No taxation
Capital tax	
Coupon tax	

⁽¹⁶⁾ The Act was also the repeal of Section 84(5) and the insertion of a new Section 86(2), which provided that the managed assets of both types of investment undertakings were explicitly exempted from payment of the capital tax.

3.4. Grounds for initiating the procedure

In its decision opening the formal investigation, the Authority raised doubts regarding the compatibility with the State aid rules of the exemption from taxation of the own assets of investment companies. Contrary to the arguments brought forward by the Liechtenstein authorities, the Authority took the initial view that the tax legislation provided a selective advantage to investment companies which distorted competition and affected trade across the EEA. On this basis, the Authority could not exclude that the tax rules applicable to the own assets of investment companies (full exemption from payment of income and coupon tax and a partial exemption from payment of capital tax) constitute State aid within the meaning of Article 61(1) of the EEA Agreement. The Authority also had doubts that these measures could be considered compatible with the State aid provisions of the EEA Agreement, in particular Article 61(3)(c).

4. COMMENTS FROM THIRD PARTIES

The comments from third parties can be summarised as follows:

- Referring to decisions of the European Commission on an Irish Company Holding Regime⁽¹⁷⁾ and a tax reduction from revenue from certain intangible assets in Spain⁽¹⁸⁾, the third parties argued that any natural or legal person could establish an investment undertaking and therefore benefit from the tax exemptions; on that basis the tax exemption does not constitute a selective measure.
- In 1996 when the legislation was enacted, it was not clear that the State aid rules would be applicable to tax measures.
- If the Authority concludes that the exemptions were aid, they had been in place since 1996 and should constitute an existing aid measure.
- With reference to Article 15 of Protocol 3 (according to which recovery shall be subject to a limitation period of 10 years), the third parties argued that no recovery of aid can be required because the tax exemption was introduced in 1996.
- Recovery, it was argued, would contravene the principles of legitimate expectations and legal certainty.
- In some cases, no recovery could be required as the amount of the tax exemptions would fall within the *de minimis* rule.

⁽¹⁷⁾ Commission Decision of 22 September 2004, State aid N 354/04.

⁽¹⁸⁾ Commission Decision of 13 February 2008, State aid N 480/07.

5. COMMENTS BY THE LIECHTENSTEIN AUTHORITIES

In letters dated 17 March 2010 and 16 July 2010, the Liechtenstein authorities commented as follows:

- The tax exemption does not involve State aid within the meaning of Article 61(1) of the EEA Agreement as it is not selective in nature. In support of this argument reference was again made to two decisions of the European Commission, on the Irish Company Holding Regime and a tax reduction from revenue from certain intangible assets in Spain.
- In the alternative it is argued that any aid is existing aid on the basis of the 10 year limitation period set out in Article 1(b)(iv) in conjunction with Article 15 of Part II of Protocol 3; and on the basis that the measure only became aid as a result of the evolution of the European Economic Area (Article 1(b)(v) of Part II of Protocol 3).
- Finally the Liechtenstein authorities argue that if this is not accepted the Authority should not order recovery of aid on the basis that this would be contrary to general principles of EEA law, specifically the protection of legitimate expectations and legal certainty.

II. ASSESSMENT

1. THE PRESENCE OF STATE AID

Article 61(1) of the EEA Agreement provides that:

‘Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Contracting Parties, be incompatible with the functioning of this Agreement.’

1.1. Presence of State resources

The aid measure must be granted by the State or through State resources.

The granting of a full or partial tax exemption involves a loss of tax revenues for the State which is equivalent to consumption of State resources in the form of fiscal (tax) expenditure⁽¹⁹⁾. The Liechtenstein authorities forego revenue corresponding to the non-payment of income, capital and coupon taxes.

For these reasons, the Authority considers that the tax rules applicable to investment companies involve the use of State resources.

⁽¹⁹⁾ See point 3(3) of the Authority's State Aid Guidelines to Business Taxation.

1.2. Favouring certain undertakings or the production of certain goods

Firstly, the aid measure must confer on the beneficiaries advantages that relieve them of charges that are normally borne from their budgets.

By not being obliged to pay any income or coupon tax and only a reduced capital tax on their own assets, investment companies receive an advantage in comparison to other undertakings that are subject to ordinary taxation on revenues from their business activities.

The advantage is selective as it was granted only to investment undertakings organised in the form of investment companies. The Authority does not accept arguments put forward by the Liechtenstein authorities and third parties that each undertaking in Liechtenstein carrying out such economic activity is in principle free to choose the most advantageous legal form and consequently profit from the tax concessions. A tax benefit which is limited to a specified group of undertakings cannot be characterised as a general measure on the basis that any interested undertaking could fulfil specified criteria and qualify if it organised itself in a particular form⁽²⁰⁾.

By reference to the European Court of Justice's conclusions in the *GIL Insurance*⁽²¹⁾ case, ‘Article 87(1) EC requires it to be determined whether, under a particular statutory scheme, a State measure is such as to favour “certain undertakings or the production of certain goods” in comparison with others which, in the light of the objective pursued by the system in question, are in a comparable legal and factual situation’. The Authority concludes that the undertakings in the same legal and factual position in this case are all those who pay the (full) income, capital and coupon taxes in Liechtenstein — and in comparison to those, investment companies in Liechtenstein receive a selective advantage. More specifically, the investment companies benefit in comparison to the fund direction of undertakings organised as investment funds, which engage in the same activity but are subject to tax like all other undertakings in Liechtenstein.

A specific tax measure can nevertheless be justified by the logic of the tax system. The specific tax rules applicable to investment companies would not be selective in the sense of Article 61(1) of the EEA Agreement if the rule is justified by the nature and general scheme of the Liechtenstein tax system⁽²²⁾. Unlike certain recent complex fiscal aid cases, the objectives of the tax system in question are straightforward. The objective, or logic, of the taxes is to generate revenue for the State. According to the Liechtenstein Tax Act, legal entities that operate in Liechtenstein must pay income tax on their revenues and a capital tax on the capital held as the

⁽²⁰⁾ The Court of First Instance has, for example, recognised that a fiscal measure does not lose its character as being selective just because it is based on objective criteria, see judgment of the CFI of 6.3.2002, T-127/99, T-129/99 and T-148/99, *Diputación Foral de Álava e.a. v Commission* [2002] ECR II-1275.

⁽²¹⁾ Case C-308/01 *GIL Insurance and Others* [2004] ECR I-4777, paragraph 68. See also Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, paragraph 41, Case C-409/00 *Spain v Commission* [2003] ECR I-1487, paragraph 47.

⁽²²⁾ Joined Cases E-5/04–E-7/04 *Fesil and others v the Authority*, cited above, paragraphs 82 et seq.

company's own equity. Companies divided into shares must also pay a coupon tax on dividends. Investment companies are legal entities incorporated under Liechtenstein law in the form of companies limited by shares. As such, they are subject to the generally applicable tax provisions of the Liechtenstein Tax Act concerning income, capital and coupon tax. The Authority considers that the tax relief for the management company's own assets falls neither within the logic of the general tax system in Liechtenstein, nor within any specific logic of the taxation of investment undertakings. In the view of the Authority, there is nothing in the organisational form of investment companies which would justify a special tax derogation in favour of the management activities of an investment company in comparison with the management activities of an investment fund⁽²³⁾. The reduction and exemptions applicable to domiciliary companies⁽²⁴⁾ and investment companies were designed to encourage these activities in Liechtenstein. In the Authority's view, therefore, the tax relief on the management company's own assets cannot be justified by the nature and overall scheme of the Liechtenstein taxation system.

In 2006, the legislation was changed and investment companies were subject thereafter to ordinary business taxation in the same way as the fund direction of investment funds and any other legal entity operating a business in Liechtenstein. In view of the Liechtenstein authorities this eliminated the 'inconsistency'⁽²⁵⁾ of not levying any taxes on the own assets before.

For these reasons, the Authority considers that the measures constituted a selective advantage to investment companies, which was remedied by the legislation effective from 2006 onwards.

Thirdly, the aid measure must favour undertakings engaged in economic activities. In the BBL⁽²⁶⁾ case, the European Court of Justice considered the activities of investment companies ('SICAVs' under Belgian law) which undertook collective investment with the aim of producing income on a continuing

basis in transferable securities from capital raised from the public. The Court held that this constitutes an economic activity within the meaning of Article 4(2) of the Sixth VAT Directive. Investment companies are active in assembling and managing the assets of various investors with the intention of making profits via various fees for the services provided. The Authority consequently considers that management companies carry out economic activities in the form of asset management and are thus undertakings within the meaning of Article 61(1) of the EEA Agreement⁽²⁷⁾.

1.3. Distortion of competition and effect on trade between Contracting Parties

The aid measure must distort competition and affect trade between the Contracting Parties to the EEA Agreement.

According to established case-law, the prohibition under Article 61(1) of the EEA Agreement applies to any aid which distorts or threatens to distort competition, irrespective of the amount, in so far as it affects trade between the Contracting Parties⁽²⁸⁾. The Commission has also concluded that investment vehicles operate in international markets and pursue commercial and other economic activities in markets where competition is intense⁽²⁹⁾. The Authority takes the view, therefore, that the tax concessions on the own assets of investment companies from 1996 to 2006 strengthened the competitive position of those investment companies within the EEA, as these tax concessions reduced the ordinary operational costs of these companies compared to others⁽³⁰⁾. Investment companies compete with other financial undertakings and operate in an open market characterised by substantial intra-EEA trade. Trade between the Contracting Parties is also affected⁽³¹⁾.

The Authority is therefore of the view that the tax concessions distort or threaten to distort competition and affect trade between the Contracting Parties.

⁽²³⁾ Both types of investment undertakings must keep the company's own assets separate from the managed assets of the investors, held in the deposit bank; and in bankruptcy proceedings, the own assets are at the disposal of the creditors for both investment funds and investment companies.

⁽²⁴⁾ Favourable tax rates for domiciliary companies have not been the subject of an investigation by the Authority as the provisions predated the EEA Agreement.

⁽²⁵⁾ Quoted from an expert opinion submitted by the Liechtenstein authorities on the legal forms of investment undertakings and the respective taxation they were subject to (Section DII, b.ii.3).

⁽²⁶⁾ Case C-8/03, *Banque Bruxelles Lambert SA (BBL) v Belgian State* [2004] ECR. I-10157, paragraphs 42 and 43. The judgment was given in the area of taxation, however the Authority considers that the problem in question is the same under the State aid rules. See also Commission Decision of 6 September 2005 on the Italian scheme for collective investments in transferable securities (OJ L 268, 27.9.2006, p. 1) (hereafter Italian collective investment scheme).

⁽²⁷⁾ See also Commission Decision of 6 September 2005 on the Italian scheme for collective investments in transferable securities (OJ L 268, 27.9.2006, p. 1) and Case T-445/05 *Associazione Italiana del risparmio gestito, e.a. v Commission*, paragraphs 127 ff.

⁽²⁸⁾ Case T-214/95 *Vlaamse Gewest v Commission* [1998] ECR II-717, paragraph 46. Case T-424/05, *Italy v Commission*, judgment of 4 March 2009, paragraphs 154 ff.

⁽²⁹⁾ See Italian collective investment scheme, paragraph 45, upheld by the Court of First Instance in Case T-445/05 *Associazione italiana del risparmio gestito v Commission* cited above, and T-424/05 *Italy v Commission*.

⁽³⁰⁾ See Case T-424/05, cited above, paragraph 156.

⁽³¹⁾ In line with case-law (see Case T-424/05, cited above, paragraph 160), the Authority need not demonstrate that all investment companies operate in international markets. It is sufficient in the assessment of aid schemes to assess their general characteristics without examining each individual application.

1.4. Conclusion

The Authority therefore concludes that the reduced taxation of management companies' own assets under the Liechtenstein Tax Act between 1996 and 2006 was State aid within the meaning of Article 61(1) of the EEA Agreement.

2. PROCEDURAL REQUIREMENTS

Pursuant to Article 1(3) of Part I of Protocol 3, 'the EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid (...). The State concerned shall not put its proposed measures into effect until the procedure has resulted in a final decision'. The Liechtenstein authorities did not notify the aid measures to the Authority. The Liechtenstein authorities have argued that the aid is existing aid as the measures only became aid due to an evolution of the EEA and/or as a result of Articles 1(b)(iv) and 15 of Part II of Protocol 3 which provides that the powers of the Authority to recover aid shall be subject to a limitation period of 10 years. The Authority is of the view, however, that the European Court of Justice made it clear as early as the 1970s that tax exemptions of the nature of those under assessment could be State aid. The Court held in 1974⁽³²⁾ that any measures intended to exempt firms in a particular sector from the charges arising from the normal application of a tax system (without there being any justification for this exemption on the basis of the nature or general scheme of this system) constituted State aid. In 1987⁽³³⁾ the Court explicitly stated that a loss of tax revenue was equivalent to consumption of State resources in the form of fiscal expenditure.

This approach is also reflected in decisions of the Authority prior to the implementation of the Liechtenstein Tax Act, where it concluded that exemptions from the tax payable by undertakings was (incompatible) State aid in Finland in 1994⁽³⁴⁾ and in Norway in 1995⁽³⁵⁾ and 1997⁽³⁶⁾. On 1 December 1997, following a wide-ranging discussion on the need for coordinated action at Community level to tackle harmful tax competition, the European Council of Ministers adopted a series of conclusions and agreed a resolution on a code of conduct for business taxation⁽³⁷⁾. As part of the agreement reached, the Commission undertook to contribute to the objective of tackling harmful tax competition by imple-

menting a notice⁽³⁸⁾ on the application of the State aid rules to measures relating to direct business taxation and committed itself 'to the strict application of the aid rules concerned.' When published in December 1998, the notice stated that 'According to well-established practice and case-law⁽³⁹⁾, a tax measure whose main effect is to promote one or more sectors of activity constitutes aid'⁽⁴⁰⁾. The Commission, therefore, committed itself to the stricter application of rules which already existed⁽⁴¹⁾.

The Authority does not accept that the arguments put forward by the Liechtenstein authorities and third parties show that the criteria for establishing selectivity applied by the Commission (or the Authority) in its assessment of tax issues has changed since the adoption of the tax measures under investigation. The Commission's notice on business taxation, and the Authority's corresponding guidelines, are based on the long-established case-law of the Court of Justice and of the Court of First Instance, and confirm that Articles 107 and 108 TFEU and Article 61(1) EEA (respectively) apply to tax measures. Further, in line with case-law, even if it could be established that there had been such a change of practice, the argument that the tax measures are existing aid still could not be accepted, for it fails to show that any change in the criteria for ascertaining selectivity applied by either the Commission or the Authority is attributable to the 'evolution of the European Economic Area' within the meaning of Article 1(b)(v) of Part II of Protocol 3⁽⁴²⁾.

The Authority does not accept, therefore, that the measures can be defined as existing aid implemented prior to an evolution of the EEA Agreement. The measure is therefore new aid which was not notified to the Authority. The Liechtenstein authorities did not, therefore, comply with their obligations under Article 1(3) of Part I of Protocol 3.

In so far as the 10 year limitation period is concerned, the Authority accepts that aid paid prior to 15 March 1997 cannot be recovered by virtue of Articles 1(b)(iv) and 15 of Part II of Protocol 3. However the Authority does not accept that the mere fact that the relevant statutory provisions were implemented before 15 March 1997 means that all aid paid thereafter is existing aid. In cases where aid is paid repeatedly (such as a scheme or tax provision such as the case in hand), the limitation period begins on the day each individual aid is

⁽³²⁾ Case 173/73 *Italy v Commission* [1974] ECR 709.

⁽³³⁾ Case 248/84 *Germany v Commission* [1987] ECR 4013.

⁽³⁴⁾ Where tax reliefs on industrial production were abolished following a decision of the Authority dated 1 December 1994, No 213/94/COL.

⁽³⁵⁾ Authority Decision No 106/95/COL concerning a tax exemption from a basic tax for glass packaging dated 31 October 1995.

⁽³⁶⁾ Authority Decision No 145/97/COL of 14 May 1997 concerning appropriate measures regarding regionally differentiated social security taxation.

⁽³⁷⁾ OJ C 2, 6.1.1998, p. 1.

⁽³⁸⁾ The Commission issued its notice in November 1998 (OJ C 384, 10.12.1998). A similar notice was incorporated into the Authority's State Aid Guidelines as Chapter 17B in June 1999.

⁽³⁹⁾ See, among others, Case C-387/92 *Banco Exterior de España SA v Ayuntamiento de Valencia* [1994] ECR I-877.

⁽⁴⁰⁾ Paragraph 18 of the notice.

⁽⁴¹⁾ See Section J of the Code of Conduct.

⁽⁴²⁾ Joined Cases T-346/99, T-347/99 and T-348/99 *Territorio Histórico de Álava and others v Commission*, paragraph 84.

granted (as opposed to when the tax measure or scheme was first put into effect). As stated by the Court of First Instance ⁽⁴³⁾, 'In the case of an aid scheme introduced more than 10 years before the first interruption of the limitation period, the unlawful aid incompatible with the common market granted under that scheme during the last 10 years is therefore subject to recovery'.

3. COMPATIBILITY OF THE AID

Support measures designated as State aid under Article 61(1) of the EEA Agreement are generally incompatible with the functioning of the EEA Agreement, unless one of the exemptions in Article 61(2) or (3) of the EEA Agreement applies. The derogation of Article 61(2) is not applicable to the aid in question, which is not designed to achieve any of the aims listed in this provision. Nor do Article 61(3)(a) or Article 61(3)(b) of the EEA Agreement apply.

The aid in question is not linked to any investment in production capital. It merely reduces the costs which companies would normally have to bear in the course of pursuing their day-to-day business activities, and is consequently to be classified as operating aid. Operating aid is normally not considered suitable to facilitate the development of certain economic activities or of certain regions as provided for in Article 61(3)(c) of the EEA Agreement. Operating aid is only allowed under special circumstances (for example for certain types of environmental or regional aid), when the Authority's Guidelines provide for such an exemption. None of these Guidelines apply to the aid in question.

The Authority therefore concludes that the aid paid through special tax rules applicable to investment management companies is not compatible with the EEA Agreement.

4. LEGITIMATE EXPECTATIONS AND LEGAL CERTAINTY

The Liechtenstein authorities and third party recipients of aid have argued that recovery of aid would breach fundamental principles of EEA law, arguing that actions of the European Commission created an expectation on the part of beneficiaries

that the aid had been lawfully granted. It has also been argued that when Liechtenstein became a party to the EEA Agreement the taxation of investment companies did not involve State aid, nor was it foreseeable.

The fundamental legal principles of legitimate expectations and legal certainty can be invoked by beneficiaries of aid to challenge an order for recovery of unlawfully granted State aid. The principles only apply, however, in exceptional circumstances and an undertaking cannot normally entertain legitimate expectations that aid is lawful unless it has been granted in accordance with the procedure for notifying the aid to the Authority (or the European Commission as the case may be ⁽⁴⁴⁾). This is a principle recently re-affirmed by the Court of Justice as follows: 'In a situation such as that in the main proceedings, the existence of an exceptional circumstance also cannot be upheld in the light of the principle of legal certainty, since the Court has already held, essentially, that, so long as the Commission has not taken a decision approving aid, ...the recipient cannot be certain as to the lawfulness of the aid, with the result that neither the principle of the protection of legitimate expectations nor that of legal certainty can be relied upon' ⁽⁴⁵⁾. In principle, the case-law of the Court of Justice has stated that a legitimate expectation that aid is lawful cannot be invoked unless that aid has been granted in compliance with the procedure laid down in Article 1(3) in Part I of Protocol 3 ⁽⁴⁶⁾, remarking that a diligent business man should normally be able to determine whether that procedure has been followed ⁽⁴⁷⁾.

Notwithstanding this, the Court has also accepted that in exceptional circumstances a recipient of aid which is granted unlawfully because it was not notified may rely on legitimate expectations that the aid was lawful in order to oppose its repayment ⁽⁴⁸⁾. The Court of Justice has held that an entity may rely on the principle of the protection of legitimate expectations where a Community authority has caused it to entertain expectations which are justified ⁽⁴⁹⁾. This means in this context that a State or beneficiary must have relied on the previous actions of the Authority (or the European Commission) in, for example, approving the same or a similar aid measure. Neither the Authority nor the Commission has taken such action, and indeed the decisions of the Authority in disallowing

⁽⁴⁴⁾ Case C-5/89, *Commission v Germany* [1990] ECR I-3437, paragraph 14; Case C-169/95, *Commission v Spain* [1997] ECR I-135, paragraph 51; Case C-24/95, *Land Rheinland-Pfalz v Alcan Deutschland GmbH* [1997] ECR I-1591, paragraph 25.

⁽⁴⁵⁾ Case C-1/09 *Centre d'Exportation du Livre Français (CELF), Ministre de la Culture et de la Communication v Société Internationale de Diffusion et d'Édition*, judgment of 11.3.2010. See also Case C-91/01 *Italy v Commission* [2004] ECR I-4355, paragraphs 66 and 67.

⁽⁴⁶⁾ Case C-5/89 *Commission v Germany* [1990] ECR I-3437, paragraph 14 and *Regione Autonoma della Sardegna v Commission* [2005] ECR II-2123, paragraph 64.

⁽⁴⁷⁾ Case C-5/89 *Commission v Germany* [1990] ECR I-3437, paragraph 14, Case C-169/95 *Spain v Commission* [1997] ECR I-135, paragraph 51.

⁽⁴⁸⁾ Joined Cases C-183/02 P and C-187/02 P *Demesa and Territorio Histórico de Álava v Commission* [2004] ECR I-10609, paragraph 51.

⁽⁴⁹⁾ Case T-290/97, *Mehibas Dordstelaan v Commission* [2000] ECR II-15 and Cases C-182/03 and C-217/03, *Belgium and Forum 187 ASBL v Commission* [2006] ECR I-05479, paragraph 147.

⁽⁴³⁾ Joined Cases T-254/00, T-270/00 and T-277/00 *Hôtel Cipriani v Commission*, Judgment of the Court of First Instance, 28.11.2008 (citing joined Cases T-195/01 and T-207/01 *Government of Gibraltar v Commission* [2002] ECR II 2309, paragraph 130).

fiscal aid measures in Finland and Norway shortly before the implementation of the Liechtenstein Tax Act should have made it clear that tax measures favouring certain companies or groups of companies should be notified to the Authority ⁽⁵⁰⁾.

Finally, the Authority does not accept that any arguments relating to legal certainty can be valid in this case given the jurisprudence of the court and the wide ranging applicability of Articles 61 (of the EEA Agreement) and 107 (TFEU). A conclusion that the tax measures under investigation could involve State aid was clearly foreseeable at all times.

The Authority does not accept therefore that this Decision breaches fundamental principles of EEA law.

5. CONCLUSION

The Authority concludes that the Liechtenstein authorities have unlawfully implemented the aid in question in breach of Article 1(3) of Part I to Protocol 3.

The aid is not compatible with the functioning of the EEA Agreement for the reasons set out above,

HAS ADOPTED THIS DECISION:

Article 1

The aid measures implemented by the Liechtenstein authorities in favour of investment companies, and which were repealed with effect from 30 June 2006, are not compatible with the functioning of the EEA Agreement within the meaning of Article 61(1) of the EEA Agreement.

Article 2

In view of the failure by the Liechtenstein authorities to comply with the requirement to notify the Authority before implementing aid in accordance with Article 1(3) of Part I of Protocol 3, the measures involved unlawful State aid.

Article 3

The Liechtenstein authorities shall take all necessary measures to recover from the investment companies the aid referred to in Article 1 and unlawfully made available to the beneficiaries from 15 March 1997 until the date in which beneficiaries last benefitted from the tax exemptions following their repeal in 2006.

Article 4

Recovery shall be effected without delay, and in any event by 3 March 2011, and in accordance with the procedures of national law, provided that they allow the immediate and effective execution of the decision. The aid to be recovered shall include interest and compound interest from the date on which it was at the disposal of the beneficiaries until the date of its recovery. Interest shall be calculated on the basis of Article 9 of the Implementing Provisions Decision.

Article 5

The Liechtenstein authorities shall inform the Authority, within two months of notification of this Decision, of the measures taken to comply with it.

Article 6

This Decision is addressed to the Principality of Liechtenstein.

Article 7

Only the English language version of this Decision is authentic.

Done at Brussels, 3 November 2010.

For the EFTA Surveillance Authority

Per SANDERUD
President

Sverrir Haukur GUNNLAUGSSON
College Member

⁽⁵⁰⁾ According to the report to the Liechtenstein Parliament regarding the EEA Agreement (*Bericht und Antrag der Regierung an den Landtag des Fürstentums Liechtenstein betreffend das Abkommen über den Europäischen Wirtschaftsraum vom 2. Mai 1992*) the Liechtenstein authorities acknowledge that in principle tax reductions constitute State aid within the meaning of Article 61(1) of the EEA Agreement and that a notification of tax measures in Liechtenstein may be necessary under certain circumstances (page 134). See also explanations in the report to the Liechtenstein Parliament regarding the participation in the European Economic Area (*Bericht und Antrag der Regierung an den Landtag des Fürstentums Liechtenstein betreffend die Teilnahme am Europäischen Wirtschaftsraum (EWR) 2. Teil, Nr. 1995/1*), page 168.

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